lgps
look forward with confidence
Falkirk Council
2016
Pensions Newsletter

BREXIT IMPLICATIONS FOR THE LGPS

As the dust settles on the aftermath of the UK's BREXIT vote and the repercussions are pondered by newsrooms, politicians, economists and the like, members may be wondering what impact BREXIT is going to have on the Local Government Pension Scheme (LGPS).

First and foremost, local authority pension funds exist in order to meet the costs of benefits arising under the Scheme.

Monies not immediately needed to pay for benefits are invested to generate returns and reduce the cost burden falling on employers and tax payers.

If investment returns are less than expected then inevitably this places an upward pressure on employer contributions and could reopen questions about member benefits.

Facing the Future

Short term, the BREXIT vote means that volatility is going to stalk financial markets, at least until the terms of the UK's exit are clarified and new trading deals concluded. The volatility could trigger a climate of lower economic growth and put investment returns under pressure.

For the present (and for the immediate future), the contributions being paid into the Falkirk Fund are greater than the benefits being paid out. This allows the Fund to take a long term view when setting its investment strategy and should allow it to ride out financial challenges such as those posed by Brexit.

An important feature of the Fund's investment strategy is diversification where investments are made in a range of asset classes (i.e. different industries, geographies and financial instruments). This helps the Fund reduce some of the risks that can arise from events such as Brexit.

"Maths of the Day"

- £2 billion – the size of the Falkirk Fund
- 15,000 – the number of current scheme members
- 600 – the "orphaned" deferred members who have failed to keep us updated with addresses
- £1,000,000 – the lifetime allowance for 2016/17
- £40,000 – the annual allowance for 2016/17

UK Equities

One area likely to be affected by Brexit is that of UK equities. Around 20% of the Fund's assets are invested in these stocks. These may come under pressure if investors seek safer havens say in Bonds or in non-UK stocks. To compensate, the UK Government might look to modify its economic policy (e.g. by cutting interest rates, corporation tax, etc.) to reignite economic growth.

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Exchange Rates

An immediate consequence of the Brexit vote was a fall in Sterling against major global currencies. Paradoxically, this has improved the value of the Fund, as its overseas investments have appreciated in value on being converted into Sterling. This should also help UK companies with exports.

Falling Bond Yields

Potentially, this is the area of greatest risk for the Fund.

Fund liabilities (i.e. the value of all benefits to be paid out by the Fund) are assessed by reference to the return on UK Government Bonds. The lower the return on bonds, then the higher the value placed on liabilities.

There is a risk that, post-Brexit, the current environment of low bond yields will continue, or move lower, pushing fund liabilities up even higher. This could exacerbate the gap between the Fund's assets and liabilities which at the last valuation in 2014 was £283m.

Conclusion

The post-Brexit world of rising liabilities and challenging asset returns is clearly a daunting prospect for the Fund. However, as a long term investor, with strong cash flows, and a diversified portfolio of assets, the Fund is well placed to ride out current uncertainties and even look for good buying opportunities amidst the volatility.

The Falkirk Fund will continue to have full and frank discussions with its Actuary and Investment Adviser to ensure that the Fund's funding and investment plans are appropriate, realistic and robust.

FOCUSING ON BENEFITS

In recent years, changes to the LGPS have made the scheme rules incredibly complicated. Here are some of the most commonly asked questions (and answers) about scheme benefits.

Q	**Can you explain the difference between Final Salary and Career Average benefits**
A	Membership rights up to 31/3/2015 are final salary rights, Membership rights from 1/4/2015 are career average rights. Final salary rights are based on the member's salary in payment on leaving the scheme (usually average salary over their final year of service). If you are part time or term time, your final salary will be calculated as if you were full time (and your membership proportionately reduced). Career average rights are based on the amount of salary earned each year. The amount of pension earned each year (currently 1/49th of earnings) is then revalued annually on 1st April in line with the Consumer Price Index.
Q	**What does the phrase Normal Pension Age mean?**
A	Normal Pension Age is the age set out in the Scheme rules when you can retire voluntarily and get immediate access to your scheme benefits without incurring a penalty.
Q	**When is Normal Pension Age?**
A	Normal Pension Age is equal to your own personal State Pension Age subject to a minimum of age 65. This means that, at present, it will be on, or between, age 65 and age 68.
Q	**Can I retire before Normal Pension Age?**
A	Yes, you can retire at any point from age 60 onwards, but a penalty reduction will be made to your benefits (unless you were born before 1/4/1960, joined the scheme before 1/12/2006 and your age and service add up to at least 85).
Q	**Can I retire after Normal Pension Age?**
A	Yes. You can keep contributing to the Scheme until age 75! Your benefits attract a "bonus" to reflect the fact that your benefits are being paid out after Normal Pension Age.
Q	**What do retirement benefits consist of?**
A	Generally, an Annual Pension and a Tax Free Lump Sum. If you have membership before 1/4/2009, the benefits will be in the form of a pension and lump sum. Any membership you have on or after 1/4/2009 provides a pension only, but you can still give up some of it to get a lump sum.
Q	**Can you tell me a bit more about my lump sum entitlement?**
A	When you retire, the Pensions Section will tell you the maximum amount of tax free lump sum you can receive. To get the maximum, you will probably have to give up part of your pension (especially if all your rights fall after 31/3/2009). Under current scheme rules, you get £12 of tax free lump sum for every £1 of pension you give up. So, if you surrender £1,000 of annual pension, you would generate an extra lump sum of £12,000.
Q	**What are the penalties if I want to retire at age 60?**
A	You lose about 5% of your pension and 2-3% of your lump sum for each year early that you take your benefits. (n.b. different "slices" of membership may have different normal pension ages. For example, one part may have a normal pension age of 65, whereas another part may have a normal pension age of 66 or 67 or 68).
Q	**Are there other ways to retire?**
A	Yes. Ill Health, Redundancy and Efficiency retirements. You can be retired on permanent Ill Health grounds irrespective of your age. You can be retired on Redundancy or Efficiency grounds if you are at least age 55 (age 50 if you were already a scheme member on 5th April, 2006). All of these retirements require employer consent.
Q	**I've heard about flexible retirement. What is this?**
A	This is a special type of retirement that allows you to get your benefits and carry on working. Flexible retirement is only available if you are age 55 or over; reduce your hours or grade; and have your employer's consent to the retirement.
Q	**Where can I get more information about Scheme benefits?**
A	More information about retirement benefits can be found on the Fund's website at www.falkirkpensionfund.org in the Guides Section in About Us-Forms and Publications.

CORPORATE GOVERNANCE MAKING A DIFFERENCE

We know that lots of our scheme members care deeply about environmental, social and governance issues.

As a shareholder with voting rights in many global companies, the Falkirk Fund is conscious of its responsibilities to encourage good corporate practice. These are set out in the Fund's Statement of Investment Principles, which, itself, is being reviewed and updated later this year.

To help implement its policies, the Fund is one of 71 local authority pension funds that are part of the Local Authority Pension Funds Forum (LAPFF).

LAPFF is an umbrella group which seeks to promote the highest standards of corporate behaviour amongst the companies in which Funds invest.

Working for Funds which have a combined asset value of £175 billion, allows LAPFF to engage with the Chairs and CEOs of many leading global organisations. Issues challenged by LAPFF recently include phone hacking, tax transparency, gender balance on Boards, child labour and climate change.

LAPFF's approach is generally to engage with companies to try and get them to change their behaviour rather than recommend outright disinvestment. This is on the basis that once you disinvest you cease to have any influence and leave the field open to less scrupulous investors.

The Paris summit on climate change has given added impetus to LAPFF's goal of forcing carbon emitting industries to be more transparent on how their businesses will be impacted by greater regulatory controls on carbon emissions.

The Falkirk Fund was one of 18 UK LGPS Funds which co-sponsored a successful resolution at the AGM of Anglo American seeking greater openness and transparency regarding how they intend to meet the challenges of climate change in relation to their business operations.

During 2015/16, the Fund (through its proxy voting agents). voted on over 1,350 resolutions.

Oppose votes were consistently lodged against excessive executive pay and remuneration policies not sufficiently linked to company performance.

INFRASTRUCTURE INVESTMENT IN THE UK

Infrastructure describes the "hard" assets, such as those found in the energy, transport and telecoms sectors, that an economy needs to thrive and prosper. Investment in infrastructure has been gaining in popularity for pension funds due to its capacity to deliver long term inflation linked cash flows often within a regulated environment.

As well as having an allocation to global infrastructure, the Falkirk Fund's Pensions Committee has been keen to ensure that an allocation is directed to UK infrastructure. To this end, the Fund has been working closely with the in house investment team of the Lothian Pension Fund to identify and evaluate potential investment opportunities. Commitments have so far been made to the following projects:

- Wind Farm in West Lothian, near Edinburgh
- Hydro Electric Assets in Scottish Highlands
- Solar Generation Assets in England
- Thames Tideway Tunnel (London Sewerage Scheme)
- Gas Supply/Distribution in Isle of Man/Channel Islands

In addition, the Fund has also made a £30m allocation to social and affordable housing with developments underway in Falkirk, Stirling and Clackmannanshire Council areas.

Construction underway at the Harburnhead Wind Farm project in the Pentlands.

FUND SUMMARY- 2015/16

2015/16 has been a challenging year for the Fund's investments. A return of 1.5% was achieved, which, although ahead of the Fund's benchmark of 0.3%, was behind the long term strategic target of 6% p.a. One year, is however, a very short period in which to assess performance and the 3 and 5 year returns of 7.2% pa and 8.2% pa remain strong.

Fund assets at 31st March, 2016 were slightly in excess of £1.8 billion — a modest increase of £38m over the year. Fund liabilities also increased and were estimated to have risen to £2.4bn at year end - mainly as a result of the continuing trend of falling gilt yields – resulting in a funding level of 77%.

Fund strategy is to invest prudently, in a diversified manner and with the aim of eliminating the current deficit over a period of 20 years. As market opportunities permit, the fund will seek to de-risk it's investment portfolio by reducing exposure to more volatile assets classes, such as equities, and increasing the allocation to defensive assets, such as bonds and infrastructure.

The funding and investment strategies and the 2015/16 Unaudited Annual Report and Accounts can all be viewed at www.falkirkpensionfund.org by following the links About Us - Forms and Publications.

How the Fund was invested at 31/3/2016

Fund Manager	Mandate	£million
Aberdeen Asset Mgt	Global Equities	223
Legal & General	Passive Equities	371
Newton	Global Equities	300
Schroder	UK Equities	229
Baillie Gifford	Global Bonds	156
Baillie Gifford	Diversified Growth	204
Ancala Partners	UK Infrastructure	10
Dalmore / FIM Capital	UK Infrastructure	6
Grosvenor Capital	Global Infrastructure	45
Hearthstone	UK Soc. / Aff. Housing	23
Schroder	UK & European Property	141
M&G	UK Private Debt	10
SL Capital	UK / Euro. Private Equity	36
Wilshire	Global Private Equity	31
Other Net Assets	Misc (inc. cash)	52
Value at 31st March, 2016		**£1,837**

How the Fund changed in 2015/16

	£million
Value at 31st March 2015	**£1,799**
Plus: Money in	
Employer Contributions	62
Member Contributions	18
Transfers in	2
Less: Money out	
Pension Payments	(47)
Retirement Lump Sums	(16)
Refunds and Transfers out	(2)
Plus: Returns on investments	
Investment Income	28
Change in Investment Value	6
Less: Management Expenses	**(13)**
Value as 31st March 2016	**£1,837**

The full Annual Report and Accounts can be viewed at www.falkirkpensionfund.org

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The chart opposite shows how the Fund's actively managed equities (both Global and UK) are invested diversely across various commercial sectors.

At 31/3/2016, actively managed equities accounted for around 40% of the Fund's total investments. Active plus passively managed equities account for around 60% of Fund Investments.

Equities - sector breakdown