



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

**2013-14**

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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 2013-14.

During 2013-14, the Council invested over £34 million of contributions, including a one-off payment of £6 million from the previous year's revenue underspend to help reduce the past-service deficit.

It was encouraging that the Fund achieved an overall return of 8.9 per cent. The Fund aims for over-performance of about 2.3 per cent and actual performance exceeded the target by 0.3 per cent.

During the year, the Investment Committee received the results of the 2013 Actuarial Valuation which indicated that the funding position had improved to 95 per cent, up from 89 per cent in 2010. This pleasing performance can be largely attributed to the excellent returns achieved from equities and the restructuring of the Fund after the 2010 valuation.

During 2013-14 an opportunity was identified and an exercise undertaken to appoint a secondary property manager with a view to bringing the target allocation to property back to five per cent and improving the cash-flow. It is anticipated that the £15 million allocation to this manager will be drawn by late summer 2014. A further review of investment strategy will be commenced in 2014, with a view to reducing the current level of equity risk, while still producing a good level of income and capital growth.

I would like to take this opportunity to thank Cllr Jonathon Read for chairing the Investment Committee for the last year and his success in continuing to build on the work of his predecessors.

Councillor Quentin Marshall, Chairman of the Investment Committee

## 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).

A new LGPS scheme was introduced with effect from 1 April 2014. This will continue to be a defined benefit scheme, but instead of final salary, contributions will 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. Consultations have continued on the structure of the LGPS and the results of these are expected in late 2014 as well as confirmation of future governance arrangements for the LGPS as a whole.

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 4 outlines the funding position of the Fund and Section 5 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 7.

# 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 – five from the majority party and one minority party representative until the elections in May 2014. There are now four majority party and two minority party members of the Committee. 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 current membership of the Investment Committee is as follows:

|                              |                         |
|------------------------------|-------------------------|
| Councillor Quentin Marshall  | Chairman since May 2014 |
| Councillor Warwick Lightfoot | Vice Chairman           |
| Councillor Emma Dent-Coad    |                         |
| Councillor Andrew Lomas      |                         |
| Councillor Andrew Rinker     |                         |
| Councillor Paul Warrick      |                         |

Cllr Jonathon Read Chaired the Committee during 2013-14

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 statement can be found by following the link:

<http://www.rbkc.gov.uk/councilanddemocracy/howthecouncilmanagesmoney/pensionfund2011-12.aspx>

## 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                    | Jonathan Hunt<br>Alex Robertson<br>Nicola Webb<br>Nikki Parsons |
| Pensions Manager                             | Maria Bailey  |

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

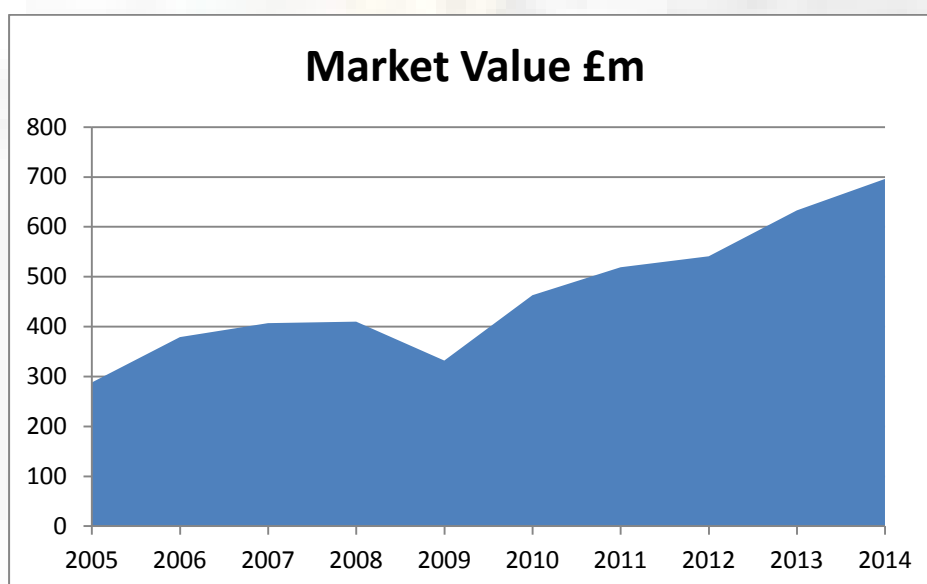
### External Advisers

|                       |  |
|-----------------------|--|
| Investment Adviser    | Hymans Robertson   |
| Investment Managers   | Adams Street Partners<br>Baillie Gifford<br>Baring Asset Management Limited<br>CBRE Global Investors<br>Legal & General Investment Management<br>Longview Asset Management<br>Pyrford LLP<br>Plus Kames Capital from late 2014 |
| 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 2013-14 was positive both in absolute terms and relative to the Fund's target. The return was 8.9 per cent, which was 0.3 per cent above the target set by the Fund. As with all performance reported here, this was net of fees. There were no changes of investment manager during the year although Kames Capital were appointed to run a secondary property mandate which will be funded in late 2014. Some of the funds for this will come from the special contribution of £6 million from the Royal Borough in 2013, the rest will be from cash and a reduction in one of the equity managers' positions. 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:



The Fund remained cash-flow positive in 2013-14 thanks to an additional £6 million contribution from the Royal Borough and improved investment income. However, benefits paid out of the Fund together with administration expenses remained very close to the normal level of contributions. There were several reasons for this, the most significant of which were a further reductions in active members and increases in the numbers of pensioners, a continuing trend in the public sector. The combination of a freeze in public sector salaries, and pensions rising in-line with higher than anticipated inflation, also reduced net cash flow.

A more detailed account is set out in Section 4.



## 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 decided to invest 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 are undertaken 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 in Section 6: 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 is 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:

| <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.

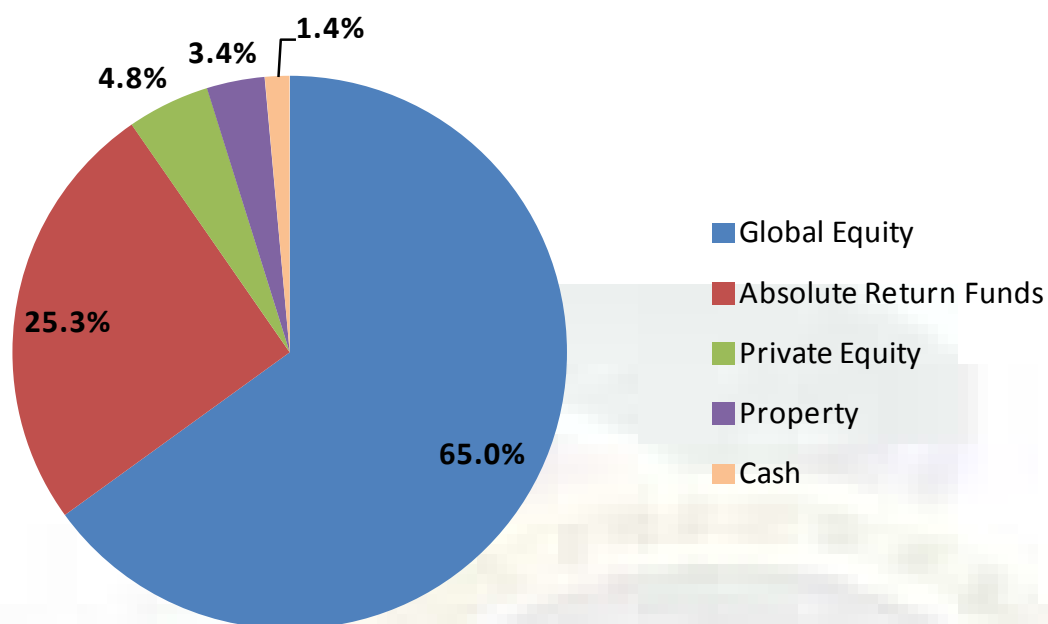
The Fund’s published statement can be found in the Pension Fund section of the following website:

<http://www.rbkc.gov.uk/councilanddemocracy/howthecouncilmanagesmoney/pensionfund2011-12.aspx>

## **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 designed 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 2013.



There were no changes to the strategic allocation of the Fund in 2013-14.

## 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.

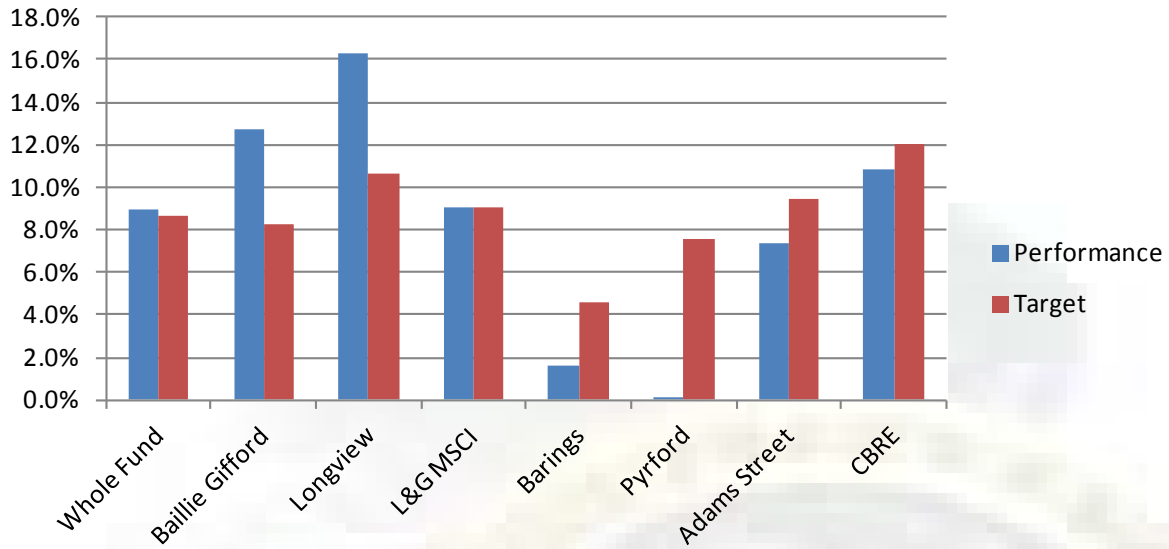
## Investment Performance

The table below shows the performance of the Fund against the target in 2012-13, the previous financial year, and the annualised performance over various time periods. The current strategy commenced in April 2011.

| Annualised return                        | 2013/14 | 2012/13 | 2011/12 | 3 years |
|--|---------|---------|---------|---------|
| Performance                              | 8.9%    | 15.1%   | 3.6%    | 9.1%    |
| Target                                   | 8.6%    | 14.5%   | 4.0%    | 9.0%    |
| Out / (under) performance against target | 0.3%    | 0.6%    | (0.4%)  | 0.1%    |

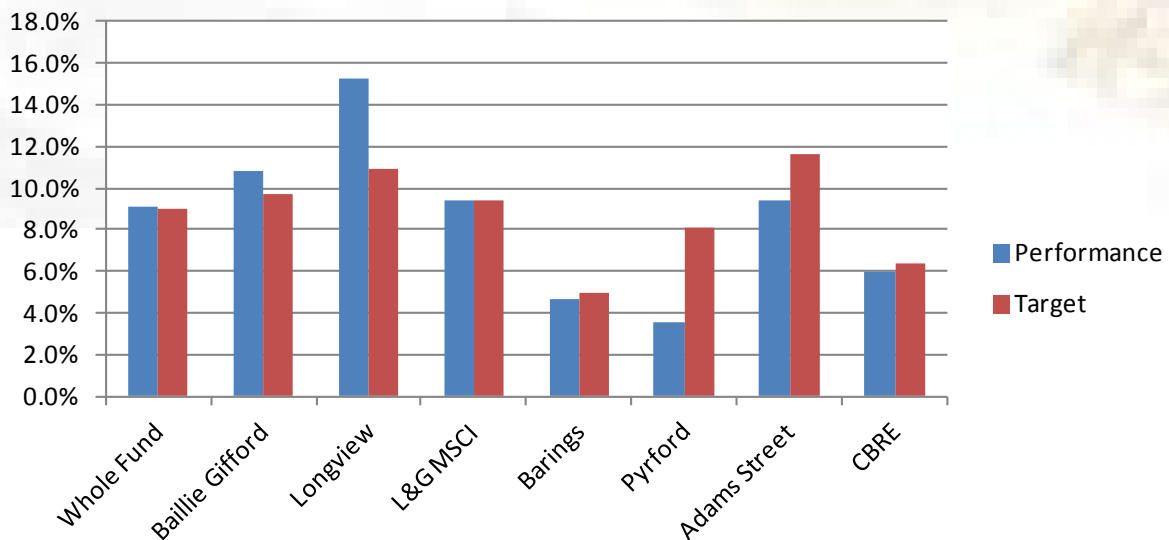
Each of the investment managers has a benchmark and target set within their Investment Management Agreements with the Fund. Performance is measured quarterly and reported to the Committee. The tables overleaf show the performance of the investment managers against their targets over 2012-13 and annualised over three years.

2013-14 performance against targets



The active equity managers outperformed their targets in 2013-14, 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. Private equity valuations tend to lag behind the public markets against which Adams Street is measured, so their investments should increase in value along with opportunities to realise their holdings.

Now that the strategy has been in place for over three years, we can see that performance over a longer 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 in accordance with the Superannuation Act 1972. It is a defined benefit pension scheme and the benefits are currently based on final salary and 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 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.

There has been considerable stability in the number of employers in the Fund for some time, with three scheduled and four admitted bodies. During 2012-13 the Specialist Schools and Academies Trust, which became an admitted body in 1990 entered administration. It was subsequently declared insolvent. Officers worked with the administrators to establish a claim on behalf of the Fund to recover as much as possible of the actuarial deficit. Agreement was reached in 2014 that the liquidators would agree to a claim of £4.5 million And it is estimated that around 70 per cent of this will be recovered.

A full list of the Fund's current employers is set out in note 6 of the accounts.

The table overleaf 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 9 per cent since 2009. In the same period, the number of pensioners and deferred members has risen, by 17 per cent and 27 per cent respectively. This pattern is common across local government pension schemes.

|                         | <b>31<sup>st</sup><br/>March<br/>2010</b> | <b>31<sup>st</sup><br/>March<br/>2011</b> | <b>31<sup>st</sup><br/>March<br/>2012</b> | <b>31<sup>st</sup><br/>March<br/>2013</b> | <b>31<sup>st</sup><br/>March<br/>2014</b> |
|-------------------------|---|---|---|---|---|
| Contributors            | 3,558                                     | 3,562                                     | 3,385                                     | 3,202                                     | 3,097                                     |
| Pensioners & Dependents | 2,225                                     | 2,331                                     | 2,430                                     | 2,515                                     | 2,656                                     |
| Deferred                | 3,271                                     | 3,429                                     | 3,706                                     | 3,966                                     | 4,305                                     |
| <b>Total Membership</b> | <b>9,164</b>                              | <b>9,322</b>                              | <b>9,521</b>                              | <b>9,683</b>                              | <b>10,058</b>                             |

## Communication policy statement

The Local Government Pension Scheme (Administration) Regulations 2008 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: <http://www.rbkc.gov.uk/councilanddemocracy/howthecouncilmanagesmoney/pensionfund2011-12.aspx>

## 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 Baillie by telephone on 020 7361 2333 or by email: [pensions@rbkc.gov.uk](mailto:pensions@rbkc.gov.uk)

## 4. PENSION FUND ACCOUNTS

### The Pension Fund Account

|   | 2013-14         | 2012-13         | Notes |
|---|-----------------|-----------------|-------|
|   | £'000           | £'000           |       |
| Dealings with members, employers and others directly involved in the fund                 |                 |                 |       |
| <b>Contributions</b>  |                 |                 |       |
| From employers (normal)   | (18,409)        | (18,199)        | 6     |
| From employers (special)  | (6,000)         | (9,000)         | 6     |
| From members  | (5,682)         | (5,695)         | 6     |
| Transfers in from other pension funds   | (4,039)         | (3,722)         |       |
| Other income  | -               | -               |       |
|   | <b>(34,130)</b> | <b>(36,616)</b> |       |
| <b>Benefits</b>   |                 |                 |       |
| Pension   | 20,209          | 19,118          | 7     |
| Commutation and lump sum retirement benefits  | 5,860           | 5,678           | 7     |
| Payments to and on account of leavers   | 20              | 117             |       |
| Individual transfers out to other pension funds   | 2,582           | 2,058           |       |
| Other expenditure   | -               | -               |       |
| Administration expenses   | 434             | 530             | 8     |
|   | <b>29,105</b>   | <b>27,501</b>   |       |
| <b>Net (additions) / withdrawals with members</b>   | <b>(5,025)</b>  | <b>(9,115)</b>  |       |
| <b>Returns on investments</b>   |                 |                 |       |
| Investment income   | (8,167)         | (5,499)         | 9     |
| Other income  | -               | (530)           |       |
| Taxes on income   | 141             | 116             |       |
| Profit and loss on disposal of investments and changes in the market value of investments |                 |                 |       |
| Realised  | (13,339)        | (14,199)        |       |
| Unrealised  | (39,100)        | (66,392)        |       |
|   | <b>(52,439)</b> | <b>(80,591)</b> | 12    |
| Investment management expenses  | 3,317           | 2,923           | 10    |
| <b>Net return on investments</b>  | <b>(57,148)</b> | <b>(83,581)</b> |       |
| <b>Net (increase) / decrease in the net assets available for benefits during the year</b> | <b>(62,173)</b> | <b>(92,696)</b> |       |
| <b>Opening Net Assets of the Scheme</b>   | <b>633,489</b>  | <b>540,793</b>  |       |
| <b>Closing Net Assets of the Scheme</b>   | <b>695,662</b>  | <b>633,489</b>  |       |

|   |
|---|
| <b>The Pension Fund Net Assets Statement*</b> |
|---|

|  | 31 March 2014  | 31 March 2013  |       |
|--|----------------|----------------|-------|
|  | £'000          | £'000          | Notes |
| <b>Investment Assets</b>   |                |                |       |
| Fixed interest securities  |                |                |       |
| Equities:  |                |                |       |
| United Kingdom   | 28,732         | 15,696         | 13    |
| Overseas   | 134,235        | 124,532        | 13    |
| Pooled index-linked Gilts  | -              | 4,745          | 13    |
| Pooled global equities   | 285,258        | 257,211        | 13    |
| Pooled global absolute return funds  | 176,264        | 174,667        | 13    |
| Pooled property investments  | 22,781         | 20,834         | 13    |
| Pooled private equity funds  | 33,500         | 30,237         | 13    |
| Cash (with managers)   | 3,656          | 2,215          | 12/13 |
| Investment income due  | 103            | 264            | 13    |
| Investment liabilities   | -              | -              |       |
| <b>Net value of investment assets</b>                                      | <b>684,529</b> | <b>630,401</b> | 12/13 |
| Current assets   | 1,540          | 762            | 12/20 |
| Current liabilities  | (451)          | (403)          | 12/21 |
| Cash (held directly by fund)   | 10,044         | 2,729          | 12/13 |
| <b>Net assets of the fund available to fund benefits at the period end</b> | <b>695,662</b> | <b>633,489</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 19.



## Notes to the Pension Fund Accounts

### 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.

From 1 April 2014, revised regulations will be effective, changing the scheme from a final salary scheme to a career average revalued earnings based scheme. All benefits payable on employees' service from 1 April 2014 will be based on the average of each year of salary revalued 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.

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

#### (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 Joint Chief Executive 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 1999* 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 November 2012 by the Investment Committee. It outlines the broad investment principles governing the investment policy of the Fund and demonstrates compliance with the "10 Investment Principles" identified in the *Myners Review of Institutional Investment* in the UK as subsequently revised in 2008 by the Department for Communities and Local Government. The SIP is available from the Council's website at:

<http://www.rbkc.gov.uk/councilanddemocracy/howthecouncilmanagesmoney/pensionfund2011-12.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 11**.

### **(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.

The following table summarises the membership numbers of the scheme:

|                               | 31 March '14<br>No | 31 March '13<br>No |
|-------------------------------|--------------------|--------------------|
| Active members                | 3,097              | 3,202              |
| Pensioners receiving benefits | 2,656              | 2,515              |
| Deferred Pensioners           | 4,305              | 3,966              |
| <b>Total</b>                  | <b>10,058</b>      | <b>9,683</b>       |

Details of the scheduled and admitted bodies in the scheme are shown in **Note 6** Contributions Receivable and **Note 7** Benefits Payable.

### (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 2013-14 and its position at year end as at 31 March 2014. The Statement of Accounts has been prepared in accordance with International Accounting Standard 26 (IAS26): *Accounting and Reporting by Retirement Benefit Plans* and the *Code of Practice on Local Authority Accounting in the United Kingdom* (The Code).

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. IAS 26 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 discussed in **Note 19**.

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

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

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

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

##### **(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. 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 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.

##### **(f) Administrative Expenses**

Expenses are accounted for on an accruals basis to ensure costs for the full accounting period are accounted for in the Fund account. All staff costs of the pension's administration team are charged directly to the Fund.

##### **(g) Investment Management Expenses**

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.

Investment management expenses are accounted for on an accruals basis to ensure expenses for the full accounting period are shown.

## **Net Assets Statement**

### **(h) Financial Assets**

Financial assets are included in the net assets statement on a fair value basis as at the Balance Sheet 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.

**(i) Foreign Currency Transactions**

Dividends, interest and purchases and sales of investments in foreign currencies have been accounted for at the spot market rates as at the transaction date. Investments held in foreign currencies at the 31 March 2014 are shown at their sterling market value calculated using the prevailing applicable spot exchange rate provided by Northern Trust.

**(j) Cash and Cash Equivalents**

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

**(k) Financial Liabilities**

The fund recognises financial liabilities at fair value as at the Balance Sheet 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.

**(l) Actuarial present value of promised retirement benefits**

The actuarial present value of promised retirement benefits is assessed on a triennial basis by the scheme actuary in accordance with the relevant actuarial and accounting standards.

As permitted under IAS26, the financial statements include a report from the actuary disclosing the actuarial present value of retirement benefits. This report is published with these accounts and summarised in **Note 19**.

**(m) 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 the relevant regulations. They are disclosed in **Note 22**.

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

The *Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998* 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 management and administration of the Fund are set out separately.

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

The accounts contain certain estimated figures that are based on assumptions made by the Council 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.

**(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 18**. The estimates are sensitive to changes in the underlying assumptions underpinning the valuations.

**(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.

**5. Events after the Balance Sheet Date**

As at end of July 2014 the Fund's investments had changed in value to £711 million compared to the value placed on the net assets statement as at the reporting date of 31 March 2014. This mainly reflects a combination of general equity and fixed-income market movements and the inflow of funds, including a partial settlement of £1.35 million received from the liquidators of the Specialist Schools and Academies Trust.

A further significant event took place at the end of August when the fund manager at the Barings Dynamic Asset Allocation Fund announced his resignation. Following the advice of the Fund's advisers, this holding was sold.

**6. Contributions Receivable**

| By authority                              | 2013-14<br>£'000    |                     | 2012-13<br>£'000    |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | Employees<br>Normal | Employers<br>Normal | Employees<br>Normal | Employers<br>Normal |
| Administering Body                        |                     |                     |                     |                     |
| <b>Kensington and Chelsea</b>             | <b>5,070</b>        | <b>22,672</b>       | <b>5,043</b>        | <b>25,507</b>       |
| <b>Scheduled Bodies</b>                   |                     |                     |                     |                     |
| ARK Brunel Academy                        | 6                   | 15                  | -                   | -                   |
| Chelsea Academy                           | 75                  | 176                 | 64                  | 148                 |
| Holland Park Academy                      | 44                  | 99                  | -                   | -                   |
| Kensington and Chelsea<br>College         | 100                 | 244                 | 141                 | 338                 |
| St Charles Sixth Form College             | 40                  | 131                 | 41                  | 132                 |
| <b>Subtotal of Scheduled<br/>bodies</b>   | <b>265</b>          | <b>665</b>          | <b>246</b>          | <b>618</b>          |
| <b>Admitted Bodies</b>                    |                     |                     |                     |                     |
| Amey                                      | 31                  | 80                  | -                   | -                   |
| EPICS                                     | 11                  | 25                  | -                   | -                   |
| Medequip                                  | 1                   | 4                   | 1                   | 4                   |
| Hestia                                    | 15                  | 34                  | 5                   | 11                  |
| Specialist Schools and<br>Academies Trust | -                   | -                   | 21                  | 44                  |
| Tenant Management<br>Organisation         | 275                 | 888                 | 358                 | 955                 |
| Westway Development Trust                 | 14                  | 41                  | 21                  | 60                  |
| <b>Subtotal of Admitted bodies</b>        | <b>347</b>          | <b>1,072</b>        | <b>406</b>          | <b>1,074</b>        |
| <b>Total *</b>                            | <b>5,682</b>        | <b>24,409</b>       | <b>5,695</b>        | <b>27,199</b>       |

\* The total employer contributions for 2013-14 includes the £6 million special contribution shown separately in the Pension Fund Accounts. A similar contribution of £9 million was made in 2012-13.



**7. Benefits Payable**

| <b>By category:</b>                          | <b>2013-14<br/>£'000</b> | <b>2012-13<br/>£'000</b> |
|--|--------------------------|--------------------------|
| Pensions                                     | 20,209                   | 19,118                   |
| Commutation and lump sum retirement benefits | 4,710                    | 4,841                    |
| Lump sum death benefits                      | 1,151                    | 837                      |
| <b>Total</b>                                 | <b>26,069</b>            | <b>24,796</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).

|  | <b>2013-14<br/>£'000</b> | <b>2012-13<br/>£'000</b> |
|--|--------------------------|--------------------------|
| <b>Royal Borough of Kensington and Chelsea</b> | 18,612                   | 17,334                   |
| <b>Scheduled Bodies</b>                        |                          |                          |
| Chelsea Academy                                | -                        | 261                      |
| Kensington and Chelsea College                 | 128                      | 117                      |
| St Charles Sixth Form College                  | 32                       | 21                       |
| <b>Subtotal of Scheduled bodies</b>            | <b>160</b>               | <b>399</b>               |
| <b>Admitted Bodies</b>                         |                          |                          |
| Medequip                                       | -                        | -                        |
| Specialist schools and academy trusts          | 383                      | 395                      |
| Tenant Management Organisation                 | 912                      | 861                      |
| Westway Development Trust                      | 105                      | 92                       |
| Other admitted bodies                          | 37                       | 37                       |
| <b>Subtotal of Admitted Bodies</b>             | <b>1,437</b>             | <b>1,385</b>             |
| <b>Total</b>                                   | <b>20,209</b>            | <b>19,118</b>            |

**8. Administrative Expenses**

|  | <b>2013-14<br/>£'000</b> | <b>2012-13<br/>£'000</b> |
|--|--------------------------|--------------------------|
| Provision of pension administration    | 289                      | 356                      |
| Support services including IT          | 76                       | 107                      |
| External audit fees (KPMG)             | 21                       | 21                       |
| External audit fees (Audit Commission) | -                        | (2)                      |
| Professional fees                      | 48                       | 49                       |
| <b>Total</b>                           | <b>434</b>               | <b>530</b>               |

**9. Investment Income**

|   | 2013-14<br>£'000 | 2012-13<br>£'000 |
|---|------------------|------------------|
| Equity dividends                        | 6,781            | 4,031            |
| Income from pooled property investments | 739              | 938              |
| Income from private equity              | 607              | 485              |
| Interest on cash deposits               | 40               | 46               |
| <b>Total</b>                            | <b>8,167</b>     | <b>5,499</b>     |

**10. Investment Expenses**

|                                  | 2013-14<br>£'000 | 2012-13<br>£'000 |
|----------------------------------|------------------|------------------|
| Investment management fees       | 3,197            | 2,838            |
| Custody and performance fees     | 41               | 49               |
| Investment consultancy fees      | 54               | 36               |
| Other Investment management fees | 25               | -                |
| <b>Total</b>                     | <b>3,317</b>     | <b>2,923</b>     |

**11. 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 & General managing a passive global equity allocation. For further diversification, 30 per cent of the Fund is allocated to global absolute return strategies (which have the ability to move between different asset classes) managed by Barings and Pyrford. The remaining 10 per cent is split between a global private equity allocation, managed by Adams Street and a UK commercial property fund of funds managed by CBRE.

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

| Fund Manager               | 31 March 2014         |              | 31 March 2013         |               |
|----------------------------|-----------------------|--------------|-----------------------|---------------|
|                            | Market Value<br>£'000 | %            | Market Value<br>£'000 | %             |
| Baillie Gifford            | 145,279               | 21.2         | 128,840               | 20.5          |
| Longview                   | 166,624               | 24.3         | 142,176               | 22.6          |
| Legal & General            | 139,979               | 20.5         | 133,115               | 21.1          |
| Barings                    | 89,656                | 13.1         | 88,153                | 14.0          |
| Pyrford                    | 86,607                | 12.7         | 86,514                | 13.7          |
| CBRE                       | 22,781                | 3.3          | 21,070                | 3.3           |
| Adams Street               | 33,500                | 4.9          | 30,269                | 4.8           |
| <b>Total Fund Managers</b> | <b>684,426</b>        | <b>100.0</b> | <b>630,137</b>        | <b>100.0%</b> |
| Investment income due      | 103                   |              | 264                   |               |
| <b>Total Investments</b>   | <b>684,529</b>        |              | <b>630,401</b>        |               |

**12. 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  |                | Purchases during the year and derivative payments | Sales during the year and derivative receipts | Net assets / liabilities movement | Changes in market value during the year | 31 March       |
|---|----------------|---|---|-----------------------------------|---|----------------|
| 2013-14   | 1 April 2013   | year and derivative payments                      | year and derivative receipts                  | / liabilities movement            | value during the year                   | 2014           |
|   | £'000          | £'000   | £'000   | £'000                             | £'000                                   | £'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> |

| Market Value<br>2012-13                                | 1 April<br>2012<br>£'000 | Purchases<br>during the<br>year and<br>derivative<br>payments<br>£'000 | Sales<br>during the<br>year and<br>derivative<br>receipts<br>£'000 | Net assets<br>/ liabilities<br>movement<br>£'000 | Changes<br>in market<br>value<br>during<br>the year<br>£'000 | Market<br>values 31<br>March<br>2013<br>£'000 |
|--|--------------------------|--|--|--|--|---|
| Index-linked Gilt pooled fund<br>(Legal & General)     | 4,250                    | -  | -  | -  | 494  | 4,745   |
| Pooled active global equities<br>(Baillie Gifford)     | 105,739                  | 2,008  | -  | -  | 21,093   | 128,840                                       |
| Active global equities<br>(Longview)                   | 112,720                  | 22,371   | (17,834)   | -  | 24,919   | 142,176                                       |
| Pooled passive global equities<br>(Legal and General)  | 106,367                  | 2,000  | -  | -  | 20,004   | 128,371                                       |
| Pooled active global absolute<br>return fund (Barings) | 80,213                   | 1,541  | -  | -  | 6,399  | 88,153  |
| Pooled active global absolute<br>return fund (Pyrford) | 79,522                   | 1,891  | -  | -  | 5,101  | 86,514  |
| Pooled UK property fund<br>(CBRE)                      | 21,678                   | 236  | -  | -  | (843)  | 21,070  |
| Global private equity fund<br>(Adams Street)           | 24,386                   | 6,007  | (3,548)  | -  | 3,424  | 30,269  |
| Fixed-term cash deposits                               | -                        | -  | -  | -  | -  | -   |
| Investment income due                                  | 269                      | -  | -  | (5)  | -  | 264   |
| <b>Sub-Total</b>                                       | <b>535,144</b>           | <b>36,054</b>  | <b>(21,382)</b>  | <b>(5)</b>                                       | <b>80,591</b>  | <b>630,401</b>                                |
| Current assets   | 896                      | -  | -  | (134)  | -  | 762   |
| Current liabilities                                    | (594)                    | -  | -  | 191  | -  | (403)   |
| Cash deposits  | 5,347                    | -  | -  | (2,618)  | -  | 2,729   |
| <b>Net Investment Assets</b>                           | <b>540,793</b>           | <b>36,054</b>  | <b>(21,382)</b>  | <b>(2,566)</b>                                   | <b>80,591</b>  | <b>633,489</b>                                |

**13. Classification of Financial Instruments**

|   | 31 March '14<br>£'000  |                          |  | 31 March '13<br>£'000  |                          |   |
|---|--|--------------------------|--|--|--------------------------|---|
|   | Designated<br>as fair value<br>through<br>profit and<br>loss | Loans and<br>receivables | Financial<br>liabilities at<br>amortised<br>cost | Designated<br>as fair value<br>through<br>profit and<br>loss | Loans and<br>receivables | Financial<br>liabilities<br>at<br>amortised<br>cost |
| <b>Financial Assets</b>                   |  |                          |  |  |                          |   |
| <b>Equities</b>                           |  |                          |  |  |                          |   |
| United Kingdom                            | 28,732   |                          |  | 15,696   |                          |   |
| Overseas                                  | 134,235  |                          |  | 124,532  |                          |   |
| <b>Pooled funds - investment vehicles</b> |  |                          |  |  |                          |   |
| UK pooled index-linked Gilts              | -  |                          |  | 4,745  |                          |   |
| Pooled global equities                    | 285,258  |                          |  | 257,211  |                          |   |
| Pooled global absolute return funds       | 176,264  |                          |  | 174,667  |                          |   |
| Pooled property investments               | 22,781   |                          |  | 20,834   |                          |   |
| Pooled private equity funds (unquoted)    | 33,500   |                          |  | 30,237   |                          |   |
| Investment income due                     | 103  |                          |  | 264  |                          |   |
| Cash                                      |  | 13,700                   |  |  | 4,944                    |   |
| Debtors                                   |  | 1,540                    |  |  | 762                      |   |
| Creditors                                 |  |                          | (451)  |  |                          | (403)   |
| <b>Subtotal</b>                           | <b>680,873</b>   | <b>15,240</b>            | <b>(451)</b>                                     | <b>628,186</b>   | <b>5,706</b>             | <b>(403)</b>  |
| <b>Total</b>                              |  | <b>695,662</b>           |  |  | <b>633,489</b>           |   |

**14. Fair Value of Financial Instruments and Liabilities**

The following table summarises the book cost of the financial instruments by class of instrument compared with their market values.

|                                   | 31 March '14<br>£'000 |                | 31 March '13<br>£'000 |                |
|-----------------------------------|-----------------------|----------------|-----------------------|----------------|
|                                   | Market<br>Value       | Book Costs     | Market<br>Value       | Book Costs     |
| <b>Financial Assets</b>           |                       |                |                       |                |
| Investment assets                 | 680,770               | 531,240        | 630,702               | 517,477        |
| Cash deposits                     | 13,700                | 13,698         | 2,729                 | 2,998          |
| Income due                        | 103                   | 103            | 264                   | 264            |
| Current assets                    | 1,540                 | 1,540          | 197                   | 197            |
| Financial liabilities             | -                     | -              | -                     | -              |
| <b>Investment liabilities</b>     |                       |                |                       |                |
| Current liabilities               | (451)                 | (451)          | (403)                 | (403)          |
| <b>Total Value of Investments</b> | <b>695,662</b>        | <b>546,130</b> | <b>633,489</b>        | <b>520,533</b> |

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

As at 31 March, the Fund had a commitment to invest a further £25.1 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. 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.

#### **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.

### **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.

### **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.

### **(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 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.

## **18. 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 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 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.

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

The table below shows the total net liability of the Fund as at 31 March 2014. 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 '14<br>£'000 | 31 March '13<br>£'000 |
|--|-----------------------|-----------------------|
| Present value of promised retirement benefits* | 887,960               | 897,050               |
| Fair value of scheme assets (bid value)        | (695,662)             | (633,489)             |
| <b>Net Liability</b>                           | <b>192,298</b>        | <b>263,561</b>        |

\*Present value of promised retirement benefits comprises £799,286,000 in respect of vested obligation and £88,674,000 in respect of non-vested obligations.

## 20. Current Assets

|                               | 31 March '14<br>£'000 | 31 March '13<br>£'000 |
|-------------------------------|-----------------------|-----------------------|
| Debtors                       |                       |                       |
| Contributions due - employers | 208                   | 146                   |
| Contributions due - employee  | 80                    | 51                    |
| Sundry debtors                | 1,252                 | 565                   |
| <b>Total</b>                  | <b>1,540</b>          | <b>762</b>            |

|                                | 31 March '14<br>£'000 | 31 March '13<br>£'000 |
|--------------------------------|-----------------------|-----------------------|
| Analysis of debtors            |                       |                       |
| Local authorities              | 1,252                 | 565                   |
| Other entities and individuals | 288                   | 197                   |
| <b>Total</b>                   | <b>1,540</b>          | <b>762</b>            |

## 21. Current Liabilities

|                  | 31 March '14<br>£'000 | 31 March '13<br>£'000 |
|------------------|-----------------------|-----------------------|
| Creditors        |                       |                       |
| Sundry creditors | 451                   | 403                   |
| Benefits payable | -                     | -                     |
|                  | <b>451</b>            | <b>403</b>            |

|                                | 31 March '14<br>£'000 | 31 March '13<br>£'000 |
|--------------------------------|-----------------------|-----------------------|
| Analysis of creditors          |                       |                       |
| Government bodies              | -                     | -                     |
| Other entities and individuals | 451                   | 403                   |
| <b>Total</b>                   | <b>451</b>            | <b>403</b>            |

## 22. 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 £478,000 was invested by members of this fund in this way during 2013-14. The AVCs invested in 2012-13 was £584,000.

|              | Market Value<br>31 March '14<br>£'000 | Market Value<br>31 March '13<br>£'000 |
|--------------|---------------------------------------|---------------------------------------|
| Prudential   | 2,431                                 | 2,339                                 |
| <b>Total</b> | <b>2,431</b>                          | <b>2,339</b>                          |

## 23. Related Party Transactions

The Fund is administered by the Royal Borough of Kensington and Chelsea. The Council incurred costs of £0.4 million in the financial year 2013-14 (2012-13 £0.5 million) in relation to the administration of the Fund and was reimbursed by the Fund for the expenses. The Fund uses the same payroll and banking providers as the Council and no additional charges are made in respect of this.

In year, and in total, the Council contributed £22 million to the Fund compared to £27 million in 2012-13.

The Council has a significant relationship with one admitted body, the Kensington and Chelsea Tenant Management Organisation (TMO). The Fund received £0.9 million in employer contributions, deficit and early retirement costs from the TMO.

## **Independent auditor's report to the members of the Royal Borough 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 2014 on pages 15 to 35.

### **Respective responsibilities of the Joint Chief Executive and Executive Director of Finance and the auditor**

As explained more fully in the Statement of the Joint Chief Executive and Executive Director of Finance's Responsibilities the Joint Chief Executive and Executive Director of Finance is responsible for the preparation of the pension fund financial statements in accordance with applicable United Kingdom law.

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 CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

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.

We conducted our work in accordance with guidance issued by the Audit Commission. 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 2014 and comply with applicable law and the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

**Andrew Sayers**  
**for and on behalf of KPMG LLP, Appointed Auditor**  
Chartered Accountants  
15 Canada Square  
Canary Wharf  
London  
E14 5GL

September 2014

## 5. CONTACTS

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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.