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Dear Sir/Madam

Date: 13 June 2017

You are invited to the following meeting:

Pension Fund Committee / Pension Board
Auditorium, Shetland Museum and Archives, Hay's Dock, Lerwick
Monday 19 June 2017 at 2pm

Please note that in accordance with the agreed terms of reference, this is a concurrent meeting of both the Pension Fund Committee and the Pension Board - SEE MEMBERSHIP OF BOTH BODIES OVERLEAF

Apologies for absence should be notified to Louise Adamson at the above number.

Yours faithfully

Executive Manager – Governance and Law
[and Joint Secretary to the Pension Board]

AGENDA

- (a) Hold Circular Calling the Meeting as Read.
- (b) Apologies for absence, if any.
- (c) Declarations of Interest - Members are asked to consider whether they have an interest to declare in relation to any item on the agenda for this meeting. Any Member making a declaration of interest should indicate whether it is a financial or non-financial interest and include some information on the nature of the interest. Advice may be sought from Officers prior to the meeting taking place.
- (d) Confirm the minutes of the meeting held on 7 March 2017 (enclosed).

Items

1. Management Accounts for Pension Fund 2016/17 – Projected
Outturn at Quarter 4
F-044-F
2. Pension Fund Unaudited Accounts
F-051-F
3. Pension Fund Management Annual Review 2016/17
F-059-F

Pension Fund Committee	Pension Board	
M Burgess A Cooper S Coutts A Duncan S Leask R McGregor C Smith G Smith T Smith R Thomson	<u>Employers Representatives:</u> M Bell, SIC E Macdonald, SIC I Scott, SIC J Johnston, SRT <u>Joint Secretary</u> J Riise, Executive Manager – Governance and Law	<u>Trade Union Representatives:</u> David Marsh, Unison Alan Goudie, Unite Robert Williamson, GMB Austin Taylor, Unison <u>Substitutes:</u> <i>C Wiseman, Unison</i> <u>Joint Secretary</u> C Wiseman, Unison



Meeting(s):	Pension Fund Committee Pension Board	19 June 2017
Report Title:	Management Accounts for the Pension Fund: 2016/17 – Draft Outturn at Quarter 4	
Reference Number:	F-044-F	
Author / Job Title:	Jonathan Belford, Executive Manager - Finance	

1.0 Decisions / Action required:

1.1 The Pension Fund Committee and Pension Board RESOLVE to:

- Review and NOTE the management accounts showing the outturn position at Quarter 4.

2.0 High Level Summary:

2.1 This report sets out the projected financial position for the Pension Fund as at Quarter 4, which is a reduction in the overall net contribution of £1.358m; see Appendix 1 for further detail.

3.0 Corporate Priorities and Joint Working:

3.1 There is a specific objective in the Corporate Plan to ensure that the Council is “continuing to keep a balanced and sustainable budget and are living within our means” and that the Council continues to pursue a range of measures which will enable effective and successful management of its finances over the medium to long term.

3.2 By 2027, the investment strategy of the Pension Fund is targeted with achieving a 100% funding position in order to ensure that the scheme remains affordable and sustainable in the future.

4.0 Key Issues:

4.1 On 18 November 2015 (SIC Min Ref: 15/15) the Pension Fund Committee approved the 2016/17 Pension Fund budget. It is vital to the economic wellbeing of the Pension Fund that financial resources are managed effectively and that expenditure and income are delivered in line with the budget, as any overspends or under-achievements of income will result in a reduction in the net contribution to the Pension Fund.

4.2 This report forms part of the financial governance and stewardship framework which ensures that the financial position of the Pension Fund is acknowledged, understood and quantified on a regular basis. It provides assurance to the Corporate Management Team and the Committee / Board that resources are being managed effectively and allows corrective action to be taken, where possible.

4.3	At Quarter 4 the Pension Fund has an under-achievement of net income of £1.358m. This is largely due to more pensions being paid out than budgeted, with a number of people retiring during the year to 31 March 2017. The value of lump sums is also higher than budgeted, with a few high-value death benefit payments.
4.4	The above adverse variances are offset by an increase in new employees transferring previous pension benefits into the Pension Fund, delivering £1.158m more income than originally budgeted.
5.0 Exempt and/or confidential information:	
5.1	None.
6.0 Implications :	
6.1 Service Users, Patients and Communities:	There are no implications arising from this report.
6.2 Human Resources and Organisational Development:	There are no implications arising from this report.
6.3 Equality, Diversity and Human Rights:	There are no implications arising from this report.
6.4 Legal:	There are no implications arising from this report.
6.5 Finance:	<p>The Pension Fund Investment Strategy, approved in 2015/16, seeks to address the prospect of falling income and rising expenditure projections over the longer term. The aim of the strategy is to ensure that the Pension Fund is 100% funded by 2027.</p> <p>It is therefore vital that the Pension Fund delivers its annual budget. In 2016/17 this was not achieved, with a net income shortfall of £1.358m. This may have a knock-on effect in future years by either delaying the sustainability date, or by having to significantly increase contributions from employers to meet any shortfall. There are other factors that have an impact on the employer contributions including the success of the investment strategy, the performance of the fund managers and the forecast cost of future liabilities; these are considered in full as part of the triennial fund valuation.</p>
6.6 Assets and Property:	There are no implications arising from this report.
6.7 ICT and new	There are no implications arising from this report.

technologies:	
6.8 Environmental:	There are no implications arising from this report.
6.9 Risk Management:	<p>From a financial management perspective, risks are an integral part of planning for the future as assumptions must be made. These assumptions can be affected by many internal and external factors, such as demand, which could have a significant financial impact. The main financial risks facing the Pension Fund are:</p> <ul style="list-style-type: none"> • That the Fund's investments fail to deliver returns in line with those required to meet the valuation of long-term liabilities; • A fall in bond yields, leading to a rise in value placed on liabilities; • Employers leaving the scheme or the scheme closing to new members which could be due to several factors eg costs, liquidation or bankruptcy; • A failure to recover unfunded payments from employers, that could lead to other employers having to subsidise by increasing their employer contribution; • A global stock market failure; • Under-performance by active fund managers.
6.10 Policy and Delegated Authority:	<p>The Pension Fund Committee has been delegated authority to discharge all functions and responsibilities relating to the Council's role as administering authority for the Shetland Islands Council Pension Fund (the Pension Fund) in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013.</p> <p>The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of The Pension Regulator.</p>
6.11 Previously considered by:	Not applicable.

Contact Details:

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Christine.mccourt@shetland.gov.uk

Appendices:

Appendix 1 – Revenue Outturn Position 2016/17 (Q4)

Background Documents: Pension Fund Budget Proposals 2016/17, Pension Fund Committee/Pension Board, 18 November 2015

<http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=18593>

END

Pension Fund Committee / Pension Board

1. Revenue Outturn Position 2016/17 (Quarter 4)

Pension Fund	Revised Annual Budget £000	Actual Outturn £000	Budget v Outturn at Q4 (Adv) / Pos £000
Employee Costs	223	219	4
Operating Costs	143	154	(11)
Investment Expenses	1,565	1,487	78
Benefits Payable	8,846	9,312	(466)
Transfers Out	100	332	(232)
Lump Sums	1,420	3,473	(2,053)
Other Expenditure	53	32	21
Total Expenditure	12,350	15,009	(2,659)
Other Income	(27)	(28)	1
Contributions Received	(15,974)	(16,026)	53
Investment Income	(3,065)	(3,154)	89
Transfers In	(100)	(1,258)	1,158
Total Income	(19,166)	(20,466)	1,301
Net Income	(6,816)	(5,457)	(1,358)

An explanation for the main variances for the Pension Fund at Quarter 4 is set out below.

1.1 Employee Costs – underspend of £4k (1.8%)

1.2 Operating Costs – overspend of £11k (7.7%)

This overspend relates to actuarial fees associated with professional advice requiring to be sought in respect of pension administration.

1.3 Investment Expenses – underspend of £78k (5.0%)

This underspend is related to WM Company ceasing to undertake performance management.

1.4 Benefits Payable – overspend of (£466k) (5.3%)

This overspend is due to more retirements during 2016/17 than anticipated when the budget was set. Members of the Pension Fund now have the option to retire between the ages of 55 and 75 and this age range is prevalent in the demographic of the Council's Pension Fund.

1.5 Transfers Out – overspend of (£232k) (232%)

The budget is based on a rolling average of 5-year spend, but actual transfer values depends on salary and length of service and number of members leaving the Fund and cannot be accurately predicted.

1.6 Lump Sums – overspend of (£2.053m) (144.6%)

This overspend relates to more lump sums being paid out than budgeted, including higher than anticipated normal retirement lump sums (£540k), which ties into the higher than anticipated number of retirements. Also included here are lump sums paid out against Additional Voluntary Contributions (AVCs) (£343k), which were not budgeted as it was anticipated that the AVC in-value would match the AVC out-value. The lump sums budgets are based upon a rolling average of 5-year spend, but actual payments depend on members' salary and length of service.

1.7 Contributions Received – over-achievement of £53k (0.3%)

This additional income arose from higher employee contributions than anticipated. Employees received a pay rise, but the tiered contribution salary bandings remained static for 2016/17.

1.8 Investment Income – over-achievement of £89k (2.9%)

This over-achievement of income relates to better than anticipated markets resulting in higher income than budgeted for three of the investment streams, offset by an under-achievement of income on the overseas unit trust investment, which is being phased out.

1.9 Transfers In – over-achievement of £1.158m (1,158%)

There have been a number of high value transfers in – where new staff transfer existing pension benefits into the Pension Fund. The budget is based upon a rolling average of 5-year income, as actual income receivable is difficult to predict. Also included here, are AVCs received in (£534k), which were not budgeted, as it was anticipated that all the AVCs received in would be paid out as lump sums. The balance of AVC in-value that is not used for lump sums is converted to pension.



Meeting(s):	Pension Fund Committee Pension Fund Board	19 June 2017
Report Title:	Pension Fund Unaudited Accounts 2016/17	
Reference Number:	F-051-F	
Author / Job Title:	Executive Manager – Finance	

1.0 Decisions / Action required:
<p>1.1 That the Pension Fund Committee and Pension Fund Board:</p> <ul style="list-style-type: none"> a) CONSIDER the 2016/17 Unaudited Accounts for the Shetland Islands Council Pension Fund (Appendix 1) and; b) CONSIDER the information at section 4.0 that highlights the key issues from the 2016/17 accounts. <p>1.2 That the Pension Fund Committee APPROVES the Annual Governance Statement 2016/17 that forms part of the accounts (Appendix 2).</p>
2.0 High Level Summary:
<p>2.1 The Local Authority Accounts (Scotland) Regulations 2014 require the Pension Fund to prepare and publish a set of accounts, including an annual governance statement, by 30 June each year.</p> <p>2.2 The draft accounts are then required to be formally considered by the Committee no later than 31 August and the Annual Governance Statement should be formally approved in the same timeframe.</p> <p>2.3 The accounts are then subject to external audit by 30 September. 2016/17 is the first year of a five-year appointment with Deloitte as external auditors, as appointed by Audit Scotland. The audited accounts will be presented to the Pension Fund Committee and Pension Board on 20 September 2017.</p>
3.0 Corporate Priorities and Joint Working:
<p>3.1 The preparation and presentation of the annual accounts is a key element of the Pension Fund's overall governance and reporting arrangements.</p>
4.0 Key Issues:
<p>4.1 The unaudited accounts include the following key points for Members' consideration:</p> <ul style="list-style-type: none"> • In 2016/17 the rate of return on investments was 19.0%, compared to a 5-year average of 9.9%; • The net assets of the fund at 31 March 2017 were £0.450m, an increase of £0.074m from 2015/16; • The fund ended the year with 3,342 active members, 1,973 deferred members and 1,728 pensioners.
5.0 Exempt and/or confidential information:
<p>5.1 None.</p>

6.0 Implications :		
6.1 Service Users, Patients and Communities:	None	
6.2 Human Resources and Organisational Development:	None	
6.3 Equality, Diversity and Human Rights:	None	
6.4 Legal:	None	
6.5 Finance:	None	
6.6 Assets and Property:	None	
6.7 ICT and new technologies:	None	
6.8 Environmental:	None	
6.9 Risk Management:	The annual accounts are subject to external audit by 30 September in order to mitigate risk of material misstatement.	
6.10 Policy and Delegated Authority:	<p>The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administering authority for the Shetland Islands Council Pension Fund (the Pension Fund) in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013.</p> <p>The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pensions Regulator.</p> <p>The preparation and presentation of the Annual Accounts is a key element of the Pension Fund's overall governance and reporting arrangements. Receiving the audited accounts of the Pension Fund and related certificates is a matter reserved by the Pension Fund Committee.</p>	
6.11 Previously considered by:	N/A	

Contact Details:

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19 June 2017

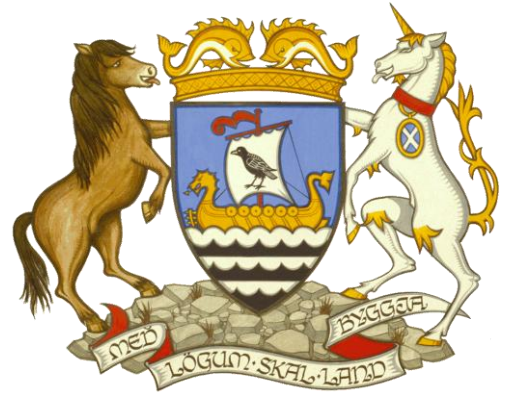
Appendices:

Appendix 1: Shetland Islands Council Pension Fund Draft Annual Report and Accounts

2016/17

Appendix 2: *Shetland Islands Council Pension Fund Annual Governance Statement*
2016/17

Background Documents: *The Local Authority Accounts (Scotland) Regulations 2014*



Shetland Islands Council

Securing the Best for Shetland

Pension Fund Unaudited Annual Report and Accounts 2016/17



Photo by Kevin Jones

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Management Commentary

The purpose of the Management Commentary is to inform all users of the accounts and help them understand the most significant aspects of the Pension Fund's financial performance during 2016/17 and year-end financial position as at 31 March 2017.

Background

The Shetland Islands Council Pension Fund is a contributory defined benefit pension scheme administered by Shetland Islands Council. The Pension Fund is governed by the Superannuation Act 1972, and is administered in accordance with The Local Government Pension Scheme (Scotland) Regulations 2014, The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 and The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015.

It provides pensions and other benefits for pensionable employees of scheduled bodies and admitted bodies within Shetland, as shown below. Teachers are not included as they have a separate national pension scheme.

Employers with active members at 31 March 2017

Scheduled Bodies:

- Shetland Islands Council
- Orkney & Shetland Valuation Joint Board

Admitted Bodies:

- Lerwick Port Authority
- Shetland Recreational Trust
- Shetland Fisheries Training Centre Trust
- Shetland Islands Tourism
- Shetland Amenity Trust
- Shetland Seafood Quality Control
- Shetland Charitable Trust
- Shetland Arts Development Agency
- Shetland Care Attendant Scheme (previously Crossroads)

Employers with no active members at 31 March 2017

Admitted Bodies:

- Shetland Enterprise Co Ltd
- ABA Services Ltd

Employers who have ceased to participate in the Scheme

Admitted Bodies:

- Shetland Youth Information Services
- Advocacy Shetland
- Atlantic Ferries
- Community Alcohol & Drugs Services Shetland (CADSS)

In general, employers pay regular monthly contributions to the Pension Fund based on the salary costs of those staff who are Pension Fund members (active members). Where an Employer continues to participate in the Scheme but has no active members, a lump sum is calculated by the actuary to cover the cost of ongoing and future pension payments.

Until 31 March 2015 the defined benefits were calculated based upon a member's final salary, however this changed with the implementation of The Local Government Pension Scheme (Scotland) Regulations 2014.

From 1 April 2015, the Pension Scheme moved away from a final salary pension scheme to a career average revalued earnings scheme (CARE). The changes were introduced to ensure the Pension Scheme is sustainable and affordable for the future.

Administering Authority Arrangements

The Council's Executive Manager - Finance is the officer with responsibility to ensure proper administration of the Council's financial affairs in terms of Section 95 of the Local Government (Scotland) Act 1973.

The Council's Executive Manager – Finance has responsibility for:

- the financial accounting of the Pension Fund;
- the preparation of the Pension Fund Annual Report; and
- being the principal adviser on investment management to the Council in its capacity as

Trustee to the Pension Fund and as the Pension Fund's Administering Authority.

The day-to-day management of the investment activities of the Pension Fund is undertaken by the Treasury Section within the Finance Service.

The day-to-day benefits administration for the Pension Fund is managed by the Expenditure Section within the Finance Service.

The Expenditure Section ensures that members of the Scheme are kept up-to-date with Scheme changes by means of regular mail-shots which includes relevant information, for example, revised tiered employee contribution rates, revised Pension Scheme booklets/factsheets, Pension Fund Accounts, etc.

Pension seminars, in conjunction with the Council's Additional Voluntary Contributions (AVC) provider, take place at least once a year. New employees are made aware of the benefits of the Local Government Pension Scheme (LGPS) with a leaflet included along with their contract. A Scheme Guide is also issued to new members of the scheme.

Investment Managers – Appointed

Blackrock - Nov 2008
Schroders - Mar 2007
M & G Investments - Nov 2014
KBI Global Investors Limited - Nov 2014
Newton - Nov 2014

Investment Advisor

KPMG

AVC Providers

Prudential
Equitable Life (closed to new members)

Banker

Bank of Scotland

Custodian

Northern Trust

Fund Actuary

Hymans Robertson LLP

The overview of the financial performance of the Pension Fund rests with the Pension Fund Committee. The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administering authority for the Shetland Islands Council Pension Fund.

This includes overseeing the administration of the Pension Scheme, managing the Pension Fund's investments and preparing and maintaining the Funding Strategy Statement, Statement of Investment Principles, Governance Compliance Statement and Pension Administration Strategy. The Pension Fund Committee is made up of the Councillors who currently sit on the Council's Policy & Resources Committee.

The Pension Board is the body responsible for assisting the Scheme Manager (the Council) in relation to compliance with scheme regulations and the requirements of the Pensions Regulator. The Pension Board is made up of three Councillors, one Admitted Body employer and four union representatives.

At an operational level, the Global Custodian is responsible for the safekeeping of the Pension Fund's assets while the external fund managers are responsible for the management of those assets. The investment risk is managed, as set out in the Statement of Investment Principles below, through various fund managers investing in a diversified range of asset classes, over a long-term investment horizon.

During the year State Street ceased the provision of performance management services. The Pension Fund is in the process of looking for a new company to undertake independent performance management of fund managers.

Valuation and Membership

At 31 March 2017, the value of the Pension Fund stood at £450m, an increase of £74m on the previous year. The increase in the value of the Pension Fund is due to investment gains and an excess of employer and employee contributions over benefits payable.

The Pension Fund membership increased during the financial year by 476 to 7,043 members, this includes active members (197), deferred members (170) and pensioners (109). The increase in active members was primarily due to an increase in part-time employees in the Council.

The table below shows the breakdown of the 109 new pensioners following retirement during the year:

Retirement Type	Number
Normal	48
Early	17
Redundancy	6
Flexible	9
Ill health	7
Late	20
Efficiency	2
Total	109

Risk

The Pension Fund risk register was updated on 7 March 2017. There are a total of 35 risks, broken down into 6 High, 14 Medium and 15 Low. The key risks are summarised below:

- Staff unable to access workplace leading to staff downtime and loss of service delivery;
- Fund's investments fail to deliver returns in line with anticipated returns required to meet the valuation of the long term liabilities;
- Fall in bond yields, leading to risk in value placed on liabilities;
- Employers leaving scheme/closing to new members due to cost/going into liquidation;
- Failure in world stock markets;
- Under performance by active fund managers.

Not all risk can be eliminated; however, every effort is made to mitigate the impact that risks present the Pension Fund, whether it be by active administration, diversification of investment mandates, engagement with employers, or implementation of policies and procedures.

Funding Strategy

The Net Assets Statement shows an increase in net assets of the Pension Fund to £450m. The Pension Fund investment strategy aims to achieve a fully funded Pension Scheme by 2027. Other objectives of the Pension Fund are:

- to secure and maintain sufficient assets to meet liabilities which fall due by the Pension Fund;
- to minimise the risk of assets failing to meet these liabilities, through an investment strategy, specifically tailored to the Pension Fund's requirements; and

- to maximise investment returns within an acceptable level of risk and providing stability in the level of employers' contribution rates.

Funding Strategy Statement

The Regulations on the management of the Pension Fund require the administering authority to prepare, maintain and publish a written Funding Strategy Statement. Details of the Funding Strategy Statement are found in note 13.

The purpose of the Funding Strategy Statement is to:

- establish a clear and transparent Fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- support the regulatory requirement to maintain as near constant employer contribution rates as possible; and
- take a prudent longer-term view of funding those liabilities.

The most recent actuarial valuation carried out was at 31 March 2014. It showed that the Pension Fund is valued at £330m and 92% funded, with a deficit of £30m. The triennial valuation sets the employer contribution rates for the next three years. The total employer contribution rate, which is an average across the whole fund, has increased from 18.8% to 20.7%. The increased liability, recognising the value of future pension benefits, is the primary driver for this increase. The next triennial valuation will be as at 31 March 2017, and will be reflected in the 2017/18 accounts.

The Statement of Investment Principles

The Pension Fund Committee and the Pension Board meetings on 26 October 2015 approved the Shetland Islands Council Pension Fund Statement of Investment Principles. This Statement includes an introduction, administration details, objective of the Pension Fund, types of investments, balance between different types of investment, risk, expected return on investments, realisation of investments, responsible investment, securities lending and compliance. The Pension Fund also complied with the six Myners Principles, which were contained in a schedule to the Statement of Investment Principles.

The Statement of Investment Principles is available for viewing at the Finance Service, Montfield, Burgh Road, during normal working

hours. It can also be found here:

<http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=18529> – Appendix A.

Performance Management

The annual accounts summarise the Pension Fund's transactions for the year and satisfies the requirement of the Local Government Pension Scheme (Scotland) Regulation 55 (1) of The Local Government Pension Scheme (Scotland) Regulations 2014) to prepare a Pension Fund Annual Report for the financial year from 1 April 2016 to 31 March 2017.

Primary Financial Statements

The annual accounts summarise the Pension Fund's transactions for the year and its year-end position at 31 March 2017. The Annual Accounts are prepared in accordance with the International Accounting Standards Board (IASB) Framework for the Preparation and Presentation of Financial Statements (the IASB Framework) as interpreted by the Code of Practice on Local Authority Accounting in the United Kingdom.

The two primary statements: the Pension Fund Account and Net Assets Statement as at 31 March 2017 include a description of their purpose. These statements are accompanied by

Notes to The Accounts, which set out the Accounting Policies adopted by the Pension Fund and provide more detailed analysis of the figures disclosed on the face of the primary financial statements.

The Primary Financial Statements and Notes to the Accounts, including the accounting policies, form the relevant Annual Accounts for the purpose of the auditor's certificate and opinion.

Financial Performance in 2016/17

The Pension Fund Account presents the full economic cost of providing Pension Fund services in 2016/17. This shows a net income of £74.192m. This differs from the draft outturn position, shown below, which was reported to the Pension Fund Committee and Pension Board on 19 June 2017, and which is on Shetland Islands Council's website.

The reason for the difference is that the Pension Fund Account includes growth in the value of the fund and income automatically reinvested into the fund, which is not included in the table below.

The table below shows the variance of actual against budget as shown in the draft outturn report:

Description	2016/17 Annual Budget £000	2016/17 Draft Outturn £000	2016/17 Variance £000
Total Expenditure	12,350	15,009	(2,659)
Total Income	(19,166)	(20,467)	1,301
Net Income	(6,816)	(5,458)	(1,358)

Expenditure was higher than budgeted due to a number of high value lump sum payments, including death benefits. More people than anticipated have retired during 2016/17 resulting in an increase in benefits payable. Income was higher than budgeted due to a number of high value transfers in from other pension funds.

Budgets were set for death benefits, lump sums and transfers in, along with all other expenditure and income. However, it is difficult to estimate these items, due to the variable nature of them. Lump sums and transfers in are based on a person's length of service and salary, which is variable for each individual, and death benefits are directly related to a person's salary.

Administration Strategy

The Pension Fund's Pension Administration Strategy highlights the duties of, and sets performance standards for, both the Fund and all the participating employers.

It is vital that employers provide prompt information to the Pension Fund so that timely and accurate information can be provided to the Scheme members. Performance is monitored on a regular basis. The information that the Pension Fund received during the year was delivered in a timely manner by all employers. This included information on new starts, leavers, normal retirements, early retirements and deaths in service. With the exception of a couple of occasions, all employer contributions were

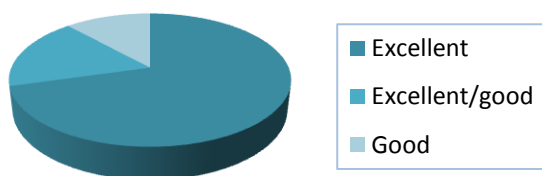
received by the 19th of the month following deduction.

Administration Performance

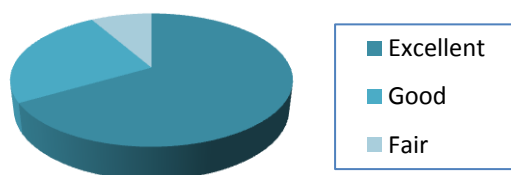
Shetland Islands Council, as a pension administering authority, is also committed to providing a high quality pension service to both members and employers and to ensure members receive their correct pension benefit entitlement.

To ensure excellent customer care is provided, retiring members and employers are requested to complete a customer satisfaction survey. Details of this survey are summarised below:

Member Satisfaction Survey (68 responses)



Employer Satisfaction Survey (6 responses)



The customer feedback is very positive for the year and specific comments received will form a basis for identifying and implementing improvement.

Monitoring Arrangements

The Pension Fund Committee and Pension Board receive regular updates on performance and the Committee papers and minutes are available via the Council committee management system website <http://www.shetland.gov.uk/coins/>.

Reports are prepared on a quarterly basis for the Pension Fund Committee and Pension Board that give an overview of the position of the Pension Fund's external investments and present a summary of each fund manager's performance for the quarter and over a three-year period.

In line with the Pension Fund's governance arrangements to monitor and review fund managers, the Pension Fund Committee and Pension Board invite fund managers to attend the quarterly meetings to give presentations on their mandates and investment performance. At the meeting on 24 May 2016, KBI Global Investors Limited (previously Kleinwort Benson) and M & G gave presentations. At the meeting on 30 August 2016, Schroders gave a presentation, and at the meeting on 7 March 2017, Hymans Robertson, the Pension Fund's actuary, gave a presentation.

Annual visits are made to each fund manager to review the six monthly investment position. For 2016/17, these meetings took place in December 2016. The Pension Fund also receives quarterly audited performance review reports and monthly valuation reports from each fund manager. This Annual Report and Accounts is available via the Council's website

http://www.shetland.gov.uk/about_finances. A full version of this report is provided to the scheduled and active admitted bodies of the Scheme and a summary of the review is provided to all Pension Fund members, via a newsletter.

Remuneration Report

There is no requirement for a remuneration report for the Pension Fund, as the Pension Fund does not directly employ any staff.

All staff are employed by Shetland Islands Council, and their costs are reimbursed by the Pension Fund. The Councillors who are members of the Pension Fund Committee and the Pension Fund Board are also remunerated by Shetland Islands Council.

Details of Councillor and Senior Employee remuneration can be found in the accounts of Shetland Islands Council on the Council's website <http://www.shetland.gov.uk/>.

Pension Fund Outlook

Administrative

Following "Brexit", a question of how this will affect the Local Government Pension Scheme has been raised. Most of EU legislation that impacts on the LGPS is already written into UK legislation. The scheme will need to continue to comply with such legislation until such time as Britain leaves the EU. Future UK Governments could seek to repeal some or all of this legislation, subject to the terms of any new trade arrangements made with the EU.

With regard to UK government policy and legislative plans for the LGPS, the situation is 'no change'. Regulatory changes, policy objectives and the timescales for implementing them remain as they were before the vote.

Investment

The recent investment strategy review in 2014 was undertaken on the basis of managing risk while investing to achieve the Funding Strategy of having a fully funded Pension Scheme by 2027. During 2016/17, there were some major events such as the US Presidential election and the European Referendum. These events caused volatility within the investment markets but over the financial year, the main markets were higher and the Pension Fund investments benefitted as a result.

The Pension Fund remains cash positive, with income from contributions and investment return exceeding pensions and administrative costs. While this remains the case, the Pension Fund seeks to take advantage of this and grow the assets, while taking an appropriate view on the risks. As the Fund matures and expenditure begins to exceed income then work will have to be undertaken to address the requirement for cash to be achieved from the assets so that the cost of pensions can be met for the long term. It is estimated that the Pension Fund will remain cash positive until 2027, which is the basis for the Investment Strategy.

.....
Cecil Smith
Leader of the Council
Chair of the Pension Fund Committee
19 June 2017

.....
Jonathan Belford, CPFA
Executive Manager – Finance
19 June 2017

.....
Mark Boden
Chief Executive
19 June 2017

Investment Policy and Performance Report

Investment Policy

The investment policy, along with the Pension Fund's approach to the management of risk for the Pension Fund as a whole and in respect of the investment managers, is outlined in the Statement of Investment Principles.

The Council, as the administering authority, has a fiduciary duty to obtain the best possible financial return on the Pension Fund investments against a suitable degree of risk. The Fund Managers, acting in the best financial interests of the Pension Fund, have delegated powers for the acquisition and realisation of investments, but as part of their investment process they are expected to consider all factors, including the social, environmental and ethical policies of companies in which they may invest to the extent that these may materially affect the long term prospects of such companies.

The Fund Managers have all signed up to the United Nations Principles on Responsible Investment Management. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, and must be given appropriate consideration by investors, if they are to fulfil their fiduciary (or equivalent) duty.

The focus of the Pension Fund's investment strategy is on achieving a 100% funding level before the Pension Fund's contributions equal benefits payable, which is expected to be 2027. Beyond this point, it is expected that payments will exceed contributions made into the Pension Fund. The strategy proposes a less volatile approach with a more diversified asset base. It is estimated that the strategy will improve the level of return, and be protected against the full negative impact of volatile and falling markets due to its increased diversity.

The Pension Fund asset allocation is diversified between equities, bonds, property and cash and is measured against a customised benchmark (which changed in 2015 when the new Investment Policy was approved) as follows:

	Allocation from 01/01/15 %	Allocation to 31/12/14 %
Asset Class		
UK Equities	18	40
Global Equities	40	40
UK Gilts	-	5
UK Corporate Bonds	-	5
Property	12	10
Alternative Bonds	10	-
Diversified Growth Fund	20	-
Total	100	100

The Pension Fund has five Fund Managers as follows:

Manager	Mandate	% of Pension Fund at March 2017
Blackrock	Passive UK Global Equities	42
Schroders	Active Property	11
Newton	Diversified Growth Fund	17
M & G	Alternative Bonds	22
Kleinwort Benson	Active Global Equities	8
Total		100

Investment Performance

Investment performance is monitored against this benchmark return on a quarterly and annual basis; however, the longer-term performance of the Fund Managers is the ultimate measure of achievement.

For the year to 31 March 2017, the Pension Fund had a return of 19.0% compared to the benchmark return of 19.1%.

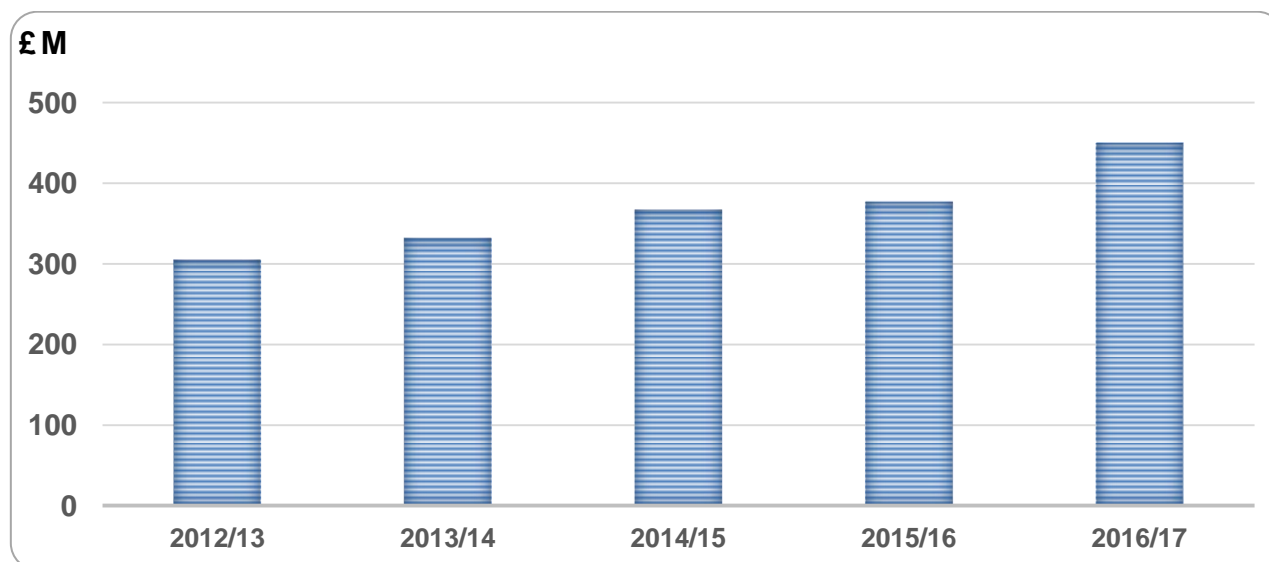
The table below shows the Pension Fund performance over the last five years, and the annualised return over three and five years:

	2012/13 %	2013/14 %	2014/15 %	2015/16 %	2016/17 %	Annualised	
						3 Year %	5 Year %
Fund Return	15.0	6.5	8.8	1.0	19.0	9.4	9.9
Benchmark	14.6	6.7	9.5	2.0	19.1	9.9	10.2
Performance	0.4	-0.2	-0.7	-1.0	-0.1	-0.5	-0.3

Over the longer term, the Pension Fund assets have grown in value at over 9% annually. The table above reveals a volatile period of five years, with very strong returns in 2016/17 and in 2012/13.

At the end of 2014/15, the revised Investment Strategy was put in place and this may have been a factor in failing to meet the benchmark in that and the subsequent year.

The graph below shows the market value of the Pension Fund over the last five years:



Annual Governance Statement

Introduction

This Statement documents the governance arrangements for the pension scheme administered by Shetland Islands Council.

Administering Authority

Shetland Islands Council (the Council) is the Administering Authority for the Local Government Pension Scheme (LGPS) set up for the Shetland Islands geographic area.

Regulatory Framework

The Scottish Public Pensions Agency (SPPA) is responsible for regulating the LGPS in Scotland and the Council administers the pension scheme in accordance with these regulations.

The Council manages the Pension Fund in terms of The Local Government Pension Scheme (Scotland) Regulations 2014. The objectives are discharged through the Pension Fund Committee. The Administering Authority is assisted in its duties by the Pension Board.

The financial transactions are conducted in compliance with the Council's Financial Regulations.

The Pension Fund is invested in compliance with the Council's Statement of Investment Principles.

Scope of Responsibility

The Council is responsible for ensuring that the Pension Fund:

- business is conducted in accordance with the law and appropriate standards;
- is safeguarded and properly accounted for; and
- is invested economically, efficiently and effectively.

In discharging these responsibilities, Council members and staff are responsible for implementing effective arrangements for governing the affairs of the Pension Fund. Considerable work has been undertaken in relation to improving the financial governance framework and ensuring that the Council's arrangements comply with the regulations of CIPFA Statement on the Role of the Chief Financial Officer in Local Government (2010).

The management of the Pension Fund is a service in its own right, governed by a suite of appropriate management arrangements, such as:

- appropriate strategic investment policies (such as the Funding Strategy Statement and Statement of Investment Principles);
- service planning arrangements;
- staff time allocations, appropriate to the scale of the Pension Fund;
- performance management arrangements, especially for Pension Fund investments and customer responsiveness;
- systems of internal control to safeguard assets and ensure best value;
- engagement with stakeholders and clear policy on representative roles and responsibilities;
- Governance Statement;
- risk register and business continuity plans;
- support for cash and treasury management;
- training plan; and
- independent and objective scrutiny.

To this end, the Pension Fund is managed within the overall governance arrangements of Shetland Islands Council. The Council has recently refreshed its decision-making arrangements and the governance of the Pension Fund is included within those arrangements. The Shetland Islands Council meeting of 8 March 2017 refreshed the Code of Corporate Governance to ensure compliance with best practice.

Governance Framework

The governance framework consists of the systems, processes, cultures and values by which the Pension Fund is directed and controlled. It describes the way in which staff and representatives inform all the stakeholders and ask for their views on any key issues. It is important to monitor the achievements of the Pension Fund, particularly with regard to the long-term investment strategy. From a service point of view, as with other service areas, there is a need to ensure that the service is delivered efficiently and effectively and in line with all the characteristics of a best value service.

Critical to the success of a well-managed Pension Fund is appropriate internal control arrangements. The systems of internal financial control are intended to ensure that:

- assets are safeguarded;

- transactions are authorised and properly recorded; and
- material errors or irregularities are either prevented or detected within a reasonable timescale.

The system is based on a framework of skilled staff who are aware of their responsibilities, good management information, financial regulations and effective systems and procedures.

Within Shetland Islands Council, there is a need to focus on the controls required to ensure clear separation of duties, due to the small number of staff directly employed to work on the Pension Fund. The Pension Fund relies on the same systems of internal control as those that are in place for Shetland Islands Council (which are internally and externally audited and assessed on an annual basis).

The effective arrangements include:

- an appropriate level of knowledge for Pension Fund Committee and Pension Board members to ensure that they have adequate knowledge to oversee the governance of the Pension Fund business;
- clear objectives, good decision making at committee level, clear delegations to committee and staff, with appropriate, independent scrutiny of decision making and performance;
- a clear set of objectives for the Pension Fund, as described in the Funding Strategy Statement and Investment Principles;
- good performance monitoring arrangements, with committee members being able to directly question those responsible for all aspects of the business on a regular basis;
- a clear statement of risk (risk register), combined with effective risk management arrangements;
- an annual review of compliance against regulation, guidance and best practice arrangements;
- the Monitoring Officer ensuring compliance with regulation and guidance;
- clear monitoring arrangements;
- compliance with LGPS Investment Regulations;
- compliance with the CIPFA / Myners investment principles;

- appropriate custodian arrangements for investments;
- codes of conduct to support good relationships between committee members and staff who support the work of the Pension Fund;
- a demonstrable best value service, including good use of benchmarking data on the cost and quality of service provided; and
- effective internal control arrangements.

The governance framework cannot eliminate all risks of failure to meet policy objectives. An effective framework can, however, provide a reasonable (but not absolute) assurance of effectiveness.

Review of Effectiveness

The Pension Fund has a responsibility for ensuring the continuing effectiveness of its governance framework and systems of internal control.

The Pension Fund approaches this with reference to the Council and its approach. This considers different layers of assurance, namely management assurance both internally through the Council and externally through the group entities; the assurance and recommendations provided by internal audit; external audit and other external scrutiny reports; and self-evaluation compliance.

Management Assurance

As the administration of the Pension Fund is directly within the remit of the Director of Corporate Services, assurance has been sought from her in relation to the effectiveness of internal financial controls. This assurance provides the opportunity to highlight any weaknesses or areas of concern that should be considered. For 2016/17, no areas of weakness or concern were raised.

In relation to the effectiveness of the Council's arrangements to its statutory officers, both the Executive Manager – Finance (Chief Financial Officer) and Executive Manager – Governance & Law (Monitoring Officer) are full members of the Corporate Management Team and are in attendance at the Council, Audit Committee and Policy and Resources Committee to advise as appropriate.

The Council Committee structure supports the organisational and management structure of the

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Council, incorporating a culture of accountability that has been developed throughout. The Pension Fund Committee oversees the business of the Pension Fund, the Administering Authority being supported by the Pension Board. The Audit Committee remains responsible for ensuring the effectiveness of the internal audit function and also considering all reports prepared by the external auditor.

The Audit Committee's remit ensures that the work of the Council, from both a control and performance perspective, is checked and scrutinised. As well as an annual plan, the Committee can call for one-off reviews to investigate a particular issue. The Council's Executive Manager - Audit, Risk & Performance reports directly to the Audit Committee.

Assurance from Internal Audit

The Council provides internal audit arrangements to the Pension Fund both as a tool of management and with direct reporting to the Council's Audit Committee. The Internal Audit service operates in accordance with the Public Sector Internal Audit Standards (PSIAS). The service works to an approved Annual Plan, based on the approved Audit Strategy, based on the Audit Universe and an annual assessment of the known and potential risks.

During the year there were no specific internal audits carried out for the Pension Fund, and the controls work undertaken across the Council systems by internal audit were found to be generally adequate.

External Audit and Other External Scrutiny

Each year, the external auditors undertake an assessment of the internal controls in operation in the Council, to determine whether they can place reliance on them in the preparation of the final accounts. Recent reports by Audit Scotland identified a limited number of minor recommendations in the area of internal control and these are being addressed by management in order to ensure weaknesses are strengthened.

The Local Government Pension Scheme (LGPS) regulations require LGPS administering authorities to measure their governance

arrangements against the standards set out in the guidance. Where compliance does not meet the published standard, there is a requirement for administering authorities to set out any reasons for non-compliance in their governance compliance statement.

Self-Evaluation of Compliance

The Governance Compliance Statement set out below describes the extent to which the governance arrangements comply with best practice and any actions required to implement improvements.

Principle	Compliance and Comments
Structure	
The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing council.	Yes, the Pension Fund Committee has been delegated responsibility for overseeing the management and administration of the LGPS and managing the investments of the Pension Fund.
That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	Yes, the Pension Board, which meets concurrently with the Pension Fund Committee, includes representatives from employers (Councillors), admitted bodies (a Board Member) and scheme members (Trade Unions).
That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes, the Pension Fund Committee and Pension Board meet concurrently to aid easy and open communication.
That where a secondary committee or panel has been established, at least one seat on the main committee is allocated for a member from the secondary committee or panel.	The Pension Board is not a secondary committee, both the Pension Fund Committee and Pension Board meet concurrently and have access to the same agenda papers. There is no need for a Pension Board member to be on the Committee.
Committee Membership and Representation	
All key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include: i) employing authorities (including non-scheme employers, e.g., admitted bodies); ii) scheme members (including deferred and pensioner scheme members); iii) where appropriate, independent professional observers; and expert advisors (on an ad-hoc basis).	i) Yes - Pension Fund Committee and Pension Board ii) Yes, Pension Board iii) Yes, e.g. engaging with the appointed actuary or investment manager when professional advice is required.
Where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Yes, Pension Board members have the same access to information, papers and training
Selection and role of lay members	
That committee or board members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.	Yes, training provided during 2015/16
That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes, 'Declarations of Interest' is a standing item on all agendas.

Principle	Compliance and Comments
Voting	
The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes, these are contained in the Terms of Reference for both Pension Fund Committee and Pension Board.
Training/Facility time/Expenses	
That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	Yes A Member Development Programme is in place. The Constitution clearly sets out the scope of approved duties. There is supplementary guidance to ensure Members' expenses are reimbursed in line with regulatory requirements.
That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	No The policies for employer representatives and staff representatives are necessarily different and cannot be equally applied.
That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.	Yes A Member Development Programme was implemented. All member development is being monitored and logged centrally. Personal development plans are in place for 18 out of 22 Members.
Meetings (frequency/quorum)	
That an administering authority's main committee or committees meet at least quarterly.	Yes, the Pension Fund Committee and Pension Board meets at least four times per annum and is wholly focused on Pension Fund business.
That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.	Yes, the Pension Board sits concurrently with the Pension Fund Committee.
That an administering authority that does not include lay members in their formal governance arrangements, must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Lay members are included in formal governance arrangements.
Access	
That subject to any rules in the Council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes, committee papers are sent out to all Pension Fund Committee and Pension Board members, and all agenda items and subsequent minutes are available on the Shetland Islands Council Committee Information Pages (COINS).

Principle	Compliance and Comments
Scope	
That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes, full scope of the Pension Fund Committee and Pension Board are found in their Terms of Reference
Publicity	
That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes The Annual Newsletter is available to all Members. The Annual Report and Accounts will be made available on-line.

Significant Governance Issues

The system of governance can provide only reasonable (and not absolute) assurance that assets are safeguarded, transactions are authorised and properly recorded, material errors or irregularities are either prevented or would be detected within a timely period and all the significant risks impacting on the achievement of our objectives have been mitigated.

Following a review of the effectiveness of the code of governance there are no significant governance issues that require to be reported.

Certification

It is our opinion that the governance and internal control environment provides reasonable and objective assurance that any significant risks impacting on the achievement of the principal objectives of the Pension Fund will be identified and actions taken to avoid or mitigate their impact.

.....
Cecil Smith
Leader of the Council
Chair of the Pension Fund Committee
19 June 2017

.....
Mark Boden
Chief Executive
Shetland Islands Council
19 June 2017

Statement of Responsibilities for the Statement of Accounts

The administering authority's responsibilities

The Authority is required to:

- make arrangements for the proper administration of its Pension Fund and to ensure that the proper officer has the responsibility for the administration of those affairs (section 95 of the Local Government (Scotland) Act 1973). In this authority, that officer is the Executive Manager – Finance;
- manage its affairs to secure economic, efficient and effective use of resources and to safeguard its assets;
- ensure the Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014), and so far as is compatible with that legislation, in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003); and
- approve the Annual Accounts for signature.

I can confirm that these Annual Accounts were approved for signature by the Council on 19 June 2017.

Signed on behalf of Shetland Islands Council

.....
Cecil Smith
Leader of the Council
Chair of the Pension Fund Committee
19 June 2017

The Executive Manager – Finance's responsibilities

The Executive Manager - Finance is responsible for the preparation of the Pension Fund Statement of Accounts in accordance with proper practices as required by legislation and as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the Accounting Code).

In preparing the Annual Accounts, the Executive Manager - Finance has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that were reasonable and prudent;
- complied with legislation; and
- complied with the local authority Accounting Code (in so far as it is compatible with legislation).

The Executive Manager - Finance has also:

- kept proper accounting records which were up to date; and
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

I certify that the Annual Accounts give a true and fair view of the financial position of the Pension Fund at the reporting date and the transactions of the Pension Fund for the year ended 31 March 2017.

.....
Jonathan Belford, CPFA
Executive Manager – Finance
Shetland Islands Council
19 June 2017

Pension Fund Account 2016/17

The Pension Fund Account sets out all income and expenditure of the Pension Fund.

2015/16 £000	Notes	2016/17 £000	2016/17 £000
	Dealings with members, employers and others directly involved in the scheme		
(16,627)	Contributions 4	(16,026)	
(529)	Transfers in from other pension funds 5	(1,258)	
(886)	Other income	(28)	
(18,042)	Total Additions		(17,312)
11,890	Benefits payable 6	12,785	
133	Payments to and on account of leavers 7	363	
946	Other payments	4	
12,969	Total Withdrawals		13,152
(5,073)	Net (additions)/withdrawals from dealings with members		(4,160)
1,736	Management expenses 8		1,856
(3,337)	Net (additions)/withdrawals Including Fund Management Expenses		(2,304)
	Return on investments		
(2,887)	Investment income 9	(3,154)	
(1,645)	(Profits) and losses on disposal of investments and changes in market value of investments 11b	(68,734)	
(4,532)	Net return on investments		(71,888)
(7,869)	Net (increase)/decrease in the net assets available for benefits during the year		(74,192)
(367,838)	Opening net assets of the scheme		(375,707)
(375,707)	Closing net assets of the scheme		(449,899)

Net Assets Statement as at 31 March 2017

The Net Assets Statement sets out the value, as at the Statement date, of all assets and liabilities of the Pension Fund. The net assets of the Pension Fund (assets less current liabilities) represent the funds available to provide for pension benefits at the statement date.

The financial statements summarise the transactions of the Pension Fund during the year and its net assets at the year-end. It should be noted, however, that they do not take account of the obligations to pay pensions and benefits that fall due after the end of the year. The actuarial position of the Pension Fund, which does take account of such obligations, is discussed in the Actuarial Statement. These financial statements should be read in conjunction with that information. In addition, as required by IAS26, the Actuarial Present Value of Promised Retirement Benefits is disclosed in the notes to these financial statements.

2015/16 £000		Notes	2016/17 £000	2016/17 £000
	Investment Assets			
375,105	Investment Assets	10	447,739	
44	Cash Deposits	10	1,218	
375,149	Total Investment Assets			448,957
	Current Assets			
1,102	Debtors	15	1,345	
1,178	Bank current accounts		1,011	
2,280	Total Current Assets			2,356
	Current Liabilities			
(1,497)	Sundry creditors	16	(366)	
(225)	Benefits payable		(1,048)	
(1,722)	Total Current Liabilities			(1,414)
375,707	Net assets of the scheme available to fund benefits at the reporting period end			449,899

The unaudited accounts were issued on 19 June 2017.

.....
Jonathan Belford, CPFA
Executive Manager – Finance
19 June 2017

Notes to the Accounts

Note 1: Description of Pension Fund

The Shetland Islands Council Pension Fund is part of the Local Government Pension Scheme and is administered by Shetland Islands Council. The Council is the reporting entity for this Pension Fund.

The following description of the Pension Fund is a summary.

General

The Pension Fund is governed by the Superannuation Act 1972 and by the Public Service Pensions Act 2013. The Pension Fund is administered in accordance with the following secondary legislation:

- The Local Government Pension Scheme (Scotland) Regulations 2014;
- The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014;
- The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015; and
- the LGPS (Management and Investment of Funds) Regulations 2010.

It is a contributory defined benefit pension scheme administered by Shetland Islands Council to provide pensions and other benefits for pensionable employees of scheduled bodies, Shetland Islands Council, Orkney and Shetland Valuation Joint Board and admitted bodies within Shetland. Teachers are not included as they have a separate national pension scheme.

The Pension Fund is overseen by the Pension Board and Pension Fund Committee.

Membership

Membership of the LGPS is automatic, but employees are free to choose to opt out of the scheme and make their own personal pension arrangements outside the scheme.

Organisations participating in the Shetland Islands Council Pension Fund include:

- Scheduled bodies, which are local authorities and similar statutory bodies whose staff are automatically entitled to be members of the Pension Fund; and
- Admitted bodies, which are other organisations that participate in the Pension Fund under an admission agreement between the Pension Fund and the relevant organisation. Admitted bodies include voluntary, charitable and similar bodies or private contractors undertaking a local authority function following outsourcing to the private sector.

There are 11 employer organisations with active members within Shetland Islands Council Pension Fund including the Council itself, a summary of membership is below:

31 March 2016	Shetland Islands Council Pension Fund	31 March 2017
12	Number of employers with active members	11
	Number of employees in scheme:	
2,763	Shetland Islands Council	2,957
382	Other employers	385
3,145	Total	3,342
	Number of pensioners/dependants	
1,493	Shetland Islands Council	1,583
126	Other employers	145
1,619	Total	1,728
	Deferred pensioners	
1,538	Shetland Islands Council	1,611
265	Other employers	362
1,803	Total	1,973
6,567	Scheme Total	7,043

Funding

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the Pension Fund in accordance with the Local Government Pension Scheme (Scotland) Regulations 2014 and range from 5.5% to 12% of pensionable pay for the financial year ending 31 March 2017. Employee contributions are matched by employers'

contributions, which are set, based on triennial actuarial funding valuations. The actuarial valuation as at 31 March 2014 set these employers' contribution rates, which range from 17.2% to 33.8% of pensionable pay.

Benefits

Pension benefits under the LGPS are calculated as per the table below:

Service pre 1 April 2009	Service post 31 March 2009	Service Post 31 March 2015
Each year worked is worth 1/80 x final FTE pensionable salary	Each year worked is worth 1/60 x final FTE pensionable salary	Each year worked is worth 1/49 x actual pensionable salary
Automatic lump sum of 3 x salary.	No automatic lump sum.	No automatic lump sum
In addition, part of annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.	Part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.	Part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.

There are a range of other benefits provided under the scheme including early retirement, ill health retirement and death benefits. For more details, please refer to <http://www.scotlgps2015.org/> or contact Shetland Islands Council Pension Section on 01595 744644.

Benefits in payment are index-linked in line with the consumer price index.

Note 2: Basis of Preparation

The Statement of Accounts summarises the Pension Fund's transactions for the 2016/17 financial year and its position at year-end as at 31 March 2017. The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17, which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts summarise the transactions of the Pension Fund and report on the net assets available to pay pension benefits. The accounts do not take account of obligations to pay pensions and benefits that fall due after the end of the financial year. The actuarial present value of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, is disclosed at Note 14 of these accounts.

Accounting Standards Issued, not Adopted

Accounting standards issued but not adopted by the code in 2016/17 are:

- Amendments to IAS 19 Employee Benefits (Defined Benefit Plans: Employee Contributions);

- Annual Improvements to IFRSs 2010-2012 Cycle;
- Annual Improvements to IFRSs 2012-2014 Cycle;
- Amendment to IAS 1 Presentation of Financial Statements (Disclosure Initiative);
- The changes to the format of the Comprehensive Income and Expenditure Statement, the Movement in Reserves Statement and the introduction of the new Expenditure and Funding Analysis;
- The changes to the format of the Pension Fund Account and the Net Assets Statement.

The Code requires implementation from 1 April 2017 and there is therefore no impact on the 2016/17 financial statements.

Note 3: Assumptions Made about the Future and Other Major Sources of Estimation Uncertainty

The Statement of Accounts contains estimated figures that are based on assumptions made by the Council about the future, or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the net assets statement at 31 March 2017 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

Item	Uncertainties	Effect if actual results differ from assumptions
Actuarial present value of promised retirement benefits	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. An actuary to the Fund is appointed to provide the fund with expert advice about the assumptions to be applied.	The effects on the net pension liability of changes in individual assumptions can be measured. For instance, 0.5% decrease in the real discount rate assumption would result in an increase in the pension liability of £83m. A 0.5% increase in salary increase rate assumption would increase the value of liabilities by approximately £30m, and a 0.5% increase in pension increase rate assumption would increase the liability by approximately £50m.

Note 4: Contributions Receivable

By category:

31 March 2016 £000		31 March 2017 £000
(12,781)	Employers - normal	(12,190)
(186)	Employers - augmentation	(18)
(3,660)	Members - normal	(3,818)
(16,627)	Total	(16,026)

By authority:

31 March 2016 £000		31 March 2017 £000
(14,160)	Administering authority	(13,589)
(129)	Scheduled bodies	(135)
(2,338)	Admitted bodies	(2,302)
(16,627)	Total	(16,026)

Note 5: Transfers in from Other Pension Funds

The total transfers received during the year are as follows:

31 March 2016 £000		31 March 2017 £000
(529)	Individual transfers in	(1,258)
(529)	Total	(1,258)

The Pension Fund received 41 transfers in during 2016/17 with an average value of £30,683 compared to 35 transfers in during 2015/16 with an average value of £15,100.

Note 6: Benefits Payable

By category:

31 March 2016 £000		31 March 2017 £000
8,920	Pensions	9,312
2,690	Commutation and lump sum retirement benefits	2,671
280	Lump sum death benefits	802
11,890	Total	12,785

By authority:

31 March 2016 £000		31 March 2017 £000
10,353	Administering authority	11,410
191	Scheduled bodies	111
1,346	Admitted bodies	1,264
11,890	Total	12,785

Note 7: Payments to and on Account of Leavers

31 March 2016 £000		31 March 2017 £000
20	Refunds to members leaving service	17
31	Payments for members joining state scheme	14
82	Individual transfers	332
133	Total	363

Note 8: Management Expenses

31 March 2016 £000		31 March 2017 £000
256	Administration Expenses	318
38	Oversight and Governance Expenses	51
	Investment Management Expenses	
1,346	Management Fees	1,420
64	Performance Fees	35
32	Custody Fees	32
1,736	Total	1,856

Note 9: Investment income

31 March 2016 £000		31 March 2017 £000
(925)	Fixed Income Unit Trusts	(888)
(1,277)	Pooled property unit trusts - UK	(1,519)
(527)	Pooled property unit trusts - Overseas	(581)
(6)	Interest on cash deposits	(4)
(152)	Other	(162)
(2,887)	Total	(3,154)

Note 10: Investments

Market Value As at 31 March 2016 £000		Market Value As at 31 March 2017 £000
294,476	Pooled funds	361,371
33,926	Fixed income unit trusts	38,019
46,668	Pooled property unit trusts	48,112
44	Cash deposits	1,218
35	Property income due	237
375,149	Total investment assets	448,957

Note 10a - Reconciliation of movements in investments

	Market Value at 1 April 2016 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2017 £000
Investment Assets:					
Pooled funds	294,207	-	(38)	67,015	361,184
Fixed income unit trusts	33,926	2,571	-	1,522	38,019
Pooled property unit trusts	46,667	3,402	(2,154)	197	48,112
Total Investment Assets	374,800	5,973	(2,192)	68,734	447,315
Investment Income Due:					
Fixed income income due	270				187
Property income due	35				237
Total Investment Income Due	375,105				447,739
Other investment balances:					
Cash deposits	44				1,218
Cash income due	-				-
Net investment assets	375,149	5,973	(2,192)	68,734	448,957

	Market Value at 1 April 2015 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2016 £000
Investment Assets:					
Pooled funds	293,166	2,000	(1,000)	41	294,207
Fixed income unit trusts	34,059	825	-	(958)	33,926
Pooled property unit trusts	38,277	7,263	(1,435)	2,562	46,667
Total Investment Assets	365,502	10,088	(2,435)	1,645	374,800
Investment Income Due:					
Fixed income due	170				270
Property income due	5				35
Total Investment Income Due	365,677				375,105
Other investment balances:					
Cash deposits	511				44
Cash income due	-				-
Net investment assets	366,188	10,088	(2,435)	1,645	375,149

The Funds are all invested within pooled funds; therefore there are no direct trading costs.

Note 10b - Analysis of investments

31 March 2016 £000		31 March 2017 £000
	Additional analysis	
67,159	Pooled funds (UK)	81,933
153,482	Pooled funds (Overseas)	203,697
73,565	Diversified Growth	75,554
33,926	Alternative Credit	38,019
45,021	Pooled property unit trust (UK)	46,731
1,647	Pooled property unit trust (Overseas)	1,381
374,800	Total investment assets	447,315

Note 10c - Analysis by Fund Manager

Market Value 31 March 2016 £000			Market Value 31 March 2017 £000	
£000	%		£000	%
147,159	39	BlackRock	188,816	42
46,774	12	Schroders	49,560	11
73,566	20	Newton Asset Management	75,554	17
73,454	20	Kleinwort Benson	96,821	22
34,196	9	M & G Investments	38,206	8
375,149	100	Total investment assets	448,957	100

The following investments represent more than 5% of the net assets of the scheme:

Market Value 31 March 2016			Market Value 31 March 2017	
£000	%		£000	%
67,128	18	Aquila Life UK equity index	81,933	18
33,926	9	M & G Alpha Opp Fd AGBP	38,019	8
73,454	20	KBI 1 Dividend Plus	96,821	22
73,566	20	Newton Real Rtrn X ACC NAV	75,554	17
80,028	21	Aquila Life World EX UK Fund Series 1	106,875	24

Note 11: Financial Instruments

Note 11a - Classification of financial instruments

Accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including gains and losses, are recognised. The following table analyses the carrying amounts of financial assets and liabilities (excluding cash) by category and net assets statement heading. No financial assets were reclassified during the accounting period.

31 March 2016				31 March 2017		
Fair value through profit and loss £000	Receiv- ables £000	Financial liabilities £000		Fair value through profit and loss £000	Receiv- ables £000	Financial liabilities £000
			Financial assets			
294,476	-		Pooled funds	361,371		
33,927	-		Fixed income unit trusts	38,019		
46,667	-		Pooled property unit trusts	48,112		
-	1,222		Cash		2,229	
35	-		Property income due	237		
-	1,102		Debtors		1,345	
375,105	2,324	-	Total Financial assets	447,739	3,574	-
			Financial liabilities			
-	-	(1,722)	Creditors			(1,414)
-	-	(1,722)	Total Financial liabilities	-	-	(1,414)
375,105	2,324	(1,722)		447,739	3,574	(1,414)

Note 11b - Net gains and losses on financial instruments

31 March 2016 £000		31 March 2017 £000
	Financial assets	
(1,645)	Fair value through profit and loss	(68,734)
(1,645)	Total	(68,734)

Note 11c - Value of financial instruments

31 March 2016			31 March 2017	
Book value £000	Market value £000		Book value £000	Market value £000
		Financial assets		
323,479	375,105	Fair value through profit and loss	327,613	447,739
323,479	375,105	Total	327,613	447,739

Note 12: Nature and Extent of Risks Arising from Financial Instruments

Risk and risk management

The Pension Fund's primary long-term risk is that its assets will fall short of its liabilities (i.e. promised benefits payable to members). Therefore the aim of investment risk management is to minimise the risk of an overall reduction in the value of the Pension Fund and to maximise the opportunity for gains across the whole Pension Fund portfolio. The Pension Fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and credit risk to an acceptable level. In addition, the Pension Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Pension Fund's forecast cash flows. The Pension Fund manages these investment risks as part of its overall Pension Fund risk management programme.

Responsibility for the Pension Fund's risk management strategy rests with the Council. Risk management policies are established to identify and analyse the risks faced by the Council's pension operations. Policies are reviewed regularly to reflect changes in activity and market conditions.

Market risk

Market risk is the risk of loss from fluctuations in equity, bond and property prices, interest and foreign exchange rates and credit spreads. The Pension Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market condition, expectations of future price and yield movements and the asset mix.

The objective of the Pension Fund's risk management strategy is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on risk.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industrial sectors and individual securities. To mitigate market risk, the Pension Fund and its investment advisors undertake appropriate monitoring of market conditions and benchmark analysis.

Other price risk

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

The Pension Fund's investment managers mitigate this price risk through diversification and the selection of investments, which is monitored by the Council, as the administering authority, and the Fund Managers to ensure it is within limits specified in the Pension Fund investment strategy.

Other Pension Fund price risk - sensitivity analysis

In agreement with the Pension Fund's performance analyst and following analysis of historical data and expected investment return during the financial year, the Pension Fund has determined that the following movements in market price risk are deemed reasonably possible for the financial year 2016/17 reporting period:

Asset Type	Potential market movements (+/-)
UK Equities	15.8%
Overseas Equities	18.4%
Property	14.2%
Cash	0.0%
Diversified Growth	12.5%
Alternative Credit	6.1%

The potential price changes disclosed above are determined based on the observed historical volatility of asset class returns. 'Riskier' assets such as equities will display greater potential volatility than bonds as an example, so the overall outcome will depend largely on Pension Funds' asset allocations. The potential volatilities are consistent with a one standard deviation movement in the change in value of the assets over the latest three years. This can then be applied to the period end asset mix.

Had the market price of the Pension Fund investments increased/decreased in line with the above, the change in the net assets available to pay benefits in the market price would have been as follows (the prior year comparator is shown below):

Asset Type	Value as at 31 March 2017 £000	Percentage Change %	Value on Increase £000	Value on Decrease £000
Cash and cash equivalents	1,218	0.00%	1,218	1,218
Investment portfolio assets:				
UK Equities	81,933	15.8%	94,878	68,988
Global Equities (ex UK)	279,250	18.4%	330,632	227,868
Property	38,206	14.2%	43,631	32,781
Diversified Growth	46,749	12.5%	52,593	40,905
Alternative Credit	1,601	6.1%	1,699	1,503
Total assets	448,957		524,651	373,263

Asset Type	Value as at 31 March 2016 £000	Percentage Change %	Value on Increase £000	Value on Decrease £000
Cash and cash equivalents	44	0.01%	44	44
Investment portfolio assets:				
UK Equities	67,159	10.61%	74,285	60,033
Overseas Equities	227,047	9.43%	248,458	205,636
Total Bonds & Index Linked	34,196	4.77%	35,827	32,565
UK Property	45,048	1.98%	45,940	44,156
Overseas Property	1,655	20.37%	1,992	1,318
Total assets	375,149		406,546	343,752

Interest rate risk

The Pension Fund invests in financial assets for the primary purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represent the risk that the value or future cash flows of a financial

instrument will fluctuate because of changes in market interest rates.

The Pension Fund's direct exposure to interest rate movements as at 31 March 2016 and 31 March 2017 are set out below:

31 March 2016 £000		31 March 2017 £000
	Asset type	
44	Cash and cash equivalents	1,218
1,178	Cash balances	1,011
1,222	Total	2,229

Interest rate risk sensitivity analysis

The Pension Fund recognises that interest rates can vary and can affect both income to the Pension Fund and the value of the net assets available to pay benefits. A 110 basis point (BPS) movement in interest rates is viewed as a reasonable level of risk sensitivity for the Pension Fund under current interest rate circumstances. The Pension Fund's performance analyst has also agreed that the long-term average rates are

expected to move less than 110 basis points (hence 100 basis points used in the examples below) from one year to the next and experience suggests that such movements are possible. The analysis that follows assumes the total Fund volatility takes into account the expected interactions between the different asset classes shown, based on the underlying volatilities and correlations of the assets, in line with mean variance portfolio theory.

Asset Type	Carrying amount as at 31 March 2017 £000	Change in year in the net assets available to pay benefits	
		+100 BPS £000	-100 BPS £000
Cash and cash equivalents	1,218	12	(12)
Cash balances	1,011	10	(10)
Total change in assets available	2,229	22	(22)

Asset Type	Carrying amount as at 31 March 2016 £000	Change in year in the net assets available to pay benefits	
		+100 BPS £000	-100 BPS £000
Cash and cash equivalents	44	-	-
Cash balances	1,178	12	(12)
Total change in assets available	1,222	12	(12)

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 Pension Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the

functional currency of the Pension Fund (£ sterling). The Pension Fund holds both monetary and non-monetary assets denominated in currencies other than £ sterling.

The following table summarises the Pension Fund's currency exposure as at 31 March 2017 and as at the previous period end:

31 March 2016 £000		31 March 2017 £000
	Asset type	
227,047	Pooled Funds - overseas equities	279,250
1,655	Pooled Property Unit Trusts - overseas	1,601
228,702	Total	280,851

Currency risk - sensitivity analysis

Following analysis of data provided by the Pension Fund's performance analysts, the Pension Fund considers the likely volatility associated with foreign exchange rate movements to be 10%.

This analysis assumes that all other variables, in particular interest rates, remain constant. A 10% strengthening/weakening of the pound against the various currencies in which the Pension Fund holds investments would increase/decrease the net assets available to pay benefits as follows:

Asset Type	Carrying amount as at 31 March 2017 £000	Change to net assets available to pay benefits	
		+10.0% £000	-10.0% £000
Pooled Funds - overseas equities	279,250	307,175	251,325
Pooled Property Unit Trusts - overseas	1,601	1,761	1,441
Total change in assets available	280,851	308,936	252,766

Asset Type	Carrying amount as at 31 March 2016 £000	Change to net assets available to pay benefits	
		+6.15% £000	-6.15% £000
Pooled Funds - overseas equities	227,047	241,010	213,084
Pooled Property Unit Trusts - overseas	1,655	1,757	1,553
Total change in assets available	228,702	242,767	214,637

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 Pension 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 Pension Fund's financial assets and liabilities.

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

Deposits are not made with banks and financial institutions unless they meet the Council's credit criteria. The Council has also set limits on the value of these deposits, which can be placed with any bank or financial institution, apart from the bank the Council uses for its daily operations.

The Council believes it has managed its exposure to credit risk, and has had no experience of default or uncollectible deposits over the past five financial years.

The Pension Fund's cash holding under its treasury management arrangements at 31 March 2017 was £2.229m (31 March 2016: £1.222m). This was held with the following institutions:

31 March 2016 £000		31 March 2017 £000
	Fund manager deposits	
42	Schroders cash	1,211
2	BlackRock cash	7
	Bank current accounts	
1,178	Bank of Scotland Plc	1,011
1,222	Total	2,229

Liquidity risk

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

The Pension Fund has immediate access to all its cash holdings. The Pension Fund also has an overdraft facility to cover any unexpected short-term cash needs. The overdraft facility has not been used over the past five years and therefore the Pension Fund's exposure to liquidity risk is considered negligible.

The Pension Fund defines liquid assets as assets that can be converted to cash within three months. Illiquid assets are those assets that will take longer than three months to convert into cash. As at 31 March 2017, the value of illiquid assets was £38.2m, which represented 8.5% of the Pension Fund assets (31 March 2016: £46.7m, which represented 12.4% of the Pension Fund assets).

Refinancing risk

The key risk is that the Pension Fund will be bound to replenish a significant proportion of its financial instruments at a time of unfavourable interest rates. The Pension Fund does not have any financial instruments that have a refinancing risk as part of its treasury management and investment strategies.

Note 13: Funding Arrangements

In line with the Local Government Pension Scheme (Scotland) Regulations 2014, the Pension Fund's actuary undertakes a funding valuation every three years for the purpose of setting employer contribution rates for the forthcoming triennial period. The valuation for the current accounting period took place as at 31 March 2014.

The funding policy is set out in the Pension Fund's Funding Strategy Statement (FSS), dated February 2015.

The key elements of the funding policy are:

- to ensure the long-term solvency of the Pension Fund using a prudent long-term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return. This will also minimise the costs to be borne by Council Tax payers;
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years;
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

Employee benefits are guaranteed, and employee contributions are fixed, so employers need to pay

the balance of the cost of delivering the benefits to members and dependants. The Funding Strategy Statement sets out how the Administering Authority has balanced the conflicting aims of affordability and stability of employer contributions and prudence in the funding basis, with regard to employer liabilities.

Funding position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was at 31 March 2014. This valuation revealed that the Pension Fund's assets, which at 31 March 2014 were valued at £333 million, were sufficient to meet 92% (91% at 31 March 2011 valuation) of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £30 million (2011 valuation: £25 million).

The common rate of contribution payable by each employing authority under regulation 32(4)(a) of the Administration Regulations for the period 1 April 2015 to 31 March 2018 is 20.7% of pensionable pay, (i.e. the rate which all employers in the Pension Fund pay).

Individual employers' rates are adjusted under regulation 32(4) (b) from the common contribution rate. The contribution rates payable for the period 1 April 2015 to 31 March 2018 were set in accordance with the Pension Fund's funding policy as set out in its Funding Strategy Statement.

The payment due by the Shetland Islands Council during this period includes an employer's rate of 18.7%, 19.8% and 20.8% per annum for each of the three years.

Copies of the 2014 Valuation Report and Funding Strategy Statement are available on request from Shetland Islands Council, the Administering Authority to the Pension Fund.

Principal actuarial assumptions and method used to value the liabilities

Full details of the method used are described in a valuation report from the actuaries, Hymans Robertson LLP, available on request from Shetland Islands Council, the Administering Authority to the Pension Fund.

Method

The liabilities were assessed using an accrued benefits method, which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

Assumptions

A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Pension Fund assets at their market value.

The key financial assumptions adopted for the 2014 valuation were as follows:

Financial assumptions	31 March 2014	
	% p.a. Nominal	% p.a. Real
Discount rate	5.2%	2.5%
Pay increases	4.5%	1.8%
Price inflation/Pension increases	2.7%	0.0%

Mortality assumptions

The key demographic assumption was the allowance made for longevity. The baseline longevity assumptions adopted at this valuation were based on the Fund's VitaCurves, and assumed that improvements have reached a peak of 1.25%. Based on these assumptions, the average future life expectancies at age 65 are as follows:

Mortality assumption at age 65	Males	Females
Current Pensioners	22.8 yrs	23.8 yrs
Future Pensioners	24.9 yrs	26.7 yrs

Historic mortality assumptions

Life expectancies for the prior year-end are based on the PFA92 and PMA92 tables. The allowances for future life expectancies are shown in the table below:

Year Ended	Prospective Pensioners	Pensioners
31 March 2016	Vita base curves with improvements in line with CMI 2012 assuming current rate of improvements have peaked with minimum underpin of 1.25% p.a.	Vita base curves with improvements in line with CMI 2012 assuming current rate of improvements have peaked with minimum underpin of 1.25% p.a.

Commutation assumption

An allowance is included for future retirements to elect to take 70% of the maximum additional tax-free cash up to HMRC limits for pre-April 2009 service and 85% of the maximum tax-free cash post-April 2009 service.

Note 14: Actuarial Present Value of Promised Retirement Benefits

In addition to the triennial funding valuation, the Pension Fund's actuary also undertakes a valuation of the Pension Fund liabilities, on an IAS 19 basis, every year using the same base data as the funding valuation rolled forward to the current financial year, taking account of changes in membership numbers and updating assumptions to the current year.

In order to assess the value of the benefits on this basis, the actuary has updated the actuarial assumptions (set out below) from those used for funding purposes (see Note 13). The actuary has also used ill health and death benefits in line with IAS 19.

The actuarial present value of promised retirement benefits at 31 March 2017 was £693 million (31 March 2016: £517 million). The Pension Fund accounts do not take account of liabilities to pay pensions and other benefits in the future.

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

Assumptions

The assumptions used are those adopted for the Administering Authority's IAS 19 report as required by the Code of Practice. These are given below:

31 March 2016 % p.a.	Year ended	31 March 2017 % p.a.
2.2	Inflation/pension increase rate	2.4
4.2	Salary increase rate	4.4
3.5	Discount rate	2.6

Note 15: Current Assets

31 March 2016 £000		31 March 2017 £000
	Debtors:	
25	Contributions due - employees	322
1,038	Contributions due - employers	1,020
27	Transfer values receivable	-
2	Sundry debtors	2
-	Prepayments	1
10	Accrued Income	-
1,178	Bank current accounts	1,011
2,280	Total	2,356

Analysis of debtors

31 March 2016 £000		31 March 2017 £000
-	Central government bodies	1
38	Other local authorities	1,162
1	Public corporations & trading funds	-
1,063	Other entities and individuals	182
1,102	Total	1,345

Note 16: Current Liabilities

31 March 2016 £000		31 March 2017 £000
(1,497)	Sundry creditors	(366)
(225)	Benefits payable	(1,048)
(1,722)	Total	(1,414)

Analysis of creditors

31 March 2016 £000		31 March 2017 £000
(1)	Central government bodies	(1)
(484)	Other local authorities	(286)
(36)	Public corporations and trading funds	(25)
(1,201)	Other entities and individuals	(1,102)
(1,722)	Total	(1,414)

Note 17: Unfunded Pension

31 March 2016 £000		31 March 2017 £000
702	Added years pension	694

Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998 [Section 31] allows local authorities and admitted bodies to pay additional pension on a voluntary basis. Additional pension in respect of added years' enhancement is awarded from the body or service where the employee retired and costs are paid directly.

Note 18: Additional Voluntary Contributions

31 March 2016 £000		31 March 2017 £000
4,704	Prudential	5,164
91	Equitable Life	89
4,795	Total	5,253

AVC contributions of £0.672m were paid directly to Prudential during the year (2015/16 £0.582m).

Note 19: Related Party Transactions

Shetland Islands Council

The Shetland Islands Council Pension Fund is administered by Shetland Islands Council. Consequently there is a strong relationship between the Council and the Pension Fund.

The Council incurred costs of £0.338m (2015/16 £0.261m) in relation to the administration of the Pension Fund and was subsequently reimbursed by the Pension Fund for these expenses.

The investments of the Pension Fund are overseen by the Council's Treasury Section; their costs are levied by staff time allocations. Costs incurred were £0.032m (2015/16 £0.051m) in relation to investment of the Pension Fund and the Council was subsequently reimbursed by the Pension Fund for these expenses.

The Council processed pensioner payments of £9.312m (2015/16 £8.920m). Such payments are reimbursed in full by the Pension Fund.

In addition the Council is the single largest employer of Pension Fund members, and contributed £10.350m to the Pension Fund (2015/16 £11.077m).

All monies owed to the Pension Fund from the Council and due from the Pension Fund to the Council, were paid in the year.

Governance

There are two members of the Pension Fund Committee who are in receipt of pension benefits from the Shetland Islands Council Pension Fund. In addition, there are other committee members who are active members of the Pension Fund.

Each member of the Pension Fund Committee and Pension Board is required to declare their interests at each meeting.

Key management personnel

Key Management personnel for the Pension Fund include the Shetland Islands Council Councillors, who sit on the Pension Fund Committee and Pension Board. These members are listed below. Another key person is the Section 95 Officer for Shetland Islands Council, Jonathan Belford. All these key personnel are remunerated by Shetland Islands Council.

Pension Fund Committee Membership
Alistair Cooper
Stephen Coutts
Gary Robinson
Cecil Smith
George Smith
Theo Smith
Michael Stout
Vaila Wishart
Pension Board Membership
Malcolm Bell
Robert Henderson
Drew Ratter

Note 20: Changes in Actuarial Present Value of Promised Retirement Benefits

Actuarial Present Value of Promised Retirement Benefits	Vested Benefits £000	Unvested Benefits £000	Total £000
Balance As at 31 March 2017	693	-	693
Increase/(Decrease) in Value during 2016/17	176	-	176
Balance As at 31 March 2016	517	-	517
Increase/(Decrease) in Value during 2015/16	(34)	-	(34)
Balance As at 31 March 2015	551	-	551

Note 21: Critical Judgements in Applying Accounting Policies

Pension Fund liability

The Pension Fund liability is calculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines and in accordance with IAS 19. Assumptions underpinning the valuations are agreed with the actuary and are summarised in Note 14. This estimate is subject to significant variances based on changes to the underlying assumptions.

Note 22: Events after the Balance Sheet Date

There have been no events since 31 March 2017, and up to the date when these accounts were authorised that require any adjustments to these accounts.

Note 23: Accounting Policies

Pension Fund account - revenue recognition

A Contribution income

Normal contributions, both from the members and from the employers, are accounted for on an accrual basis at the percentage rate recommended by the Pension Fund actuary in the payroll period to which they relate.

Employers' augmentation contributions and pension strain costs are accounted for in the period in which the liability arises. Any amounts due in the year but unpaid will be classed as current financial assets. Amounts not due until future years are classed as long-term financial assets.

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 Pension Fund during the financial year and are calculated in accordance with the Local Government Pension Scheme Regulations (see notes 5 and 7).

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

C Investment income

• Interest income

Interest income is recognised in the Pension Fund account as it accrues.

• Distributions from pooled funds

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

• Movement in the net market value of investments

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

Pension Fund account - expense items

D Benefits payable

Pensions and lump-sum benefits payable include all amounts known to be due as at the end of the financial year. Any amounts due but unpaid are disclosed in the net assets statement as current liabilities.

E Taxation

The Pension 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 the 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 Pension Fund expense as it arises.

F Management expenses

All administrative expenses are accounted for on an accruals basis. All costs relating to staff of the pensions administration team are charged direct to the Pension Fund. Management, accommodation and other overheads are apportioned to the Pension Fund in accordance with Council policy.

All investment management expenses are accounted for on an accruals basis.

Fees of the external investment managers and custodian are agreed in the respective mandates

governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change.

One of the investment managers invests using a fund of funds approach and within these unit trusts managers levy charges.

Any fees due but unpaid are disclosed in the net assets statement as current liabilities.

The cost of obtaining investment advice from external consultants is included in investment management charges.

A proportion of the Council's costs, representing management time spent by officers on investment management, are charged to the Pension Fund in accordance with Council policy.

Net assets statement

G Financial assets

Financial assets are included in the net assets statement on a fair value basis as at the reporting date. A financial asset is recognised in the net assets statement on the date the Pension Fund becomes party to the contractual acquisition of the asset. From this date, any gains or losses arising from changes in the value of the asset are recognised by the Pension Fund.

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

H Pooled investment vehicles

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

I Foreign currency transactions

Dividends, interest and purchases and sales of investments in foreign currencies have been accounted for at the market rates at the date of transaction. End-of-year market exchange rates are used to value cash balances held in foreign currency bank accounts, market values of overseas investments and purchase and sales outstanding at the end of the reporting period.

J Cash and cash equivalents

Cash comprises cash in hand and demand deposits.

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

K Actuarial present value of promised retirement benefits

The actuarial present value of promised retirement benefits is assessed on an annual basis by the Fund actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

As permitted under IAS 26, the Pension Fund has opted to disclose the actuarial present value of the promised retirement benefits by way of a note to the net assets statement (Note 14).

L Additional voluntary contributions

Shetland Islands Council Pension Fund provides an additional voluntary contributions (AVC) scheme for its members, the assets of which are invested separately from those of the Pension Fund. The Pension Fund has appointed Prudential and Equitable Life (closed to new members) as its AVC providers. AVCs are paid to the AVC provider by employers and are specifically for providing additional benefits for individual contributors. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year.

AVCs are not included in the accounts in accordance with section 4(1) (b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 but are disclosed as a note only (Note 18).

Actuarial Statement for 2016/17

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

Description of Funding Policy

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

- to ensure the long-term solvency of the Fund, using a prudent long-term view. This will ensure that sufficient funds are available to meet all members'/dependents' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return;
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £333 million, were sufficient to meet 92% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £30 million.

Individual employers' contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the valuation report dated 31 March 2015.

Method

The liabilities were assessed using an accrued benefits method, which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

Assumptions

A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Fund assets at their market value.

The key financial assumptions adopted for the 2014 valuation were as follows:

Financial Assumptions	31 March 2014	
	% p.a. Nominal	% p.a. Real
Discount rate	5.2%	2.5%
Pay increases	4.5%	1.8%
Price inflation/Pension increases	2.7%	-

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

	Males	Females
Current Pensioners	22.8 years	23.8 years
Future pensioners*	24.9 years	26.7 years

*Future pensioners are assumed to be currently aged 45 as at 31 March 2014.

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

Experience over the period since April 2014

The Fund's experience has been worse than expected since the last formal valuation (excluding the effect of any membership movements). Real bond yields have fallen sharply, which places a significantly higher value on liabilities. The effect of this will have been partially offset by strong asset returns. The overall impact on the funding position at 31 March 2017 is that funding levels have likely worsened and deficits increased since the last formal valuation. This excludes the impact of possible changes to funding assumptions for the 2017 formal valuation, and membership experience, which will be measured as part of that valuation: these items may improve or worsen the funding position.

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



Douglas Green

Fellow of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

3 May 2017

Hymans Robertson LLP
20 Waterloo Street, Glasgow G2 6DB

Independent Auditor's Report

Annual Governance Statement

Introduction

This Statement documents the governance arrangements for the pension scheme administered by Shetland Islands Council.

Administering Authority

Shetland Islands Council (the Council) is the Administering Authority for the Local Government Pension Scheme (LGPS) set up for the Shetland Islands geographic area.

Regulatory Framework

The Scottish Public Pensions Agency (SPPA) is responsible for regulating the LGPS in Scotland and the Council administers the pension scheme in accordance with these regulations.

The Council manages the Pension Fund in terms of The Local Government Pension Scheme (Scotland) Regulations 2014. The objectives are discharged through the Pension Fund Committee. The Administering Authority is assisted in its duties by the Pension Board.

The financial transactions are conducted in compliance with the Council's Financial Regulations.

The Pension Fund is invested in compliance with the Council's Statement of Investment Principles.

Scope of Responsibility

The Council is responsible for ensuring that the Pension Fund:

- business is conducted in accordance with the law and appropriate standards;
- is safeguarded and properly accounted for; and
- is invested economically, efficiently and effectively.

In discharging these responsibilities, Council members and staff are responsible for implementing effective arrangements for governing the affairs of the Pension Fund. Considerable work has been undertaken in relation to improving the financial governance framework and ensuring that the Council's arrangements comply with the regulations of CIPFA Statement on the Role of the Chief Financial Officer in Local Government (2010).

The management of the Pension Fund is a service in its own right, governed by a suite of appropriate management arrangements, such as:

- appropriate strategic investment policies (such as the Funding Strategy Statement and Statement of Investment Principles);
- service planning arrangements;
- staff time allocations, appropriate to the scale of the Pension Fund;
- performance management arrangements, especially for Pension Fund investments and customer responsiveness;
- systems of internal control to safeguard assets and ensure best value;
- engagement with stakeholders and clear policy on representative roles and responsibilities;
- Governance Statement;
- risk register and business continuity plans;
- support for cash and treasury management;
- training plan; and
- independent and objective scrutiny.

To this end, the Pension Fund is managed within the overall governance arrangements of Shetland Islands Council. The Council has recently refreshed its decision-making arrangements and the governance of the Pension Fund is included within those arrangements. The Shetland Islands Council meeting of 8 March 2017 refreshed the Code of Corporate Governance to ensure compliance with best practice.

Governance Framework

The governance framework consists of the systems, processes, cultures and values by which the Pension Fund is directed and controlled. It describes the way in which staff and representatives inform all the stakeholders and ask for their views on any key issues. It is important to monitor the achievements of the Pension Fund, particularly with regard to the long-term investment strategy. From a service point of view, as with other service areas, there is a need to ensure that the service is delivered efficiently and effectively and in line with all the characteristics of a best value service.

Critical to the success of a well-managed Pension Fund is appropriate internal control arrangements. The systems of internal financial control are intended to ensure that:

- assets are safeguarded;

- transactions are authorised and properly recorded; and
- material errors or irregularities are either prevented or detected within a reasonable timescale.

The system is based on a framework of skilled staff who are aware of their responsibilities, good management information, financial regulations and effective systems and procedures.

Within Shetland Islands Council, there is a need to focus on the controls required to ensure clear separation of duties, due to the small number of staff directly employed to work on the Pension Fund. The Pension Fund relies on the same systems of internal control as those that are in place for Shetland Islands Council (which are internally and externally audited and assessed on an annual basis).

The effective arrangements include:

- an appropriate level of knowledge for Pension Fund Committee and Pension Board members to ensure that they have adequate knowledge to oversee the governance of the Pension Fund business;
- clear objectives, good decision making at committee level, clear delegations to committee and staff, with appropriate, independent scrutiny of decision making and performance;
- a clear set of objectives for the Pension Fund, as described in the Funding Strategy Statement and Investment Principles;
- good performance monitoring arrangements, with committee members being able to directly question those responsible for all aspects of the business on a regular basis;
- a clear statement of risk (risk register), combined with effective risk management arrangements;
- an annual review of compliance against regulation, guidance and best practice arrangements;
- the Monitoring Officer ensuring compliance with regulation and guidance;
- clear monitoring arrangements;
- compliance with LGPS Investment Regulations;
- compliance with the CIPFA / Myners investment principles;

- appropriate custodian arrangements for investments;
- codes of conduct to support good relationships between committee members and staff who support the work of the Pension Fund;
- a demonstrable best value service, including good use of benchmarking data on the cost and quality of service provided; and
- effective internal control arrangements.

The governance framework cannot eliminate all risks of failure to meet policy objectives. An effective framework can, however, provide a reasonable (but not absolute) assurance of effectiveness.

Review of Effectiveness

The Pension Fund has a responsibility for ensuring the continuing effectiveness of its governance framework and systems of internal control.

The Pension Fund approaches this with reference to the Council and its approach. This considers different layers of assurance, namely management assurance both internally through the Council and externally through the group entities; the assurance and recommendations provided by internal audit; external audit and other external scrutiny reports; and self-evaluation compliance.

Management Assurance

As the administration of the Pension Fund is directly within the remit of the Director of Corporate Services, assurance has been sought from her in relation to the effectiveness of internal financial controls. This assurance provides the opportunity to highlight any weaknesses or areas of concern that should be considered. For 2016/17, no areas of weakness or concern were raised.

In relation to the effectiveness of the Council's arrangements to its statutory officers, both the Executive Manager – Finance (Chief Financial Officer) and Executive Manager – Governance & Law (Monitoring Officer) are full members of the Corporate Management Team and are in attendance at the Council, Audit Committee and Policy and Resources Committee to advise as appropriate.

The Council Committee structure supports the organisational and management structure of the

10

Council, incorporating a culture of accountability that has been developed throughout. The Pension Fund Committee oversees the business of the Pension Fund, the Administering Authority being supported by the Pension Board. The Audit Committee remains responsible for ensuring the effectiveness of the internal audit function and also considering all reports prepared by the external auditor.

The Audit Committee's remit ensures that the work of the Council, from both a control and performance perspective, is checked and scrutinised. As well as an annual plan, the Committee can call for one-off reviews to investigate a particular issue. The Council's Executive Manager - Audit, Risk & Performance reports directly to the Audit Committee.

Assurance from Internal Audit

The Council provides internal audit arrangements to the Pension Fund both as a tool of management and with direct reporting to the Council's Audit Committee. The Internal Audit service operates in accordance with the Public Sector Internal Audit Standards (PSIAS). The service works to an approved Annual Plan, based on the approved Audit Strategy, based on the Audit Universe and an annual assessment of the known and potential risks.

During the year there were no specific internal audits carried out for the Pension Fund, and the controls work undertaken across the Council systems by internal audit were found to be generally adequate.

External Audit and Other External Scrutiny

Each year, the external auditors undertake an assessment of the internal controls in operation in the Council, to determine whether they can place reliance on them in the preparation of the final accounts. Recent reports by Audit Scotland identified a limited number of minor recommendations in the area of internal control and these are being addressed by management in order to ensure weaknesses are strengthened.

The Local Government Pension Scheme (LGPS) regulations require LGPS administering authorities to measure their governance

arrangements against the standards set out in the guidance. Where compliance does not meet the published standard, there is a requirement for administering authorities to set out any reasons for non-compliance in their governance compliance statement.

Self-Evaluation of Compliance

The Governance Compliance Statement set out below describes the extent to which the governance arrangements comply with best practice and any actions required to implement improvements.

Principle	Compliance and Comments
Structure	
The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing council.	Yes, the Pension Fund Committee has been delegated responsibility for overseeing the management and administration of the LGPS and managing the investments of the Pension Fund.
That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	Yes, the Pension Board, which meets concurrently with the Pension Fund Committee, includes representatives from employers (Councillors), admitted bodies (a Board Member) and scheme members (Trade Unions).
That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes, the Pension Fund Committee and Pension Board meet concurrently to aid easy and open communication.
That where a secondary committee or panel has been established, at least one seat on the main committee is allocated for a member from the secondary committee or panel.	The Pension Board is not a secondary committee, both the Pension Fund Committee and Pension Board meet concurrently and have access to the same agenda papers. There is no need for a Pension Board member to be on the Committee.
Committee Membership and Representation	
All key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include: i) employing authorities (including non-scheme employers, e.g., admitted bodies); ii) scheme members (including deferred and pensioner scheme members); iii) where appropriate, independent professional observers; and expert advisors (on an ad-hoc basis).	i) Yes - Pension Fund Committee and Pension Board ii) Yes, Pension Board iii) Yes, e.g. engaging with the appointed actuary or investment manager when professional advice is required.
Where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Yes, Pension Board members have the same access to information, papers and training
Selection and role of lay members	
That committee or board members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.	Yes, training provided during 2015/16
That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes, 'Declarations of Interest' is a standing item on all agendas.

Principle	Compliance and Comments
Voting	
The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes, these are contained in the Terms of Reference for both Pension Fund Committee and Pension Board.
Training/Facility time/Expenses	
That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	Yes A Member Development Programme is in place. The Constitution clearly sets out the scope of approved duties. There is supplementary guidance to ensure Members' expenses are reimbursed in line with regulatory requirements.
That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	No The policies for employer representatives and staff representatives are necessarily different and cannot be equally applied.
That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.	Yes A Member Development Programme was implemented. All member development is being monitored and logged centrally. Personal development plans are in place for 18 out of 22 Members.
Meetings (frequency/quorum)	
That an administering authority's main committee or committees meet at least quarterly.	Yes, the Pension Fund Committee and Pension Board meets at least four times per annum and is wholly focused on Pension Fund business.
That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.	Yes, the Pension Board sits concurrently with the Pension Fund Committee.
That an administering authority that does not include lay members in their formal governance arrangements, must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Lay members are included in formal governance arrangements.
Access	
That subject to any rules in the Council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes, committee papers are sent out to all Pension Fund Committee and Pension Board members, and all agenda items and subsequent minutes are available on the Shetland Islands Council Committee Information Pages (COINS).

Principle	Compliance and Comments
Scope	
That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes, full scope of the Pension Fund Committee and Pension Board are found in their Terms of Reference
Publicity	
That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes The Annual Newsletter is available to all Members. The Annual Report and Accounts will be made available on-line.

Significant Governance Issues

The system of governance can provide only reasonable (and not absolute) assurance that assets are safeguarded, transactions are authorised and properly recorded, material errors or irregularities are either prevented or would be detected within a timely period and all the significant risks impacting on the achievement of our objectives have been mitigated.

Following a review of the effectiveness of the code of governance there are no significant governance issues that require to be reported.

Certification

It is our opinion that the governance and internal control environment provides reasonable and objective assurance that any significant risks impacting on the achievement of the principal objectives of the Pension Fund will be identified and actions taken to avoid or mitigate their impact.

.....
Cecil Smith
Leader of the Council
Chair of the Pension Fund Committee
19 June 2017

.....
Mark Boden
Chief Executive
Shetland Islands Council
19 June 2017



Meeting(s):	Pension Fund Committee Pension Board	19 June 2017 19 June 2017
Report Title:	Pension Fund Management Annual Review 2016/17	
Reference Number:	F-059-F	
Author / Job Title:	Executive Manager - Finance	

1.0 Decisions / Action required:

1.1 It is recommended that the Pension Fund Committee and Pension Board:

- note with satisfaction the performance of BlackRock in 2016/17;
- note with disappointment the performance of KBI in 2016/17;
- note with disappointment the performance of Newton in 2016/17;
- note the performance of Schrodgers in 2016/17; and
- note with satisfaction the performance of M&G in 2016/17.

2.0 High Level Summary:

2.1 The purpose of this report is to inform the Pension Committee and Pension Board on the position and performance of the Pension Fund's external investments, with fund managers for the financial year 2016/17.

2.2 The Pension Fund's investments increased in value by £73 million over the 2016/17 financial year and now have an overall value at the end of March 2017 of £450 million. The investment return for the Pension Fund in 2016/17 was 18.8%. See additional information in Appendix 1.

2.3 Over the 2016/17 financial year BlackRock were equal to their benchmark aim, KBI Global Investors and Newton underperformed their benchmarks and Schrodgers and M&G outperformed their benchmarks.

3.0 Corporate Priorities and Joint Working:

3.1 This report links to the Council's corporate priorities, defined in its Corporate Plan, specifically in relation to assisting the Council in ensuring the financial resources are managed.

4.0 Key Issues:

4.1 This report is an annual review of how the markets and fund managers have

<p>performed. All of the Pension Fund's investments are invested for the long term in line with the 2014 Pension Fund investment strategy, which aims at reaching a fully funded position by 2027 when pension contributions are expected to equal pension benefits payable.</p>	
5.0 Exempt and/or confidential information:	
5.1 None	
6.0 Implications :	
6.1 Service Users, Patients and Communities:	None
6.2 Human Resources and Organisational Development:	None
6.3 Equality, Diversity and Human Rights:	<p>None</p> <p>An Equalities Impact Assessment is not required.</p>
6.4 Legal:	<p>As required by The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, where investment Managers have been appointed their performance must be kept under review.</p>
6.5 Finance:	<p>The long term investments and their performance are important to the Pension Fund and the achievements of its outcomes and objectives.</p> <p>It is recognised that the actual investment performance each year will be different to what is expected or required however over the long term this will be monitored and reviewed to ensure that the Pension Fund is working towards meeting its long term objectives.</p> <p>It is not likely that the Pension Fund can expect a positive investment return from its investments every year but having diversification in the investment mandates, as well as robust governance and monitoring in place, mitigates the financial risks and enables the Pension Fund to take action at appropriate times to address poor performance by the fund managers. This report is part of that governance and monitoring framework.</p>
6.6 Assets and Property:	<p>Long term investments are assets of the Pension Fund and represent money given to fund managers to manage on its behalf for long term benefit. The Pension Fund relies upon each fund manager's fiduciary duty and to buy and sell appropriate assets in accordance with the mandate awarded to them and to</p>

	report regularly on the value and performance of the fund in which Pension Fund money is invested. The value of long term investments under these mandates can go down as well as up.
6.7 ICT and new technologies:	None
6.8 Environmental:	<p>Whilst the fund managers have delegated powers for the acquisition and realisation of investments, fund managers are expected as part of their investment process to consider all factors, including the social, environmental and ethical policies of companies in which they may invest, to the extent that these may materially affect the long term prospects of such companies. The fund managers will also be expected to enter into dialogue with companies in which they invest, in relation to the pursuance of socially responsible business practices, and report on these activities.</p> <p>Corporate Governance is a key responsibility for institutional shareholders and as a matter of principle the Pension Fund will seek to exercise all of its voting rights in respect of its shareholdings. It is recognised however that in practical terms this may not always be possible for overseas holdings. However for UK stocks all voting rights will be exercised in a positive fashion, i.e. no abstentions.</p> <p>The fund managers, who will act in accordance with this policy, will exercise voting.</p> <p>All of the Pension Fund Managers have signed up to the United Nations Principles on Responsible Investment. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, and therefore must be given appropriate consideration by investors, if they are to fulfil their fiduciary (or equivalent) duty. The Principles provide a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices, and so better align their objectives with those of society at large.</p> <p>A Strategic Environmental Impact Assessment is not required.</p>
6.9 Risk Management:	<p>All investments carry risk. Risks, such as market risk are mitigated and actively managed through diversification of fund managers, asset classes, markets, size of holdings and through performance monitoring against benchmarks. The risk framework used was proposed by the Pension Fund's investment consultants and approved by the Council on 26th March 2014 (min ref 17/14).</p> <p>The risk framework is reviewed by the Pension Fund's investment consultants every three years after the actuarial valuation results are known.</p>

6.10 Policy and Delegated Authority:	<p>The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administrating authority for the Shetland Islands Council Pension Fund (the Pension Fund) in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013.</p> <p>The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pensions Regulator. The Pension Board will determine the areas they wish to consider.</p>	
6.11 Previously considered by:	None	

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Appendices:

Appendix 1 - Pension Fund Management Annual Investment Review 2016/17

Background Documents:

None

Pension Fund Management Annual Investment Review 2016/17

1.0 Background

- 1.1 This report forms part of the Pension Fund's governance arrangements where the Pension Committee and Pension Board will receive an annual investment report for 2016/17 on the external investments.
- 1.2 This report also fulfils a requirement under The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 for the Council, as administering authority for the Pension Fund, to keep investment Managers' performance under review.
- 1.3 This report concentrates on the financial year 2016/17. The report looks at the performance of the Pensions fund managers, the overall investment performance relative to the markets, the physical movement of funds, any changes from the investment strategy, and any other relevant issues relating to the investments over the period.
- 1.4 From this report there are recommendations to note Fund Manager performance during 2016/17. To note performance as either satisfactory where a Manager's performance is above benchmark and target, or to just note performance where the Manager's performance is above benchmark but below target, or to note performance as unsatisfactory where the Manager's performance is below benchmark.
- 1.5 The current investment strategy was approved by the Council on 26 March 2014 (Min. Ref. 17/14). The strategy's focus is on achieving a 100% funding level over a period of time, which is before the Pension Fund's contributions equal benefits payable.
- 1.6 The reorganisation of the Pension Fund's investments occurred in November and December 2014 with performance monitoring of the new strategy commencing on the 1st January 2015. The new investment strategy resulted in three new mandates being awarded, a new Equity mandate to Kleinwort Benson (now KBI Global Investors), a new Alternative Credit mandate to M&G and a new Diversified Growth Fund mandate to Newton.
- 1.7 Every three years the Pension Fund's actuaries conduct an actuarial review of the Pension Fund and this is an actuarial year. The actuaries are currently undertaking their review, and once the results of this review are known KPMG, the Pension Fund's investment consultants, will be asked to conduct an interim investment strategy review in light of the actuaries report.

2.0 Investment Position and Market Performance

- 2.1 The Pension Fund has five Fund Managers, with total investments under management at the end of March 2017 of £450 million. Their specific mandates and current percentage allocations are as follows:

Manager	Fund	% of Assets
BlackRock	Equity	42
KBI Global Investors	Equity	22
Newton	Diversified Growth	17
Schroders	Property	11
M&G	Alternative Credit	8

- 2.2 The initial investment allocations were set when the investment strategy was put in place at the end of December 2014. The percentage allocations at 2.1 are a reflection of the market movements, investment management by fund managers and cash additions since December 2014. These movements have altered the initial investment percentages. No movement of funds between Fund Managers occurred during 2016/17 and none are planned in 2017/18, as there will be an interim investment strategy review conducted after the actuarial results are known later in 2017/18.
- 2.3 The external investments of the Pension Fund are co-ordinated by the Council's Treasury function. The Council's reserves and Charitable Trust's reserves (as per a Service Level Agreement) are also co-ordinated by the Council's Treasury function. This approach provides the opportunity to share experience and benefit from knowledge in a specialist subject area built up over a number of years.
- 2.4 On an annual basis each Fund Manager makes available their internal controls report. These reports are produced by their respective external auditors, and review all aspects of the Fund Manager's operating controls, with any concerns and weaknesses reported. The reports are reviewed by the Treasury Section within the Finance Service annually, with any concerns or issues identified that may impact on the Pension Fund reported accordingly. No issues were found that required to be reported.
- 2.5 The Council's Pension Fund is in a growth phase where income from Employer and Employee contributions are projected to exceed benefits paid to pensioners, and is expected to continue for the next 10 years. Consequently, a long-term investment strategy is appropriate. This allows us to have a higher percentage of equity investments, which in itself produces a greater volatility of returns over the short to medium term, i.e. 1-3 years, but is less

evident over longer periods. Over the long term this investment policy has proved beneficial with the Pension Fund up 60% over the last 5 years.

2.6 The Managers, type of mandate and market value are listed below:

Manager	Market Value £ million	
	2017	2016
BlackRock	189	147
KBI Global Investors	97	74
Newton	75	73
Schroders	51	49
M&G	38	34
Total	450	377

2.7 This report at section 3 presents a review and comparison of the performance of each Fund Manager in turn and a comparison of their performance in 2016/17 against the relevant market's performance where they were asked to invest, and if appropriate, also against any additional out performance target they were asked to achieve.

2.8 Due to the nature of the investments the fund managers are investing into, a long term investment view is appropriate, generally a five year period. The report therefore looks not only at each manager's performance over 2016/17 but also at their performance over a five year period, or from inception of the mandate if that is shorter.

2.9 This report concentrates on the fund manager's performance relative to the markets but there is a need to consider the effect of any cash withdrawals or injections to the funds and the performance of the markets themselves. These influences can easily alter the absolute fund value.

2.10 The following table shows the effect on the fund due to withdrawals/additions, the investment return over the financial year to March 2017 and as a comparison the previous financial year.

	Pension Fund £ million	
	2016/17	2015/16
Opening Value	377	367
Additions/(Withdrawals)	2	5
Investment Return	71	5
Closing Value	450	377

2.11 During 2016/17 the overall value of the Pension Fund's investments increased by £73 million.

- 2.12 The figures show an overall investment return of £71 million for the financial year 2016/17. This equates to an investment return of 18.8%. The main contribution to the investment return was the equity investments, as all of the major equity markets produced positive returns.
- 2.13 The £2 million of additions is in main due to the difference between the employer and employee contributions (Council and admitted bodies) versus the pension payments during the year.
- 2.14 The 2016/17 market performance by asset class is set out below:

		%
Equities:	UK	22.0
	North America	34.0
	Europe (Ex UK)	27.2
	Japan	31.6
	Pacific	36.1
	Emerging	34.7
Bonds:	UK Index Linked Gilts	22.0
	UK Corporate	9.2
Property		3.7
Cash		0.2

- 2.15 The best performing sector in 2016/17 was equities with impressive returns ranging from the UK at 22.0% to the Pacific region achieving a return of 36.1%. This is in contrast to 2015/16 where all of the equity markets had negative returns apart from North America. The bond sectors in 2016/17 were also positive with UK Index Linked Gilts achieving 22.0% and corporate bonds at 9.2%. Property was the best performing asset class in 2015/16 but had a quieter year in 2016/17 with a 3.7% return. Cash returns are still low as UK interest rates remain low.
- 2.16 The main constituent of a fund's performance is the market return, i.e. where the fund is invested. A number of Fund Managers are asked to outperform the market return, a UK equity scenario in 2016/17 where a Fund Manager is asked to outperform the UK market by 2% would equate to a 24.0% target return.
- 2.17 In some instances Fund Managers are investing in many different markets and in this situation no market benchmark is appropriate, so a cash plus benchmark is used. This is the situation for Newton and M&G where they have fixed benchmarks that are not related to investment markets, e.g. Newton's benchmark is 1 month LIBOR + 4%.
- 2.18 While this report reviews performance in 2016/17; a brief update for the start of the 2017/18 financial year sees equity markets continue to rise and OPEC looking to curb oil production to allow the oil price to strengthen. Current issues that will most likely affect certain markets this year are the Brexit

negotiations between the UK and Europe, uncertainty over the future direction and actions of the US President and possible future interest rate movements in the UK, Europe and North America.

3.0 Fund Manager Review

- 3.1 This section of the report takes each mandate in turn and discusses manager performance.
- 3.2 A Fund Manager's performance is measured against a specific fund benchmark, which is made up of market indices of the countries where they invest.
- 3.3 Some Fund Managers are passive managers (in general they match their investment profile to the indices (benchmark) they are compared to, with the objective being to achieve investment returns that are the same as the index, and is a common equity mandate); while other Fund Managers are active managers (they make choices and investment decisions that move their investment profile away from a particular index and look to exceed the index by taking account of various investment decision making factors, for example future dividend or growth prospects. Active management will often involve research activities and involve a higher level of risk – it incorporates Manager risk).
- 3.4 Where the Pension Fund decides, a Fund Manager's target is a level of outperformance above the benchmark that is seen as achievable with a low level of measured risk on a given mandate. The Manager will seek to produce investment returns in order to achieve the stated target. Performance at or above target is desirable but any returns above the benchmark will add value to the fund above the market return that was achieved for the period.

BlackRock

- 3.5 BlackRock was initially a large US fund management business but over the past few years they have acquired Merrill Lynch and BGI, to become one of the largest global Fund Managers.
- 3.6 BlackRock's mandate was reorganised in line with the Pension Fund strategy review in December 2014. Before this reorganisation BlackRock held funds on a temporary basis but they were awarded a passive equity mandate as part of the new Pension Fund strategy.
- 3.7 BlackRock's benchmark until December 2014 was 45% UK equities, 45% overseas equities and 10% bonds. After the Pension Fund reorganisation BlackRock's fund now has a benchmark of 50% UK equities and 50% global ex UK equities.
- 3.8 The fund is passively invested, removing the Manager risk, therefore the benchmark and the target are the same, i.e. one aim the index return. For

performance comparison purposes the fund return is only compared against the index return.

- 3.9 The following table sets out in summary the performance of BlackRock versus the benchmark return for 2016/17 and also on a cumulative basis over a five-year investment period.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Annualised Fund Return (%)
2016/17	28.3	0.0	28.3
Five years 12/13 to 16/17	72.9	0.3	11.6
The performance v benchmark figure gives the percentage that the fund has out or underperformed the benchmark.			

- 3.10 The equity fund with BlackRock returned 28.3% in 2016/17 which equalled the benchmark return.
- 3.11 Both investment sectors of the mandate performed well, 50% of the mandate is invested in global equities and this returned 33.6%, and the remaining 50% is invested in UK equities which returned 22.0%. This is a passive investment that tracks the market return, and with rising equity markets over the past financial year the fund has benefitted with an overall investment return of 28.3%.
- 3.12 On a cumulative basis over the five year rolling monitoring period the fund is 0.3% above the benchmark return, which is very close to the fund's investment aim of replicating the performance of the markets. During this five year period the fund has increased in value by 72.9%, which equates to a return of 11.6% per annum.

KBI Global Investors

- 3.13 Kleinwort Benson (now KBI Global Investors) was awarded a £68 million global equity mandate in November 2014 as part of the Pension Fund's investment strategy review. They received the funds in December 2014 with performance monitoring commencing January 2015.
- 3.14 KBI Global Investors was originally formed in 1980. Their headquarters is in Dublin, Ireland. They were founded in 1980 and were part of the Kleinwort Benson Group. During 2016 the Kleinwort Benson Group sold their Dublin investment company to Amundi, a large European Fund Manager. Amundi have left KBI Global Investors alone to continue to operate their business.

- 3.15 KBI invests via a set systematic investment process, which uses a strategy that financially robust, higher dividend paying stocks will outperform over the long term. It is an actively managed equity mandate.
- 3.16 The performance target for this fund is to beat its benchmark by 2.0% per annum.
- 3.17 The following table sets out in summary the performance of KBI versus the benchmark and the performance target in 2016/17 and on a cumulative basis since inception of the mandate in January 2015.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Performance v Target (%)	Annualised Fund Return (%)
2016/17	31.3	-0.7	-2.7	31.3
From inception Jan 15 – Mar 17	39.1	-1.7	-8.0	15.8
<p>The performance v benchmark figure gives the percentage that the fund has out or underperformed the benchmark return (market indices).</p> <p>The performance v target figure gives the percentage that the fund has out or underperformed the set target.</p>				

- 3.18 KBI returned a positive 31.3% in 2016/17 which was 0.7% below the benchmark and 2.7% below the target. This is a pure equity fund and Kleinwort Benson has underperformed during a year of rising equity markets.
- 3.19 On a cumulative basis since inception in January 2015 KBI are 1.7% below the benchmark and 8.0% below the target. However, since inception the fund has increased in value by 39.1%.
- 3.20 KBI is under benchmark over the two and a quarter years after a poor initial first quarter investment return to March 2015 but they have since made steady progress although in 2016/17 they underperformed. Equity investments are long term by their nature, with performance evaluation being more relevant over a five year or more investment period.

Newton

- 3.21 Newton was awarded a £68 million global equity mandate in November 2014 as part of the Pension Fund's investment strategy review. They received the funds in December 2014 with performance monitoring commencing January 2015.

- 3.22 Newton is a wholly owned but autonomous subsidiary of Bank of New York Mellon. Bank of New York Mellon has various investment businesses throughout the world but generally leave the companies alone to continue with their specialist services.
- 3.23 The Pension Fund mandate with Newton is a diversified growth fund mandate and is invested in Newton's Real Return Fund, which is an unconstrained multi asset strategy seeking to return 1 month LIBOR (cash) +4% per annum. The agreed benchmark is a cash plus benchmark, which aims at a constant positive return every year. As it is a fixed constant positive benchmark, the benchmark and target are the same so performance is only compared to the benchmark.
- 3.24 The Real Return Fund uses a wide range of different investments which they categorise into return seeking assets (infrastructure, equities, debt), stabilising assets (commodities, index-linked bonds, government debt) and hedging positions to provide downside protection (currency, equity and bond options).
- 3.25 The following table sets out in summary the performance of Newton versus the fixed benchmark in 2016/17 and on a cumulative basis since inception of the mandate in January 2015.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Annualised Fund Return (%)
2016/17	2.9	-1.5	2.9
From inception Jan 15 – Mar 17	6.9	-3.1	3.0
The performance v benchmark figure gives the percentage that the fund has out or underperformed the fixed benchmark return.			

- 3.26 Newton returned 2.9% in 2016/17, which was 1.5% below the benchmark. Newton outperformed over the first six months of 2016/17 but a poor return in the quarter to December 2016 created an underperformance, which they could not make up over the remaining quarter to March 2017. The main contributors to the underperformance were equity investments, gold and Government bonds.
- 3.27 On a cumulative basis since inception in January 2015 Newton are 3.1% below the benchmark. Newton has over the first two and a quarter years of this mandate taken a cautious outlook on the global economic situation. Their strategy has remained patient and they believe that "a determined focus on longer term trends, rather than short term noise is in the best interests of their clients", and that "current prices of many risk assets simply do not provide much reward for the elevated levels of risk that investors currently face".

Schroders

- 3.28 Schroders were awarded a £20 million Property Mandate in March 2007 with the first investments commencing in July 2007. It was agreed that Schroders would be allowed time to invest, to give added protection to the capital value of the investment. Schroders therefore only invested when opportunities arose, to the extent that they achieved full investment of the fund during the later part of 2010/11.
- 3.29 The benchmark for this fund is based on a 100% UK property investment. The Fund Manager does however have the scope to invest up to a maximum of 30% of the fund in overseas property if attractive investment opportunities exist. The performance target for this fund is to beat a specific benchmark by 1.0% per annum.
- 3.30 Schroders have used the flexibility in the mandate to invest in their European property fund. This investment initially outperformed, but then went through a number of years where it was a drag on performance due to the general European economic climate. This investment is now currently less than 3% of the overall mandate.
- 3.31 As part of the Pension Fund strategy review in 2014 Schroders mandate was increased from 10% to 12% of the Pension Fund's assets. Schroders invested the additional funds in UK property when good opportunities arose and achieved full investment in 2016/17. Investing in property is costly and this has impacted on their performance figures over the past couple of years.
- 3.32 The following table sets out in summary the performance of Schroders versus the benchmark and the performance target in 2016/17, on a cumulative basis over a five-year investment period and since inception of the mandate in July 2007. As property is an expensive asset class to invest into and to allow these costs to be spread over many years, performance since inception is shown.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Performance v Target (%)	Annualised Fund Return (%)
2016/17	3.9	0.2	-0.8	3.9
Five years 12/13 to 16/17	45.2	-3.3	-8.0	7.8
From inception July 2007	41.9	16.5	5.7	3.7
<p>The performance v benchmark figure gives the percentage that the fund has out or underperformed the benchmark return (market indices).</p> <p>The performance v target figure gives the percentage that the fund has out or underperformed the set target.</p>				

- 3.33 The Property Fund with Schroders in 2016/17 increased in value by 3.9%, which was 0.2% above the benchmark return but 0.8% below the target. The UK part of the mandate outperformed the benchmark by 0.5% but it was again the European investment which underperformed against a UK benchmark and pulled down the performance.
- 3.34 On a cumulative basis over the five year rolling monitoring period Schroders are below the benchmark return by 3.3%. Over this period the UK property investments have outperformed the benchmark and it is the European investment, due to the economic climate, that has pulled down the five year return figure.
- 3.35 The fund's cumulative performance from inception (July 2007) is above the benchmark by 16.5%. This performance was due to initial cash holdings plus European property investment returns over the first couple of years and long term UK property outperformance.

M&G

- 3.36 M&G was awarded a £34 million global equity mandate in November 2014 as part of the Pension Fund's investment strategy review. They received the funds in November 2014 with performance monitoring commencing January 2015.
- 3.37 M&G investment management is a wholly owned subsidiary of the listed financial services group, Prudential.
- 3.38 The Pension Fund mandate with M&G is an alternative credit mandate invested in M&G's Alpha Opportunities Fund. This fund is an actively managed multi-asset fund that will move in and out of different credit markets to generate returns. The fund can invest in investment grade bonds, loans, high yield bonds and asset backed securities.
- 3.39 The fund's performance benchmark is 1 month LIBOR (cash) plus 3-5%. The agreed benchmark is a cash plus benchmark, which aims at a constant positive return every year, which is independent of the investment classes that the fund invests into. As it is a fixed constant positive benchmark, the benchmark and target is the same so performance is only compared to the benchmark.
- 3.40 The following table sets out in summary the performance of M&G versus the benchmark in 2016/17 and on a cumulative basis since inception of the mandate in January 2015.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Annualised Fund Return (%)
2016/17	7.0	3.7	7.0
From inception Jan 15 – Mar 17	7.6	-0.5	3.3
The performance v benchmark figure gives the percentage that the fund has out or underperformed the fixed benchmark return.			

- 3.41 M&G returned 7.0% in 2016/17, which was 3.7% above the benchmark. M&G had a good outperformance in the quarter to September 2016 of 2.5%, which was the main contributor to their 2016/17 performance, with the main returns coming from industrial holdings, alongside securitised and financial bond holdings.
- 3.42 On a cumulative basis since inception in January 2015 M&G are 0.5% below the benchmark. The fund has since inception increased in value by 7.6%. This mandate has been in place for two and a quarter years, and after a poor initial start over the first year and a half Newton have outperformed in each of the last three quarters and are close to the long term benchmark return.

4.0 Investment Governance

- 4.1 The Pension Committee and Pension Board receive quarterly investment performance reports covering all of the Pension Fund's investment managers. This reporting framework incorporates the statutory Annual Review and Mid Year review.
- 4.2 The Pension Committee and Pension Board on reviewing the quarterly report can if they believe it would be beneficial request a presentation from a fund manager, to find out more about a specific mandate or question that manager about their performance. During 2016/17 fund managers KBI, M&G and Schroders along with Hymans Robertson the scheme's actuary gave presentations to the Pension Committee and Pension Board.
- 4.3 State Street GS Performance Services ceased their performance measurement service during 2016/17. The Pension Fund has used State Street (previously WM Company) to provide independent performance measurement on its external investments for as long as the Council has been investing.
- 4.4 The final performance figures received from State Street was for the quarter to end June 2016. Performance figures from July 2016 are taken from the Fund Managers. Options are being considered to ensure that a new independent performance measurement service is put in place for future reporting.

5.0 Conclusions

- 5.1 BlackRock achieved their aim of equalling the equity benchmark return during 2016/17. Over the five year period BlackRock are very close to the equity benchmark return.
- 5.2 KBI underperformed the equity benchmark and target during 2016/17. Over the two and a quarter years of their mandate KBI are under the equity benchmark.
- 5.3 Newton underperformed the fixed benchmark during 2016/17. Over the two and a quarter years of their mandate Newton are under the fixed benchmark.
- 5.4 Schroders outperformed the UK property benchmark during 2016/17 but did not achieve the target. Over the five year period Schroders are under the property benchmark.
- 5.5 M&G outperformed the fixed benchmark during 2016/17. Over the two and a quarter years of their mandate M&G are under the fixed benchmark.
- 5.6 All of the main investment markets produced positive returns during 2016/17 but it was the equity markets that produced the highest returns. This along with the fund managers' management of the funds helped to contribute £71 million in value to the Pension Fund during 2016/17. The Pension Fund ended the financial year with a valuation of £450 million.