

# **Royal Borough of Kensington and Chelsea Pension Fund Annual Report and Accounts**

**2014-15**

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## Chairman's report

Councillor Quentin Marshall, Chairman of the Investment Committee

The Investment Committee is responsible for the strategy for investing the pension fund's assets and appoints and oversees a set of professional fund managers to undertake this task. If the Committee's strategy and the fund managers' decisions are sound, the costs to the Council should be contained. I am pleased to report that the Committee's strategy continued to work well in 2014-15.

During 2014-15, the Fund received almost £26 million of contributions from its employers and members and it achieved an overall return of 19.1 per cent on its investments. The Fund aims for over-performance of about 2.3 per cent against market movements and actual performance exceeded the target by 3.3 per cent.

It is encouraging that, as at 31 March, the Fund's actuary assessed that the funding position had improved to just over 100 per cent. This compares with 95 per cent at the 2013 actuarial valuation and is the first time that the level has exceeded 100 per cent since the 2001 valuation. This performance is mainly attributable to the excellent returns achieved from equities in the years since the restructuring of the Fund following the 2010 valuation.

Two significant adjustments were made to the portfolio during 2014-15. In August concerns arose over the future management of the Barings absolute return mandate following the departure of key personnel, including the chief investment officer. As a consequence, the Fund's advisers recommended selling the holding and this was done at the end of August. The proceeds of around £90 million were reinvested with Legal and General, with equal amounts allocated to passive global equities and a Sterling Liquidity Fund in order to maintain similar characteristics in the balance of investments to those held in the absolute return fund, although it is appreciated that the current allocation to absolute return funds is now significantly below the 30 per cent agreed in the original strategy.

During the second half of the year, the investments which had been allocated to Kames were drawn down so that the full £15 million commitment had been invested by 31 March. This effectively restored the level of property investment to 5 per cent of the Fund, in line with the investment strategy.

A further review of investment strategy is currently underway, with a view to reducing the level of equity risk, while still producing a good level of income and capital growth for the Fund in the future. The Fund has also been preparing for the introduction of a Pension Board which will provide a statutory oversight function.

## INTRODUCTION

The Pension Fund is part of the national Local Government Pension Scheme (LGPS) and is administered locally by the Royal Borough of Kensington and Chelsea. It is a contributory defined benefit pension scheme established by the Superannuation Act 1972, which provides for the payment of benefits to employees and former employees of the Council and the admitted and scheduled bodies in the Fund.

The Fund receives contributions from employees, the Council, the admitted and scheduled bodies and returns from the Fund's investments. The employers' contributions are set by the Fund's actuary in discussion with the Council at the actuarial valuation, which is carried out every three years.

The benefits payable from the Fund are set out in the Local Government Pension Scheme regulations and in summary are:

- A guaranteed pension based on final salary (to 1 April 2014, career average since) and length of service;
- The option to take up to 25% of pension as a tax-free lump sum;
- Death and survivor benefits;
- Early payment of pensions in the event of ill health; and
- Pension increases in line with Consumer Price Inflation (CPI).

The Fund is governed by the Public Service Pensions Act 2013, the Local Government Pension Scheme Regulations 2013 (as amended) and the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

A new LGPS scheme was introduced with effect from 1 April 2014. This continues to be a defined benefit scheme, but instead of final salary, contributions from that date form part of a Career Average Revalued Earnings (CARE) scheme, so that a scheme member's pension will be based on their earnings throughout their career, rather than solely on their final salary.

This annual report starts with a section on Management and Performance, explaining the governance and management arrangements for the Fund, as well as summarising the financial position and the approach to risk management.

The Investment section then sets out the Fund's strategy, arrangements and performance. This is followed by a section on Scheme Administration, which sets out how the administration of the scheme's benefits and membership is undertaken. Section 2 outlines the funding position of the Fund and Section 4 provides a summary of the Fund's annual accounts.

The report concludes with a glossary of some of the more technical terms in Section 6 and a list of contacts in Section 5.

# 1. MANAGEMENT AND PERFORMANCE

## Governance Arrangements

The Council of the Royal Borough of Kensington and Chelsea has delegated decision making powers in respect of pensions to the Investment Committee (the Committee). The Committee comprises six elected representatives of the Council – four from the majority party and two minority party representatives. Up to four co-opted members may attend the committee meetings but have no voting rights.

The Committee meets at least four times a year and has the following terms of reference:

- To determine the overall investment strategy and strategic asset allocation of the Pension Fund;
- To appoint the investment manager(s), custodian, actuary and any independent external advisors felt to be necessary for the good stewardship of the Pension Fund;
- To monitor the performance of the custodians, actuary and external advisors to ensure that they remain suitable;
- To review on a regular basis the investment managers' performance against established benchmarks, and satisfy themselves as to the managers' expertise and the quality of their internal systems and controls;
- To prepare, publish and maintain the Statement of Investment Principles, and monitor compliance with the statement and review its contents;
- To prepare, publish and maintain the Funding Strategy Statement, the Governance Compliance Statement, and the Communications Policy and Practice Statement and revise the statements to reflect any material changes in policy;
- To approve the final accounts and balance sheet of the Pension Fund and approve this Annual Report;
- To receive actuarial valuations of the Pension Fund regarding the level of employers' contributions necessary to balance the Pension Fund;
- To consider any proposed legislative changes in respect of the Compensation and Pension Regulations and to respond appropriately; and
- To receive and consider the external auditors' report on the governance of the Pension Fund.

The Committee reports to the full Council annually on its activities. The Committee obtains and considers advice from the Town Clerk and Executive Director of Finance, and as necessary from the Fund's appointed actuary, advisors and investment managers.

The membership of the Investment Committee in 2014-15 was as follows:

Councillor Quentin Marshall	Chairman
Councillor Warwick Lightfoot	Vice Chairman
Councillor Emma Dent-Coad	
Councillor Andrew Lomas	
Councillor Andrew Rinker	
Councillor Paul Warrick	

There are also four co-opted, non-voting members:

Sir Michael Craig-Cooper  
Hon Alderman John Cox  
Mr Dominic Johnson  
Mr Jonathon Read

## **Governance Compliance Statement**

The Local Government Pension Scheme (Administration) Regulations 2008 require Pension Funds to prepare, publish and maintain a governance compliance statement; and to measure its governance arrangements against a set of best practice principles. This measurement should result in a statement of full, partial or non-compliance with a further explanation provided for any non or partial compliance.

The key issues covered by the best practice principles are:

- Formal committee structure;
- Committee membership and representation;
- Selection and role of lay members;
- Voting rights; and
- Training, facility time and expenses.

The Fund's published statements can be found by following the link:

<https://www.rbkc.gov.uk/council/how-council-manages-money/council-spending-and-finances/pension-fund-2013-14>

## Scheme Management and Advisers

The City of Westminster, London Borough of Hammersmith & Fulham and the Royal Borough of Kensington and Chelsea have combined some operational areas to provide a more efficient service and greater resilience. This includes the Pensions and Treasury teams.

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 Westminster City Hall.

The Pension Funds continue to be managed separately in accordance with each borough's strategy and so each continues to have sovereignty over decision making. However, officers are continually seeking to improve efficiency and resilience and to minimise the cost of running the Pension Funds, in line with the tri-borough working aims.

### Officers

Town Clerk and Executive Director of Finance	Nicholas Holgate
Tri-Borough Pensions Team in 2014-15	Jonathan Hunt Alex Robertson Nicola Webb Nikki Parsons
Pensions Manager	Maria Bailey

Contact details for officers are provided in Section 5 of this document.

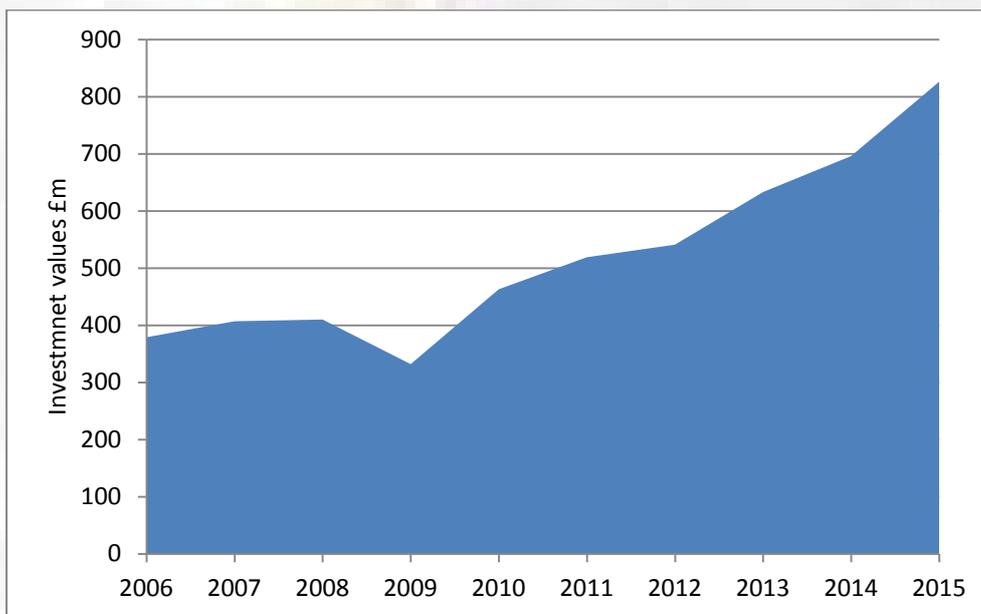
### External Advisers

Investment Adviser	Hymans Robertson
Investment Managers	Adams Street Partners Baillie Gifford CBRE Global Investors Legal & General Investment Management Longview Asset Management Kames Capital Pyrford LLP
Custodian & Bankers	Northern Trust, NatWest
Actuary	Barnett Waddingham
Auditor	KPMG
Legal Adviser	Eversheds
Scheme Administrators	Capita Hartshead
AVC Providers	Prudential

## Financial Summary and performance

The investment return in 2014-15 was positive both in absolute terms and relative to the Fund's target. The return was 19.1 per cent, which was 3.3 per cent above the target set by the Fund. As with all performance reported here, this was net of fees. There were two changes of investment manager during the year. The absolute return contract with Barings was terminated on the investment adviser's advice, due to a significant change in the management of the Fund. The proceeds from this sale were invested with Legal and General, split between their World Equity Index and their Sterling Liquidity Fund, to approximate the proportions of the absolute return fund. The £15 million Kames Capital investment which had been agreed in 2013-14 was funded from the Sterling Liquidity fund towards the end of 2014-15. The Investment Policy and Performance report in Section 2 provides more detail on the Fund's investments and performance.

The table below shows how the value of the Fund's investments have increased over time by showing the total value at 31<sup>st</sup> March every year for the last ten years:



For the first time in 2014-15, benefits paid from the fund exceeded the contributions made to it, by around £2.5 million, but it was possible to meet this shortfall from the Fund's cash reserves. There are several reasons for this deterioration of the cashflow position, the most significant of which were further reductions in active members and increases in the numbers of pensioners, a continuing trend in the public sector. Pensions continued to rise at a faster rate than the income from contributors to the scheme.

A more detailed account is set out in Section 3.

## Risk Management

The most significant long term risk is that the Fund's assets are not sufficient to meet its liabilities. In the light of this, the Fund obtains quarterly reports from the actuary showing movement in the levels of liabilities as well as a smoothed asset position, so that the Committee can assess whether its strategy is succeeding or not.

In order to improve the funding level, the Investment Committee has invested in growth assets, the value of which can fluctuate significantly. To mitigate this risk, the investment strategy encompasses a range of asset classes and is generally invested globally to ensure diversification. All of the investments have been made in line with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 and only following advice from the Fund's investment adviser.

All of the Fund's assets (apart from cash) are managed by external investment managers. They are required to provide regular audited internal controls report or audited accounts to the Fund. These set out how assets are managed in accordance with the Investment Management Agreements the Council has signed with each investment manager. A range of investment managers is used to diversify manager risk. All the Fund's assets are held for safekeeping by the custodian, who is independent of all the investment managers and also required to provide an audited internal controls report to the Fund on a regular basis.

## 2. INVESTMENT POLICY AND PERFORMANCE

The Fund's investment policy, objectives and strategy are set out in detail in the Statement of Investment Principles, which can be found as an appendix to this report under Pension Fund Policy Statements. One of the Fund's key objectives is to manage employers' liabilities effectively and one of the key risks for the Fund is that the assets will fall short of the liabilities. As a result, the investment policy is set and performance measured by reference to a benchmark which reflects the liabilities.

### Strategic Benchmark and Objective

The strategic benchmark for the Fund has been set with reference to the long term nature of the Fund's liabilities, and is reviewed regularly. The current benchmark is set out in the table below, with the real returns taking account of assumed consumer price inflation (CPI) of 2.7 per cent:

<b>Asset</b>	<b>Benchmark Allocation (%)</b>	<b>Expected real long-term return</b>
<b>Global equities</b>	60	4.2%
<b>Absolute return fund</b>	30	1.8%
<b>Private Equity</b>	5	4.2%
<b>Property</b>	5	0.8%
<b>Total</b>	100	3.2%

Cash is not included in the benchmark as there is no set allocation to it as an asset class.

The target of the Fund as a whole is to outperform the overall benchmark by 2.3 per cent per annum on a rolling three year basis.

## **Statement of Investment Principles**

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 require Pension Funds to prepare, maintain and publish a statement setting out the investment policy of the Fund. In addition Pension Funds are required to demonstrate compliance with the six “Myners Principles”.

The “Myners Principles” are a set of recommendations relating to the investment of pension funds. The current version of the principles covers the following areas:

- Effective decision making;
- Clear objectives;
- Risk and liabilities;
- Performance Measurement;
- Responsible ownership; and
- Transparency and reporting.

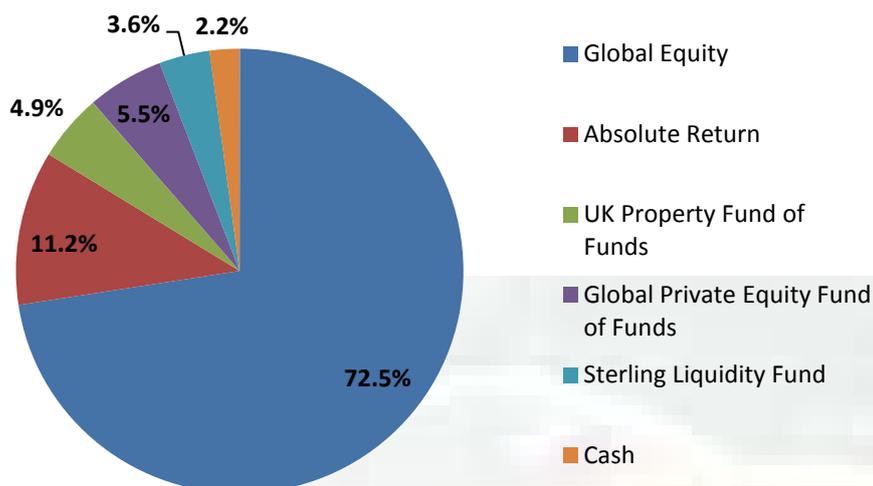
The Fund’s published statement can be found in the Pension Fund section of the following website:

<https://www.rbkc.gov.uk/council/how-council-manages-money/council-spending-and-finances/pension-fund-2013-14>

## **Investment Strategy**

The investment strategy of the Fund is to have four main portfolios - Global Equity, Absolute Return, UK Property and Private Equity. The investment strategy is intended to provide diversification and specialisation to reduce exposure to market risk and achieve optimum return against the Fund’s strategic benchmark.

The graph below shows how the Fund was split between the different portfolios at 31 March 2015.



The strategic allocation of the Fund changed during 2014-15 as a result of the sale of the Barings Dynamic Asset Allocation Fund which has cut the allocation to absolute return funds. However, by reinvesting in equities and a liquidity fund, the Fund has attempted to minimise the impact on the underlying asset allocation.

A summary of the Fund's assets is given in the table below:

<b>Assets</b>				
	<b>UK £'000s</b>	<b>Non-UK £'000s</b>	<b>Global £'000s</b>	<b>Total £'000s</b>
Equities	35,873	168,730	394,628	599,231
	40,251	-	-	40,251
Alternatives	-	45,809	92,702	138,511
Cash and Equivalents	48,975	-	-	48,975
Other	(1,072)	-	-	(1,072)
	<b>124,027</b>	<b>214,539</b>	<b>487,330</b>	<b>825,896</b>

A summary of the investment income received in respect of these assets is given below:

<b>Investment Income</b>				
	<b>UK £'000s</b>	<b>Non-UK £'000s</b>	<b>Global £'000s</b>	<b>Total £'000s</b>
Equities	813	3,009	2	3,824
Pooled property	1,095	-	-	1,095
Alternatives	-	3	3,435	3,438
Cash and Equivalents	53	-	-	53
	<b>1,961</b>	<b>3,012</b>	<b>3,437</b>	<b>8,410</b>

Overall income from all sources (excluding market movements) exceeded overall expenditure for the year by £2.148 million during 2014-15 and this was generally reinvested. The equivalent figure was £3.734 million in 2013-14 (excluding the £6m additional contribution from the Council).

## Investment Managers

The Fund has appointed external investment managers for each of the four main portfolios. The investment managers have clear benchmarks and targets, which place maximum accountability for performance on the manager. The detail of these is set out in the Statement of Investment Principles.

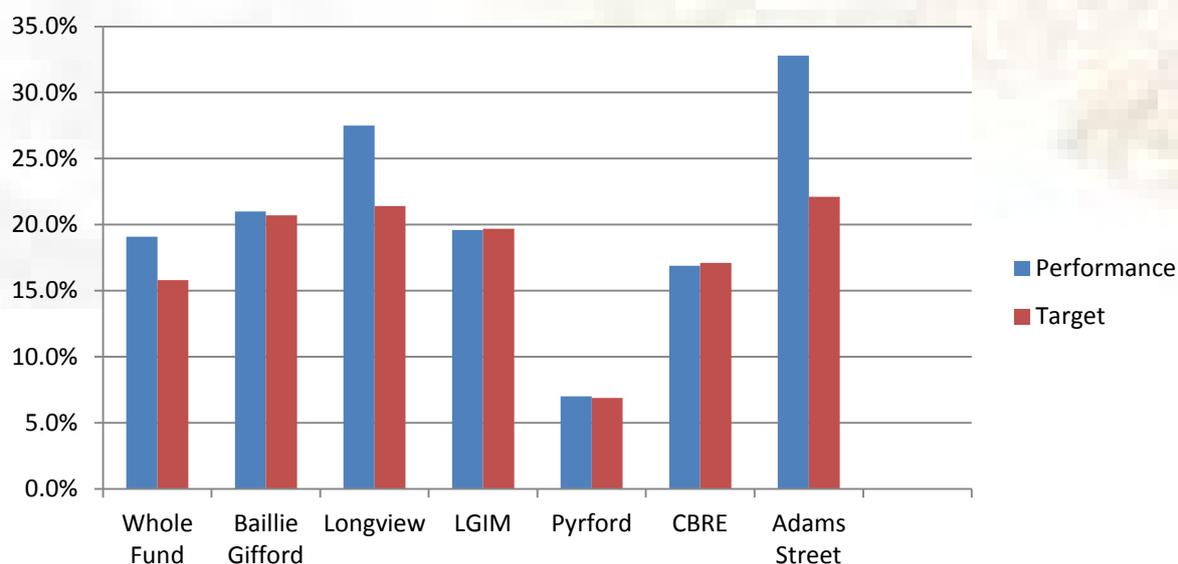
## Investment Performance

The table below shows the performance of the Fund against the target for the three years to 31 March 2015. The current strategy commenced in April 2011.

Annualised return	2014-15	2013-14	2012-13	3 years
Performance	19.1%	8.9%	15.1%	14.3%
Target	15.8%	8.6%	14.5%	13.0%
Out / (under) performance against target	3.3%	0.3%	0.6%	1.3%

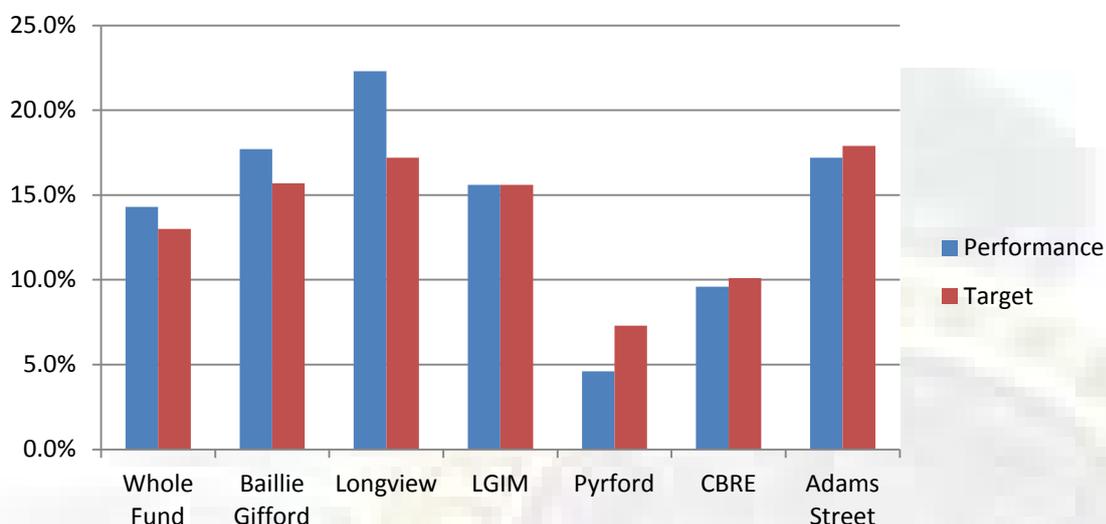
Each of the investment managers has a benchmark and target set within their Investment Management Agreements with the Fund. Performance is measured quarterly and reported to the Committee. The tables overleaf show the performance of the investment managers against their targets over 2014-15 and annualised over three years.

### 2014-15 performance against targets



The active equity managers outperformed their targets in 2014-15, which led to outperformance against target for the Fund as a whole over the year. Pyrford's target is to beat the Retail Prices Index (RPI) by 5 per cent over a rolling three year period which has been difficult with prevailing levels of inflation and low interest rates. Private equity valuations tend to lag behind the public markets against which

Adams Street is measured, and the considerable improvement in their performance reflects the improved opportunities to realise investments on appropriate markets. Since the strategy has been in place for over three years, we can see that overall performance over a three-year period is similar, as shown below:



## Responsible Investment

The Fund recognises that the neglect of corporate governance and corporate social responsibility may lead to poor or reduced shareholder returns. Following consideration of how to address the issue, and in the light of the resources available to the Fund, it has been decided to delegate responsibility for the consideration of responsible investment matters to the Fund's investment managers. The Committee believes this is the most efficient approach for a Fund of this size.

All of the managers used by the Royal Borough Fund have signed up to the United Nations Principles for Responsible Investment.

## Custody and Banking

Northern Trust is the global custodian for the Fund's assets and is independent of the investment managers. Northern Trust is responsible for the safekeeping of all of the Fund's investments as well as for the settlement of all investment transactions and the collection of income.

The Fund's bank account is held at with NatWest (part of the RBS Group). Funds not immediately required to pay benefits are invested in a NatWest Business Reserve Account.

### 3. SCHEME ADMINISTRATION

The LGPS is a statutory pension scheme whose regulations are made by the government. It is a defined benefit pension scheme and the benefits are currently based on combination of final salary career average earnings together with the length of scheme membership.

#### Service Delivery

Although the LGPS is a national scheme, it is administered locally. The Royal Borough of Kensington and Chelsea has a statutory responsibility to administer the records of active and deferred members, as well as the pension benefits payable from the Pension Fund on behalf of the participating employers and the past and present members and their dependents. Capita Hartshead have been contracted to perform the pension administration service for the Fund and the Council monitors their performance.

#### Membership of the Fund

The Fund provides pensions not only for employees of the Royal Borough of Kensington and Chelsea, but also for the employees of a number of Scheduled and Admitted Bodies. Scheduled Bodies are organisations which have the right to be a member of the LGPS under the regulations (e.g. academies). Admitted bodies participate in the scheme via an admission agreement, which is a legal document made between the Council and the organisation. Examples of admitted bodies are not for profit organisations with a link to the Council and contractors who have taken on the Council's services where staff have been transferred and have a right to remain in the LGPS.

The number of employers in the Fund has increased over recent years as some services have been outsourced and as new academies have been started or existing schools have taken on academy status. During 2014-15 officers continued to work with the administrators of the Specialist Schools and Academies Trust (SSAT), which ceased to be an admitted body in 2012. Just over £2 million was received from SSAT's liquidators in 2014-15.

A summary of the employers other than the Administering Authority is given in the table below:

<b>Fund Employers</b>	<b>Active</b>	<b>Ceased</b>	<b>Total</b>
Scheduled Bodies	7	-	7
Admitted Bodies	7	5	12
<b>Total</b>	<b>14</b>	<b>5</b>	<b>19</b>

A full list of the Fund's current active employers is set out below.

<p><b>Admitted Bodies</b></p> <p>Amey                  EPICS                  Hestia                  Medequip                  Octavia                  TMO                  Westway</p>
<p><b>Scheduled Bodies</b></p> <p>Brunel Academy                  Chelsea Academy                  Holland Park Academy                  Kensington Aldridge Academy                  Latimer Academy                  Kensington and Chelsea College                  St Charles College</p>

In addition, there are five employers which have no active members and have ceased:

<p><b>Ceased Admitted Bodies</b></p> <p>Housing Action Centre                  Maxilla Nursery                  Portobello Business Centre                  Specialist Schools and Academies Trust                  West London Family Service Units</p>
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The table below shows how the Fund's membership has changed over the last five years. The number of active contributing members in the Pension Fund has fallen by 8 per cent since 2011. In the same period, the number of pensioners and deferred members has risen, by 16 per cent and 29 per cent respectively. This pattern is similar to that seen in other local government pension schemes.

	<b>31<sup>st</sup> March 2011</b>	<b>31<sup>st</sup> March 2012</b>	<b>31<sup>st</sup> March 2013</b>	<b>31<sup>st</sup> March 2014</b>	<b>31<sup>st</sup> March 2015</b>
Contributors	3,562	3,385	3,202	3,097	3,271
Pensioners & Dependents	2,331	2,430	2,515	2,656	2,693
Deferred	3,429	3,706	3,966	4,305	4,421
<b>Total Membership</b>	<b>9,322</b>	<b>9,521</b>	<b>9,683</b>	<b>10,058</b>	<b>10,385</b>

## **Communication policy statement**

The Local Government Pension Scheme Regulations 2013 require Pension Funds to prepare, publish and maintain a communication policy statement. This statement sets out the methods used by the Fund to communicate with the various stakeholders, including scheme members, employers and their representatives.

The Fund's Communication policy statement can be found on the following website:

<https://www.rbkc.gov.uk/council/how-council-manages-money/council-spending-and-finances/pension-fund-2013-14>

## **Sources of information**

Further information about the benefits payable from the Pension Fund can be found on the national Local Government Pension Scheme website [www.lgps.org.uk](http://www.lgps.org.uk) . For further information about the administration of the scheme in Kensington and Chelsea, contact Maria Bailey by telephone on 020 7361 2333 or by email: [pensions@rbkc.gov.uk](mailto:pensions@rbkc.gov.uk)

## 4. PENSION FUND ACCOUNTS

<b>The Pension Fund Account</b>			
	<b>2014-15</b>	<b>2013-14</b>	Notes
Dealings with members, employers and others directly involved in the fund	<b>£'000</b>	<b>£'000</b>	
<b><u>Contributions</u></b>			
From employers (normal)	(18,290)	(18,409)	6
From employers (special)	-	(6,000)	6
From members	(6,374)	(5,682)	6
Transfers in from other pension funds	(1,240)	(4,039)	
Other income	-	-	
	<b>(25,904)</b>	<b>(34,130)</b>	
<b><u>Benefits</u></b>			
Pension	21,391	20,209	7
Commutation and lump sum retirement benefits	4,637	5,860	7
Payments to and on account of leavers	54	20	
Individual transfers out to other pension funds	2,279	2,582	
Other expenditure	-	-	
	<b>28,361</b>	<b>28,671</b>	
<b>Net (additions) / withdrawals with members</b>	<b>2,457</b>	<b>(5,459)</b>	
<b>Management expenses</b>	<b>3,733</b>	<b>3,751</b>	8
<b><u>Returns on investments</u></b>			
Investment income	(8,410)	(8,167)	9
Other income	(30)	-	
Taxes on income	102	141	
Profit and loss on disposal of investments and changes in the market value of investments			
Realised	(27,660)	(13,339)	
Unrealised	(100,426)	(39,100)	
	<b>(128,086)</b>	<b>(52,439)</b>	
<b>Net return on investments</b>	<b>(136,424)</b>	<b>(60,465)</b>	
<b>Net (increase) / decrease in the net assets available for benefits during the year</b>	<b>(130,234)</b>	<b>(62,173)</b>	
<b>Opening Net Assets of the Scheme</b>	<b>(695,662)</b>	<b>(633,489)</b>	
<b>Closing Net Assets of the Scheme</b>	<b>(825,896)</b>	<b>(695,662)</b>	

<b>The Pension Fund Net Assets Statement*</b>
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	31 March 2015	31 March 2014	
	£'000	£'000	Notes
<b>Investment Assets</b>			
Fixed interest securities			
Equities:			
United Kingdom	35,873	28,732	12
Overseas	168,642	134,235	12
Pooled sterling liquidity fund	30,118	-	12
Pooled global equities	394,628	285,258	12
Pooled global absolute return funds	92,702	176,264	12
Pooled property investments	40,251	22,781	12
Pooled private equity funds	45,809	33,500	12
Cash (with managers)	9,469	3,656	12
Investment income due	88	103	12
Investment liabilities		-	
<b>Net value of investment assets</b>	<b>817,580</b>	<b>684,529</b>	12
Current assets	142	1,540	12/19
Current liabilities	(1,214)	(451)	12/20
Cash (held directly by fund)	9,388	10,044	12
<b>Net assets of the fund available to fund benefits at the period end</b>	<b>825,896</b>	<b>695,662</b>	

\* 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 in Note 18.

## Notes to the Pension Fund Account

### 1. Description of The Royal Borough Of Kensington And Chelsea Pension Fund

#### (a) General

The Pension Fund (the 'Fund') is part of the Local Government Pension Scheme (LGPS) and is administered by the Council. It is a contributory defined benefits scheme established in accordance with statute, which provides for the payment of benefits to employees and former employees of the Council and the admitted and scheduled bodies to the Fund.

These benefits include retirement pensions, early payment of benefits on medical grounds and payment of death benefits where death occurs either in service or in retirement. The benefits payable are based on an employee's final salary and the number of years of eligible service. Pensions are increased each year in line with the Consumer Price Index.

The benefits payable in respect of service from 1<sup>st</sup> April 2014 are based on career average re-valued earnings and the number of years of eligible service. The benefits payable in respect of service prior to 1<sup>st</sup> April 2014 are based on an employee's final salary and the number of years of eligible service. Pensions are increased each year in line with the Consumer Price Index.

The Fund is financed by contributions from employees, the Council, the admitted and scheduled bodies and from interest and dividends on the Fund's investments. Contributions from employees are made in accordance with the Local Government Pension Scheme Regulations 2013 and range from 5.5% to 12.5% of pensionable pay. Employer contributions are set based on triennial actuarial funding valuations, as detailed in Note 18.

The Fund is governed by the Public Service Pensions Act 2013, the Local Government Pension Scheme Regulations 2013 (as amended) and the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

#### (b) Investment Committee

The Council has delegated the investment arrangements of the scheme to the Investment Committee (the Committee), which decides on the investment policy most suitable to meet the liabilities of the Fund and has ultimate responsibility for the investment policy.

The Committee is made up of six elected representatives of the Council, including one opposition party representative, each of whom has voting rights. In addition, there are up to four co-opted members who may attend committee meetings, but have no voting rights.

The Committee reports to the full Council and has full delegated authority to make investment decisions. The Committee obtains and considers advice from the Town Clerk and, as necessary, from the Fund's appointed investment advisers, managers and actuary.

### (c) Investment Principles

The *Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2009* require administering authorities to prepare and review from time to time a written statement recording the investment policy of their Pension Fund. The purpose of this document is to satisfy the requirements of the regulations, to explain how the Fund is managed and to set out the factors taken into account in doing so.

The latest *Statement of Investment Principles* (SIP) was approved in February 2015 by the Investment Committee. The SIP is available from the Council's website at:

<https://www.rbkc.gov.uk/committees/Meetings/tabid/73/ctl/ViewMeetingPublic/mid/669/Meeting/6773/Committee/1547/Default.aspx>

The Fund's investment objective is to ensure that its assets are invested in a way that maximises the likelihood that benefits will be paid to members as they fall due and to ensure the continued long-term financial support from the sponsoring employers.

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. Please see **Note 10**.

### (d) Membership

Membership of the LGPS is voluntary and employees are free to choose whether to join the scheme, remain in the scheme or make their own personal arrangements outside the scheme. Organisations participating in the Fund include scheduled bodies, which are local authorities and similar bodies whose staff are automatically entitled to be members of the Fund and admitted bodies, which are other organisations that participate in the Fund under an admission agreement between the Fund and the relevant organisation. Admitted bodies include voluntary, charitable and similar bodies or private contractors undertaking a local authority function following outsourcing to the private sector.

The following table summarises the membership numbers of the scheme:

	31 March '15 No	31 March '14 No
Active members	3,271	3,097
Pensioners receiving benefits	2,693	2,656
Deferred Pensioners	4,421	4,305
<b>Total</b>	<b>10,385</b>	<b>10,058</b>

Details of the scheduled and admitted bodies in the scheme are shown in the Fund's Annual Report.

### **(e) Tri-borough Working**

The Council, the London Borough of Hammersmith & Fulham and the City of Westminster councils have combined certain operational areas to provide a more efficient service and greater resilience. Two of the first areas to be jointly operated across the Tri-borough were the treasury and pension teams of the three councils.

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 fund and treasury operations are managed separately in accordance with Government regulations and the strategies agreed by each council, which retains sovereignty over decision making in relation to its pension fund.

## **2. Basis of the Preparation of the Financial Statements**

The Statement of Accounts summarises the Fund's transactions for 2014-15 and its position at year end as at 31 March 2015. The Statement of Accounts has been prepared in accordance with the *Code of Practice on Local Authority Accounting in the United Kingdom 2014-15* (The Code) issued by the Chartered Institute of Public Finance and Accountancy ("CIPFA") which is based on International Financial Reporting Standards (IFRS) as amended for the UK public sector.

The accounts have been prepared on an accruals basis, apart from transfer values which have been accounted for on a cash basis in accordance with the Code.

The accounts do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year, nor do they take into account the actuarial present value of promised retirement benefits. The Code gives administering authorities the option to disclose this information in the Net Asset Statement, in the notes to the accounts or by appending an actuarial report, prepared for this purpose. The Council has opted to disclose this information in an accompanying report to the accounts which is disclosed in **Note 18**.

## **3. Summary of Significant Accounting Policies**

### **Fund Account – Revenue Recognition**

#### **(a) Contribution Income**

All contributions, both from the members and from the employer, are accounted for on an accruals basis.

**(b) Transfers to and from other schemes**

Transfer values represent the amounts received and paid during the year for members who have either joined or left the Fund during the financial year and are calculated in accordance with the LGPS regulations. Individual transfers in and out are accounted for when received or paid, which is normally when the member liability is accepted or discharged. Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

**(c) Investment Income**

Dividends from quoted securities are accounted for when the security is declared ex-dividend. Interest income is accrued on a daily basis. Investment income is reported gross of withholding taxes which are accrued in line with the associated investment income. Irrecoverable withholding taxes are reported separately as a tax charge. Investment income arising from the underlying investments of the Pooled Investment Vehicles is reinvested within these and reflected in the unit price.

**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. Lump sums are accounted for in the period in which the member becomes a pensioner. Any amounts due, but unpaid, are disclosed in the net assets statement as current liabilities.

**(e) Taxation**

The Fund is an exempt approved fund 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. As the Council is the administering authority for the Fund, VAT input tax is recoverable on all Fund activities, including expenditure on investment expenses. Where tax can be reclaimed, investment income in the accounts is shown gross of UK tax. 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.

**(f) Management Expenses**

The Code does not require a breakdown of management expenses, however disclosure of expenses in accordance with the CIPFA guidance “Accounting for Local Government Pension Scheme Management costs” is provided in the interests of greater transparency.

All expenses are accounted for on an accruals basis to ensure costs for the full accounting period are accounted for in the Fund account. Staff costs associated with the running of the Fund are charged to the Fund along with an element of overhead charges.

The fees of the Fund’s external investment managers reflect their differing mandates. Management fees are usually linked to the market value of the Fund’s investments and therefore may increase or reduce as the value of the

investment changes. Fees are also payable to the Fund's custodian and other advisers.

## **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. Quoted securities and Pooled Investment Vehicles have been valued at the bid price and fixed interest securities are recorded at net market value based on their current yields at the balance sheet date. Quoted securities are valued by Northern Trust, the Fund's custodian.

The values of the private equity investments are based on valuations provided by the general partners to the private equity funds. Valuations are usually undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

There are no significant restrictions affecting the ability of the Fund to realise its investments at the accounting date or at the value at which they are included in the accounts, apart from the investments in private equity which, by their nature, will be realised over a long period of time.

### **(h) Foreign Currency Transactions**

Where appropriate, market values, cash deposits and purchases and sales outstanding listed in overseas currencies are converted into sterling at the rates of exchange ruling at the reporting date.

### **(i) Cash and Cash Equivalents**

Cash and cash equivalents comprise cash in hand and deposits with financial institutions that are repayable on demand without penalty.

### **(j) Financial Liabilities**

The Fund recognises financial liabilities at fair value as at the reporting date. A financial liability is recognised in the net assets statement on the date the Fund becomes party to the liability. From this date, any gains or losses arising from changes in the fair value of the liability are recognised by the Fund.

### **(k) Actuarial present value of promised retirement benefits**

The CIPFA Code of Practice on Local Authority Accounting sets out that the actuarial present value of promised retirement benefits should be disclosed and based on the requirements of IAS19 Post Employment Benefits and relevant actuarial standards.

As permitted under the Code, the financial statements include a report from the actuary disclosing the actuarial present value of retirement benefits. See **Note 18**.

**(l) Additional Voluntary Contributions**

Members of the Fund may choose to make Additional Voluntary Contributions (AVCs) into a separate scheme run by Prudential Assurance in order to obtain additional pensions benefits. The company is responsible for providing the investors with an annual statement showing their holding and movements in the year. AVCs are not included within the accounts in accordance with Regulation 4 (2)(b) of the LGPS (Management and Investment of Funds) Regulations 2009 . They are disclosed in **Note 21**.

**(m) Recharges from the General Fund**

The *Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009* permit the Council to charge administration costs to the Fund. A proportion of the relevant Council costs have been charged to the Fund on the basis of actual time spent on Pension Fund business. Costs incurred in the administration, oversight and governance of the Fund are set out separately in **Note 8**.

**4. Critical Judgements in Applying Accounting Practices**

The accounts contain certain estimated figures that are based on assumptions made by the Fund and other bodies about the future or that are otherwise uncertain. Estimates are made because they are required to satisfy relevant standards or regulations and are on the basis of best judgement at the time, derived from historical experience, current trends and other relevant factors. As a result, actual results may differ materially from those assumptions.

The items for which there is significant risk of material adjustment are:

**(a) Pension Fund Liability**

The Pension Fund liability is calculated triennially by the appointed actuary, with annual updates in the intervening years. The methodology used follows generally agreed guidelines and is in accordance with IAS 19. These assumptions are summarised in **Note 17**. The estimate of the net liability to pay pensions depends on a number of judgments and assumptions. In particular are those relating to the discount rate, the rate at which salaries are projected to increase, change in retirement ages, mortality rates and expected returns on the Fund's assets.

The effect of changes in individual assumptions can be measured. A 0.5% increase in the discount rate would result in a decrease in the pension liability of £94.6m. A 0.25% increase in the pay inflation assumption would increase the value of liabilities by £6.3m, and a one-year increase in assumed life expectancy would increase liabilities by £37.9m.

**(b) Unquoted Private Equity Investments**

The fair value of private equity investments is unavoidably subjective. The valuations are based on forward-looking estimates and judgements involving many factors. Unquoted private equity assets are valued by the investment

managers in accordance with industry standards. The value of private equity investments at the balance sheet date was £45.8m.

## 5. Events after the Balance Sheet Date

As at end May 2015 the Fund's investments and cash had changed in value to £822 million compared to the value placed on the net assets statement as at the reporting date of 31 March 2015. This mainly reflects a combination of general equity and fixed-income market movements.

## 6. Contributions Receivable

Employees' contributions are calculated on a sliding scale based on a percentage of their gross pay. The Council, scheduled and admitted bodies are required to make contributions determined by the Fund's actuary to maintain the solvency of the Fund. The table below shows a breakdown of the total amount of employers' and employees' contributions.

By authority	2014-15 £'000		2013-14 £'000	
	Employees Normal	Employers Normal	Employees Normal	Employers Normal
Administering Body				
Kensington and Chelsea	5,453	13,909	5,070	* 22,672
Scheduled bodies	388	901	265	665
Admitted bodies	533	# 3,480	347	1,072
<b>Total</b>	<b>6,374</b>	<b>18,290</b>	<b>5,682</b>	<b>24,409</b>
<b>Of which, Employers' Deficit Recovery Contributions</b>				
<b>Total</b>		<b>2,543</b>		<b>5,418</b>

\* The total employer contributions for 2013-14 include £6 million special contribution shown separately in the Pension Fund Accounts. # Includes £2.025m recovered from Specialist Schools and Academies Trust in 2014.

## 7. Benefits Payable

By category:	2014-15 £'000	2013-14 £'000
Pensions	21,391	20,209
Commutation and lump sum retirement benefits	4,104	4,710
Lump sum death benefits	533	1,150
<b>Total</b>	<b>26,028</b>	<b>26,069</b>

### By authority:

The Fund paid benefits to members of the scheme who were previously employed by the bodies set out below (this summary excludes lump sum retirement benefits and death benefits as this information is not held at employer level).

	2014-15 £'000	2013-14 £'000
Royal Borough of Kensington and Chelsea	19,740	18,612
Scheduled bodies	175	160
Admitted Bodies	1,476	1,437
<b>Total</b>	<b>21,391</b>	<b>20,209</b>

## 8. Management Expenses

	2014-15 £'000	2013-14 £'000
Administrative costs	233	297
Investment management expenses	3,277	3,238
Oversight and governance costs	223	216
<b>Total</b>	<b>3,733</b>	<b>3,751</b>

Of the investment management fees for 2014-15, £23,000 was in respect of identifiable transaction costs. The majority of the Fund is held in pooled assets for which transaction costs are not available.

## 9. Investment Income

	2014-15 £'000	2013-14 £'000
Equity dividends	7,259	6,781
Income from pooled property investments	1,095	739
Income from private equity	3	607
Interest on cash deposits	53	40
<b>Total</b>	<b>8,410</b>	<b>8,167</b>

## 10. Investment Strategy

The strategy of the Fund is to have around 60 per cent of the investments in global equities, diversified through three managers, Baillie Gifford and Longview managing active portfolios, with Legal and General managing a passive global equity allocation. For further diversification, the remainder of the Fund is allocated to a global absolute return strategy managed by Pyrford, a global private equity allocation, managed by Adams Street, UK commercial property funds of funds managed by CBRE and Kames and a liquidity fund managed by Legal and General.

The market value and proportion of assets managed by each manager at 31 March was:

<b>Fund Manager</b>	<b>31 March 2015</b>		<b>31 March 2014</b>	
	<b>Market Value £'000</b>	<b>%</b>	<b>Market Value £'000</b>	<b>%</b>
L and G Liquidity	30,118	3.7	-	
Baillie Gifford	176,326	21.6	145,279	21.2
Longview	213,867	26.2	166,624	24.3
L and G Equities	218,302	26.7	139,979	20.5
Barings	-		89,656	13.1
Pyrford	92,702	11.3	86,607	12.7
CBRE	25,660	3.1	22,781	3.3
Kames	14,616	1.8	-	
Adams Street	45,901	5.6	33,500	4.9
<b>Total Fund Managers</b>	<b>817,492</b>	<b>100</b>	<b>684,426</b>	<b>100.0</b>
Investment income due	88		103	
<b>Total Investments</b>	<b>817,580</b>		<b>684,529</b>	

Although several allocations exceed 5 per cent of the Fund's value, all of the allocations to pooled funds are made up of underlying investments, each of which represents substantially less than 5 per cent.

The Fund has appointed Northern Trust as its global custodian. They are responsible for safe custody and settlement of all investment transactions, collection of income and the administration of corporate actions. The bank account for the Pension Fund is held by Nat West.

**11. Reconciliation in Movements in Investments**

Transaction costs are included in the cost of purchases and sale proceeds. Transaction costs include costs charged directly to the scheme such as fees, commissions, stamp duty and other fees.

Market Value	1 April 2014 £'000	Purchases during the year and derivative payments £'000	Sales during the year and derivative receipts £'000	Net assets / liabilities movement £'000	Changes in market value during the year £'000	31 March 2015 £'000
Stirling liquidity pooled fund (Legal & General)	-	45,000	(15,000)	-	118	30,118
Pooled active global equities (Baillie Gifford)	145,279	-	-	-	31,047	176,326
Active global equities (Longview)	166,624	19,954	(16,222)	-	43,511	213,867
Pooled passive global equities (Legal and General)	139,979	45,000	-	-	33,323	218,302
Pooled active global absolute return fund (Barings)	89,656	35	(92,273)	-	2,582	-
Pooled active global absolute return fund (Pyrford)	86,607	3,385	(417)	-	3,127	92,702
Pooled UK property fund (CBRE)	22,781	-	-	-	2,879	25,660
Pooled UK property fund (Kames)	-	15,025	-	-	(409)	14,616
Global private equity fund (Adams Street)	33,500	8,563	(8,070)	-	11,908	45,901
Investment income due	103	-	-	(15)	-	88
<b>Sub-Total</b>	<b>684,529</b>	<b>136,962</b>	<b>(131,982)</b>	<b>(15)</b>	<b>128,086</b>	<b>817,580</b>
Current assets	1,540	-	-	(1,398)	-	142
Current liabilities	(451)	-	-	(763)	-	(1,214)
Cash deposits	10,044	-	-	(656)	-	9,388
<b>Net Investment Assets</b>	<b>695,662</b>	<b>136,962</b>	<b>(131,982)</b>	<b>(2,832)</b>	<b>128,086</b>	<b>825,896</b>

Market Value 2013-14	1 April 2013 £'000	Purchases during the year and derivative payments £'000	Sales during the year and derivative receipts £'000	Net assets / liabilities movement £'000	Changes in market value during the year £'000	Market values 31 March 2014 £'000
Index-linked Gilt pooled fund (Legal & General)	4,745	-	(4,647)	-	(98)	-
Pooled active global equities (Baillie Gifford)	128,840	-	-	-	16,439	145,279
Active global equities (Longview)	142,176	47,003	(43,817)	-	21,262	166,624
Pooled passive global equities (Legal and General)	128,371	-	-	-	11,609	139,979
Pooled active global absolute return fund (Barings)	88,153	64	-	-	1,440	89,656
Pooled active global absolute return fund (Pyrford)	86,514	2,606	-	-	(2,513)	86,607
Pooled UK property fund (CBRE)	21,070	-	(236)	-	1,947	22,781
Global private equity fund (Adams Street)	30,269	5,690	(4,799)	-	2,340	33,500
Fixed-term cash deposits	-	-	-	-	-	-
Investment income due	264	-	-	(161)	-	103
<b>Sub-Total</b>	<b>630,401</b>	<b>55,363</b>	<b>(53,499)</b>	<b>(161)</b>	<b>52,426</b>	<b>684,529</b>
Current assets	762	-	-	778	-	1,540
Current liabilities	(403)	-	-	(48)	-	(451)
Cash deposits	2,729	-	-	7,302	13	10,044
<b>Net Investment Assets</b>	<b>633,489</b>	<b>55,363</b>	<b>(53,499)</b>	<b>7,871</b>	<b>52,439</b>	<b>695,662</b>

## 12. Classification of Financial Instruments

The following table shows the classification of the Fund's financial instruments and also shows the split between UK and overseas. All investments are quoted unless otherwise stated.

	31 March '15 £'000			31 March '14 £'000		
	Designated as fair value through profit and loss	Loans and receivables	Financial liabilities at amortised cost	Designated as fair value through profit and loss	Loans and receivables	Financial liabilities at amortised cost
<b>Financial Assets</b>						
<b>Equities</b>						
United Kingdom	35,873			28,732		
Overseas	168,642			134,235		
<b>Pooled funds - investment vehicles</b>						
UK pooled liquidity fund	30,118			-		
Pooled global equities	394,628			285,258		
Pooled global absolute return funds	92,702			176,264		
Pooled property investments	40,251			22,781		
Pooled private equity funds (unquoted)	45,809			33,500		
Investment income due	88			103		
Cash		18,857			13,700	
Debtors		142			1,540	
<b>Financial Liabilities</b>						
Creditors			(1,214)			(451)
<b>Subtotal</b>	<b>808,111</b>	<b>18,999</b>	<b>(1,214)</b>	<b>680,873</b>	<b>15,240</b>	<b>(451)</b>
<b>Total</b>		<b>825,896</b>			<b>695,662</b>	

The carrying value is the same as the fair value for all financial instruments held by the Fund.

## 13. 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. The definitions of the levels are detailed below and the table showing the analysis is overleaf.

### Level 1 – Quoted market price

Fair values are derived from unadjusted quoted prices in active markets for identical assets and liabilities. Examples are quoted equities, quoted index linked securities and unit trusts. All level 1 investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

**Level 2 – Using observable inputs**

Quoted prices are not available for financial instruments at this level. The valuation techniques used to determine fair value use inputs that are based significantly on observable market data.

**Level 3 – With significant unobservable inputs**

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 e.g. private equity investments.

The values of the private equity investments are based on valuations provided by the General Partners to the private equity funds. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines, which follow the valuation principles of IFRS and US GAAP. Valuations are undertaken annually at the end of December and cashflow adjustments are used to roll forward the valuations to 31 March as appropriate.

	31 March '15 £'000			31 March '14 £'000		
	Quoted market price Level 1	Using observable inputs Level 2	With significant unobserva ble inputs Level 3	Quoted market price Level 1	Using observable inputs Level 2	With significant unobserva ble inputs Level 3
<b>Financial Assets</b>						
Financial assets at fair value through profit and loss	722,051	40,251	45,809	624,592	22,781	33,500
Loans and receivables	18,999			15,240		
<b>Total Financial Assets</b>	<b>741,050</b>	<b>40,251</b>	<b>45,809</b>	<b>639,832</b>	<b>22,781</b>	<b>33,500</b>
<b>Financial Liabilities</b>						
Financial liabilities at fair value through profit and loss						
Financial liabilities at amortised cost	(1,214)			(451)		
<b>Total Financial Liabilities</b>	<b>(1,214)</b>			<b>(451)</b>		
<b>Net Financial Assets</b>	<b>739,836</b>	<b>40,251</b>	<b>45,809</b>	<b>639,381</b>	<b>22,781</b>	<b>33,500</b>
<b>Total</b>		<b>825,896</b>			<b>695,662</b>	

**14. Nature of Risk Arising from Financial Instruments****Risk and Risk Management****(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 basket 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, along with the Pension Fund Risk Register.

### 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.

All assets with the exception of cash, forward foreign exchange contracts, other investment balances, debtors and creditors are exposed to price risk. The table overleaf shows the value of these assets at the balance sheet date (and the prior year) and what the value would have been if prices had been 10% higher or 10% lower.

#### Assets exposed to price risk

	<b>Value £000</b>	<b>+ 10% £000</b>	<b>-10% £000</b>
At 31 <sup>st</sup> March 2015	808,023	888,825	727,221
At 31 <sup>st</sup> March 2014	680,770	748,847	612,693

### 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.

Index linked gilts, cash and some elements of the pooled investment vehicles are exposed to interest rate risk. The table below shows the value of these assets at the balance sheet date (and the prior year) and what the value would have been if interest rates had been 1% higher or 1% lower.

Assets exposed to interest rate risk

	<b>Value £000</b>	<b>+ 1% £000</b>	<b>-1% £000</b>
At 31 <sup>st</sup> March 2015	114,357	115,501	113,213
At 31 <sup>st</sup> March 2014	103,705	104,742	102,668

### 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.

Overseas equities, overseas index linked securities, cash in foreign currencies, the value of the forward foreign exchange contracts and some elements of the pooled investment vehicles are exposed to currency risk. The table below shows the value of these assets at the balance sheet date (and the prior year) and what the value would have been if currencies had been 10% higher or 10% lower.

Assets exposed to currency risk

	<b>Value £000</b>	<b>+ 10% £000</b>	<b>-10% £000</b>
At 31 <sup>st</sup> March 2015	611,786	672,965	550,607
At 31 <sup>st</sup> March 2014	513,994	565,393	462,595

### (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 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.

### (c) Liquidity Risk

Liquidity risk represents the risk that the Fund will not be able to meet its financial obligations as they fall due. The Fund 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.

The only assets in the Fund which cannot be liquidated within a month are the private equity assets which amounted to £45.8m at 31<sup>st</sup> March 2015 (£33.5m at 31<sup>st</sup> March 2014). The majority of the investments can in fact be liquidated within a matter of days.

## **15. Contingent Liabilities and Contractual Commitments**

As at 31 March, the Fund had a commitment to invest a further £18.8 million into the Adams Street private equity funds of funds. It is anticipated that these commitments will be spread over the next 10 years and will be largely offset by cash distributions from the investments made since 2007.

## **16. Stock Lending**

The Fund does not participate in stock lending.

## **17. Funding Arrangements**

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

The most recent full triennial valuation of the Fund was carried out by Barnett Waddingham, the Fund's actuary, as at 31 March 2013, 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 2014.

The 2013 valuation certified a common contribution rate of 17.8 per cent of pensionable pay to be paid by each employing body participating in the Fund, based on a funding level of 95 per cent. In addition, 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. It should, however, be noted that the employers' contributions for the period to 31 March were based on the results of the 2010 valuation.

The actuary's smoothed market value of the scheme's assets at 31 March 2013 was £630 million and the actuary assessed the present value of the funded obligation at £663 million indicating a net liability of £33 million.

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.

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 7 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 payments 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.

The next actuarial revaluation of the Fund will be as at 31 March 2016 and will be published in 2017.

## **18. Actuarial Present Value of Promised Retirement Benefits**

The table below shows the total net liability of the Fund as at 31 March 2015. The figures have been prepared by the Fund's actuary, only for the purposes of providing the information required by IAS26. In particular, they are not relevant for calculations undertaken for funding purposes or for other statutory purposes under UK pensions legislation.

In calculating the required numbers the actuary adopted methods and assumptions that are consistent with IAS19.

	31 March '15 £'000	31 March '14 £'000
Present value of promised retirement benefits*	1,066,149	887,960
Fair value of scheme assets (bid value)	(825,896)	(695,662)
<b>Net Liability</b>	<b>240,253</b>	<b>192,298</b>

\*Present value of promised retirement benefits comprises £952,402,000 in respect of vested obligation and £113,747,000 in respect of non-vested obligations.

**19. Current Assets**

	31 March '15 £'000	31 March '14 £'000
<b>Debtors</b>		
Contributions due - employers	100	208
Contributions due - employees	42	80
Sundry debtors	-	1,252
<b>Total</b>	<b>142</b>	<b>1,540</b>
	31 March '15 £'000	31 March '14 £'000
<b>Analysis of debtors</b>		
Local authorities	-	1,252
Other entities and individuals	142	288
<b>Total</b>	<b>142</b>	<b>1,540</b>

**20. Current Liabilities**

	31 March '15 £'000	31 March '14 £'000
<b>Creditors</b>		
Sundry creditors	793	451
Benefits payable	421	-
	<b>1,214</b>	<b>451</b>
	31 March '15 £'000	31 March '14 £'000
<b>Analysis of creditors</b>		
Government bodies	280	-
Other entities and individuals	934	451
<b>Total</b>	<b>1,214</b>	<b>451</b>

**21. Additional Voluntary Contributions**

The *Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998* do not permit Additional Voluntary Contributions (AVCs) to be paid into the 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 £516,000 was invested by members of this fund in this way during 2014-15. The value of AVCs invested in 2013-14 was £478,000.

	Market Value 31 March '15 £'000	Market Value 31 March '14 £'000
Prudential	2,647	2,431
<b>Total</b>	<b>2,647</b>	<b>2,431</b>

## **22. Related Party Transactions**

The Fund is administered by the Royal Borough of Kensington and Chelsea. The Council incurred costs of £0.5 million in the financial year 2014-15 (2013-14 £0.4 million) in relation to the administration of the Fund and was reimbursed by the Fund for the expenses. The Fund uses the same banking providers as the Council and no additional charges are made in respect of this.

In year, and in total, the Council contributed £14 million to the Fund compared to £22 million in 2013-14.

The Council has a significant relationship with one admitted body, the Kensington and Chelsea Tenant Management Organisation (TMO). The Fund received £1.1 million in employer contributions, deficit and early retirement costs from the TMO.

## **Independent auditor's report to the members of Kensington and Chelsea Pension Fund on the pension fund financial statements published with the Pension Fund Annual Report**

We have examined the pension fund financial statements for the year ended 31 March 2015 on pages 17 to 37.

### **Respective responsibilities of the Section 151 Officer and the auditor**

As explained more fully in the Statement of the Section 151 Officer's Responsibilities the Section 151 Officer is responsible for the preparation of the pension fund financial statements in accordance with applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15.

Our responsibility is to report to you our opinion on the consistency of the pension fund financial statements included in the Pension Fund Annual Report with the pension fund financial statements included in the annual published statement of accounts of the Royal Borough of Kensington and Chelsea, and their compliance with applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15.

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

Our report on the administering authority's annual published statement of accounts describes the basis of our opinion on those financial statements.

### **Opinion**

In our opinion, the pension fund financial statements are consistent with the pension fund financial statements included in the annual published statement of accounts of the Royal Borough of Kensington and Chelsea for the year ended 31 March 2015 and comply with applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15.

We have not considered the effects of any events between the date we signed our report on the full annual published statement of accounts TBC and the date of this report.

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

The Code of Audit Practice for Local Government Bodies 2010 requires us to report to you if:

- the information given in the Pension Fund Annual Report for the financial year for which the financial statements are prepared is not consistent with the financial statements; or
- any matters relating to the pension fund have been reported in the public interest under section 8 of Audit Commission Act 1998 in the course of, or at the conclusion of, the audit.

We have nothing to report in respect of these matters

**Andrew Sayers**

**for and on behalf of KPMG LLP, Appointed Auditor**

Chartered Accountants

15 Canada Square

Canary Wharf

London

E14 5GL

**XX** September 2015

## 5. CONTACTS

### **Tri Borough Pensions Team**

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64 Victoria Street  
London  
SW1E 6QE  
Telephone: 020 7641 6000  
Email: [pensionfund@rbkc.gov.uk](mailto:pensionfund@rbkc.gov.uk)

### **Pensions Manager**

Royal Borough of Kensington and Chelsea  
Town Hall  
Hornton Street  
London  
W8 7NX

### **Capita Hartshead**

Capita Employee Benefits (Re RBKC)  
Castle House  
Park Road  
Banstead  
SM7 3BX

### **National Local Government Pension Scheme information website**

[www.lgps.org.uk](http://www.lgps.org.uk)

### **The Pensions Advisory Service (TPAS)**

11 Belgrave Road  
London SW1V 1RB  
Telephone: 0845 601 2923  
Email: [www.pensionsadvisoryservice.org.uk/online-enquiry](http://www.pensionsadvisoryservice.org.uk/online-enquiry)

### **The Office of the Pensions Ombudsman**

11 Belgrave Road  
London, SW1V 1RB  
Telephone: 020 7630 2200  
Email: [enquiries@pensions-ombudsman.org.uk](mailto:enquiries@pensions-ombudsman.org.uk)

## 6. GLOSSARY

**Active member:** Current employee who is contributing to a pension scheme.

**Actuary:** An independent professional who advises the Council on the financial position of the Fund. Every three years the actuary values the assets and liabilities of the Fund and determines the funding level and the employers contribution rates.

**Additional Voluntary Contributions (AVC):** An option available to active scheme members to secure additional pension benefits by making regular contributions to separately held investment funds managed by the Fund's AVC provider.

**Admitted Body:** An organisation, whose staff can become members of the Fund by virtue of an admission agreement made between the Council and the organisation. It enables contractors who take on the Council's services with employees transferring, to offer those staff continued membership of the Fund.

**Asset Allocation:** The apportionment of a fund's assets between different types of investments (or asset classes). The long-term strategic asset allocation of a Fund will reflect the Fund's investment objectives.

**Benchmark:** A measure against which the investment policy or performance of an investment manager can be compared.

**Deferred members:** Scheme members who have left employment or ceased to be an active member of the scheme whilst remaining in employment, but retain an entitlement to a pension from the scheme.

**Defined Benefit Scheme:** A type of pension scheme, where the pension that will ultimately be paid to the employee is fixed in advance, and not impacted by investment returns. It is the responsibility of the sponsoring organisation to ensure that sufficient assets are set aside to meet the pension promised.

**Dynamic Asset Allocation Portfolio:** A portfolio that involves the movement of assets through different investment markets as market conditions change.

**Employer Contribution Rates:** The percentage of the salary of employees that employers pay as a contribution towards the employees' pension.

**Equities:** Ordinary shares in UK and overseas companies traded on a stock exchange. Shareholders have an interest in the profits of the company and are entitled to vote at shareholders' meetings.

**Fixed Interest Securities:** Investments, mainly in government stocks, which guarantee a fixed rate of interest. The securities represent loans which are repayable at a future date but which can be traded on a recognised stock exchange in the meantime.

**Index:** A calculation of the average price of shares, bonds, or other assets in a specified market to provide an indication of the average performance and general trends in the market.

**Indexed Linked Securities:** Bonds on which the interest and ultimate capital repayment are recalculated on the basis of changes in the Retail Price Index.

**Pooled Investment Vehicles:** Funds which manage the investments of more than one investor on a collective basis. Each investor is allocated units which are revalued at regular intervals. Income from these investments is normally returned to the pooled fund and increases the value of the units.

**Private Equity:** Investments in companies not quoted on public stock exchanges. Commonly these are start up businesses (also known as venture capital) or buyouts of companies with a view to restructuring and selling on.

**Return:** The total gain from holding an investment over a given period, including income and increase or decrease in market value.

**Scheduled Body:** An organisation that has the right to become a member the Local Government Pension Scheme under the scheme regulations. Such an organisation does not need to be admitted, as it's right to membership is automatic.

**Unrealised Gains/Losses:** The increase or decrease in the market value of investments held by the fund since the date of their purchase.