

PENSION FUND ANNUAL REPORT AND STATEMENT OF ACCOUNTS 2016/17

Report of the Director of Resources

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1 Purpose of the Report

- 1.1. To provide the Pension Committee with the audited Pension Fund Annual Report and Statement of Accounts for 2016/17 ("Report and Accounts"). This is attached at Appendix A.
- 1.2. To provide the Pension Committee with an updated Governance Compliance Statement (GCS), to reflect recent regulatory and operational changes. This is attached at Appendix B.

2 Summary

- 2.1 The Pension Fund accounts are audited separately by Ernst & Young (EY) LLP and a separate Audit Results Report (ARR) issued for these accounts. The ARR and the Authority's response to this are included as separate items on this agenda. There were no recommendations arising from the audit of the Pension Fund's accounts.
- 2.2 During 2016/17 the value of the Pension Fund increased by £659.1m, the significant majority of this increase relating to return on investments. The overall investment return for the year was 17.8% (net of fees), which was in line with the benchmark for the year.
- 2.3 The number of members in the Pension Fund increased by 3,821 members from 95,212 at 31 March 2016 to 99,033 at 31 March 2017.
- 2.4 During the external audit review of the Report and Accounts by Ernst & Young (EY) there were a small number of amendments made to the accounts regarding minor presentational and disclosure corrections, but EY determined that these did not require any comment in their report.
- 2.5 Extracts of the Report and Accounts will be included within the County Council's Statement of Accounts, that will be submitted to the Audit Committee on 11 September 2017.

3 Recommendations

- 3.1 The Pensions Committee is asked to note and comment on the audited Report and Accounts for 2016/17, and to approve the revised Governance Compliance Statement included at Appendix B.

4 2016/17 Report and Accounts

- 4.1 During 2016/17 the value of the Pension Fund increased by £659.1m, the significant majority of this increase relating to return on investments. The overall investment return for the year was 17.8% (net of fees) which was in line with the benchmark for the year.
- 4.2 The fund continued to be cash flow positive (describing a position whereby contributions received from employers and members outweighs benefits paid to pensioners).
- 4.3 The table below shows how the increase of £659.1m is comprised:

£m	£m	
180.1		Additions from contributions and other income relating to members
(146.1)		Benefits payable to members
(9.9)		Payments to and on account of leavers
	24.0	Net additions relating to members' contributions and payments
(1.6)		Administrative costs
(1.0)		Oversight and governance costs
(12.2)		Investment management expenses
	(14.8)	Management Expenses
609.9		Increase in the market value of investments and profits and losses from the sale of investments
40.3		Investment income
(0.3)		Tax on income
	649.9	Net return on investments
	659.1	Increase in the Pension Fund during 2015/16

- 4.4 An explanation for any significant movements within the Fund Account (Appendix A, p22) between 2015/16 and 2016/17 is provided below.
- 4.5 Transfers (in) from other schemes or funds increased from £3.6m in 15/16 to £14.5m in 16/17. This is the result of a significant number of individual member transfers, rather than any bulk transfer. There were 50 transfers of benefits into the scheme greater than £85k during 16/17, as opposed to 6 during 15/16.

4.6 Management expenses fell slightly from £15.9m to 14.7m. Whilst returns on the fund's investments were strong, they were in line with the benchmark - therefore the fund did not incur significant additional costs for performance related elements of fees. Further to this, during 16/17 the fund has negotiated a number of fee reductions with managers, principally Henderson and Allianz Global Investors.

4.7 Profits and losses on the disposal of investments and changes in the value of investments increased from a loss of £40.9m in 2015/16 to a gain of £609.9m in 2016/17. This reflects the higher investment return for the year (17.8%) compared to 2015/16 (-0.2%). The return achieved on the Pension Fund's investments reflected general market conditions over the year and the benchmark return of 17.9%. A review of world markets is provided as part of the Investment report on page 60 of the Report and Accounts.

4.8 The table below summarises the Net Asset Statement (Appendix A, p23), and highlights the movement in the main asset classes between 31 March 2016 and 31 March 2017.

31 March 2016			31 March 2017		% Change
£000s	£000s		£000s	£000s	
1,091,917		Equities	1,148,718		5.2%
		Pooled investment vehicles:			
269,692		Pooled property investments	286,375		6.2%
1,094,728		Unitised insurance policies	1,365,648		24.7%
544,296		Unit trusts	598,057		9.9%
115,942		Private equity	131,052		13.0%
383,660		Other managed funds	605,223		57.7%
124		Derivative contracts	1,703		1,273.4%
56,642		Cash deposits	67,496		19.2%
9,929		Other investment balances	3,881		(60.9%)
	3,566,930	Total Investment Assets & Liabilities		4,208,151	18.0%
2,956		Long term assets	2,217		(25.0%)
14,364		Net Current Assets	33,003		129.8%
	3,584,250	Net assets of the Fund available to fund benefits as at 31st March		4,243,371	18.4%

4.9 The 2016/17 CIPFA Code of Practice on Local Authority Accounting has specified revised categories for reporting on the Net Asset Statement. For clarity, the instruments and managers which feed into these categories are broken down below:

- Equities: Includes quoted UK and overseas equities held with the fund's active equity managers Allianz, Baillie Gifford and Jupiter.
- Pooled Property Investments: Investments in property managed by CBRE.

- Unitised Insurance Policies: Passively managed bond and equity investments held by the fund's passive manager Legal & General.
 - Unit Trusts: Includes unit trusts for both equity investments, managed by Jupiter, as well as bond funds, managed by Hendersons and Royal London.
 - Private Equity: The fund currently has Private Equity investments managed by HarbourVest, Permira, Standard Life and Pantheon.
 - Other Managed Funds: This is principally made up of the new global equity mandate with Baillie Gifford (Long-Term Global Growth Fund) and the alternatives mandate, managed by LGT.
- 4.10 Equities have increased by £56.8m (5.2%) despite the dismissal of JP Morgan, and transfer of funds invested with that manager (£142.6m as at 31st March 2016) to the Baillie Gifford Long Term Global Growth Fund (reported within 'Other Managed Funds'). Strong performance of the fund's remaining equity managers - Baillie Gifford, Allianz and Jupiter (21.4%, 30.1% and 12.0% respectively) still resulted in an overall increase in the value of investments in this category given the strong performance of Equity markets.
- 4.11 The increases in pooled property investments, unitised insurance policies, unit trusts, and private equity are all the results of market returns over the period – the 'Review of World Markets' on p60 of Appendix A outlines some of the drivers behind these returns.
- 4.12 Other managed funds increased by £221.6m (57.7%) as a result of a combination of factors. At the point of transfer, the funds held in the JP Morgan portfolio resulted in a transfer into the Baillie Gifford Long Term Global Growth Fund (LTGGF) of £183.1m which was conducted in three phases over January and February 2017. This is a global equity mandate, but reported within 'Other managed funds' in the Net Assets Statement due to the nature of the investment vehicle. The remaining increase in the value of other managed funds was a result of the returns on the LGT Alternatives portfolio (7.0%), and managed fund elements of the Baillie Gifford UK Equities mandate, as well as the LTGGF.
- 4.13 There has been a £1.59m (1,273.4%) increase in derivative contracts – these are operated by the funds property manager CBRE to hedge against foreign currency movements and protect overseas returns from this volatility. With an effective hedge, the value of the asset which is being hedged will increase/decrease in value equal and opposite to the hedge.
- 4.14 Other investment balances fell by £6.0m (-60.9%), this represents accrued income from fund managers, and the reduction is a result of timing differences, and a fall in overall income received during 16/17.
- 4.15 Net current assets increased by £18.6m (129.8%) principally as a result of a short term debtor of £15m held over year end. This related to excess local cash transferred from the Administering Authority to the alternatives manager LGT on 28th March 2017, but not credited to investment balances until 4th April 2017.

5 Annual Report

5.1 The Annual Report summarises the main aspects of the Pension Fund and is split into four sections – Scheme Administration, Administering Authority Report, Financial Statements and Investment Report.

5.2 Scheme Administration (p3)

This section provides a background to the Scheme, describes how it is funded and details the main benefits for members.

5.3 Administering Authority Report (p4 – 18)

This section outlines how the Hertfordshire Pension Fund is governed and managed and includes the following statements and policies:

- Governance Compliance Statement (pages 7 – 11)
- Communication Policy Statement (pages 15-16)
- Actuarial Statement for 2016/17 (pages 17-18)

5.3.1 The Governance Policy and Compliance Statement was approved by the Pensions Committee on 5 February 2016 and includes the terms of reference and division of responsibility between the Pensions Committee and LGPS Pensions Board.

5.3.2 An updated Governance Compliance Statement has been prepared, and is attached at Appendix B to this paper for approval. The main changes to this statement include:

- An update to reflect the new LGPS Management and Investment of Funds Regulations 2016 – which replaced the previous 2009 regulations, and necessitated the production of a revised Investment Strategy Statement to be published by 31st March 2017.
- To formalise the use of a cross-party working group, made up of members of the Pension Committee to work with Officers as well as external parties (such as the investment consultant) – on tasks such as managing the transition to the revised 2017 Investment Strategy, and other pension related work where appropriate.
- To outline and clarify the role of the Joint Governance Committee (JGC) in its position within the ACCESS pool, of which the Hertfordshire Pension Fund is a member.

5.3.3 A revised Communication Strategy is being presented to this meeting of the Committee as a separate agenda item.

5.3.4 An annual performance report is provided on pages 13 - 14 of the Annual report which provides a summary of the performance of the Administering Authority, Pensions Administration Service and employers during the year.

5.3.4 A summary of membership to the Scheme is provided on page 19 of the Annual report including the distribution of Scheme members across employer categories. This shows an increase in total membership of 3,821 members from 95,212 at 31 March 2016 to 99,033 at 31 March 2017. Of the overall

increase, active members increased by 1,312, deferred members by 1,505 and pensioners by 1,004.

5.4 Financial Statements (p20 – 48)

This section includes the 2016/17 Pension Fund Accounts, discussed in section 4 above. This includes the Fund Account and Net Asset statement, statement of accounting policies and notes to the accounts.

5.5 Investment Report (p49 – 64)

This section sets out the context for investment and the background against which investments took place and includes the following:

5.5.1 Statement of Investment Principles (SIP) (p50 – 58)

This section sets out the investment strategy that was in place for the period covered by the Annual Report and Accounts. The 2017 Investment Strategy Statement, which is effective from 1st April 2017 is provided via link in the annual report on p49.

5.5.2 The performance of the Pension Fund's investments against benchmark over 2016/17 and the longer term. Performance over 16/17 was in line with the general benchmark, with the fund returning 17.8% (net of fees) against a benchmark of 17.9%.

6 Post audit changes

6.1 During the audit by Ernst & Young, a small number of minor amendments and corrections were highlighted and made to the Annual Report and Accounts 2016/17; however EY did not determine that any of these were material enough to require disclosure.