



Executive Manager: Jan-Robert Riise
Director of Corporate Services: Christine Ferguson

Governance & Law
Corporate Services Department
8 North Ness Business Park
Lerwick
Shetland, ZE1 0LZ

Telephone: 01595 744550
committee.services@shetland.gov.uk
www.shetland.gov.uk

If calling please ask for
Louise Adamson
Direct Dial: 01595 744555
Email: louise.adamson@shetland.gov.uk

Date: 8 July 2020

Dear Sir/Madam

You are invited to the following meeting:

Pension Fund Committee / Pension Board
Wednesday 15 July 2020 at 11.30am

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

Please note that because of the current COVID-19 (Coronavirus) emergency, and as permitted by legislation, this meeting will not be open to members of the public.

This meeting will take place by remote means, by video and teleconference, for Councillors, Employer's and Trade Union Representatives and advising officers only. Joining details will be sent separately to those attending.

Public reports are available on the Council's website. The actions and decisions taken at the meeting will be published on the Council's website as soon as possible thereafter.

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

Yours faithfully

Executive Manager – Governance and Law

Chair: Steven Coutts

AGENDA

- (a) Hold circular calling 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 12 March 2020 (enclosed)

ITEMS

- 1. Management Accounts for Pension Fund Committee: 2019/20 – Draft Outturn
F-024
- 2. Pension Fund Unaudited Accounts 2019/20
F-025
- 3. Pension Fund Management Annual Investment Review 2019/20
F-034
- 4. Pension Fund – Risk Register (*report to follow*)

Pension Fund Committee
A Cooper S Coutts S Leask E Macdonald R McGregor I Scott G Smith T Smith R Thomson

Pension Board	
<u>Employers Representatives:</u> M Bell, SIC S Flaws, SIC J Fraser, SIC J Johnston, SRT <u>Joint Secretary</u> J Riise, Executive Manager – Governance and Law	<u>Trade Union Representatives:</u> I Arthur, Nautilus D Marsh, Unison A Taylor, Unison A Thompson, Nautilus <u>Substitutes:</u> C Wiseman, Unison <u>Joint Secretary</u> C Wiseman, Unison



MINUTES

A&B - Public

<p>Pension Fund Committee Council Chamber, Town Hall, Lerwick Thursday 12 March 2020 at 10am</p> <p>Present - Members: A Cooper S Coutts S Leask R McGregor G Smith T Smith</p> <p><u>Apologies:</u> E Macdonald I Scott R Thomson</p>	<p>Pension Board Council Chamber, Town Hall, Lerwick Thursday 12 March 2020 at 10am</p> <p>Present - Members: I Arthur J Fraser D Marsh</p> <p><u>Apologies:</u> M Bell S Flaws J Johnston A Taylor A Thompson C Wiseman</p>
<p>In Attendance: J Manson, Executive Manager - Finance K Collins, Senior Management Accountant L Malcolmson, Committee Officer</p> <p>Also in Attendance: D Peuters, Deloitte (By Telephone)</p>	

Chair

Mr Coutts, Chair of the Pension Fund Committee presided.

Circular

The circular calling the meeting was held as read.

Declarations of Interest

None

Minutes

The minutes of the meeting held on 21 November 2019 were confirmed on the motion of Mr Leask, seconded by Mr G Smith.

01/20

Management Accounts for Pension Fund Committee – Projected Outturn at Quarter 3

The Committee and Board considered a report by the Executive Manager - Finance (F-005-F) which presented the Management Accounts showing the projected outturn position for 2019/20 as at 31 December 2019.

The Executive Manager - Finance summarised the main terms of the report.

There being no debate the Pension Committee and Pension Board noted the report.

Decision:

The Committee and Board NOTED the Management Accounts showing the projected outturn position at Quarter 3.

02/20

Annual Audit Plan 2019/20

The Committee and Board considered a report by the Executive Manager - Finance (F-006-F) that presented the external auditor's Annual Audit Plan 2019/20.

Ms Peuters, Deloitte, introduced the each section the Annual Audit Plan.

During questions Ms Peuters was asked whether she believed that the Pension Fund Committee and Pension Board members had the skills and knowledge to carry out the scrutiny of the Pension Fund. Ms Peuters said that the Committee has responsibilities and it is expected that Members understand their responsibility in regard to the quality of the fund advisers. She said that the way to do that was to review the internal quality report annually provided by fund managers. She explained that the reports provide internal controls in regard to the evaluation of investments and the Council's Audit Committee review these annual reports. As External Auditors, Mrs Peuters explained that Deloitte reports on the results of those reviews. She said that the Pension Fund Committee is expected to know what the financial statement should look like and scrutinise in detail, asking questions if clarity is required.

The Executive Manager – Finance added that the role of the External Auditors was to provide assurance that the financial statements present a true and fair view of the Fund's financial position, and not to give an opinion on whether the Committee or Board are performing their role. He said that historically the Pension Fund's Annual Report and accounts is appended to the main set of Council accounts and presented to multiple committees. Next year it will be presented to this Committee only.

Reference was made to the Audit Quality Review and the percentages given in the third paragraph on page 21 of the Appendix. In responding to a question Ms Peuters explained how seriously Deloitte had taken the findings of the review and that the only way to ensure high quality files are provided across the whole firm, is through internal training programmes to ensure that improvements are translated across all files held by Deloitte.

The Chair thanked Ms Peuters for her contributions and she left the meeting.

The Executive Manager – Finance explained that next year the Pension Fund Committee/Board would be the sole committee receiving Pension Fund audit reports removing any cross over with the Audit Committee.

Decision:

The Committee and Board CONSIDERED and NOTED the contents of the Audit Plan 2019/20 for Shetland Islands Council Pension Fund (Appendix1) from external auditors, Deloitte LLP.

03/20

2020/21 Budget Proposal – Pension Fund

The Committee and Board considered a report by the Executive Manager - Finance (F-007-F) that presented the proposed Pension Fund budget for 2020/21.

The Executive Manager - Finance introduced the main terms of the report.

In responding to questions relating to the number of full time equivalent staff stated in paragraph 1.1 of Appendix 1 the Executive Manager – Finance explained that some of these staff are not solely carrying out pension related duties. He also confirmed as of today the Pension Fund team was fully staffed but having recruited internally this left vacancies in other parts of the Finance team.

It was noted that the income from expenditure and investment benefits goes towards fluctuations in the market but the Executive Manager – Finance said that this was being operated within comfortable margins.

Members acknowledged that the Pension Fund was currently in a good position.

Mr Coutts moved that the Pension Fund Committee approve the recommendations contained in the report. Mr McGregor seconded.

Decision:

- The Pension Fund Committee RESOLVED to approve the budget proposals for 2020/21
- The Pension Board NOTED the report

04/20

Pension Fund – Quarter to December 2019 Investment Review Report

The Committee and Board considered a report by the Executive Manager – Finance (F-022-F) that presented the investment position and performance of the Pension Fund's external investments, managed by Fund Managers, for the quarter to December 2019.

In introducing the report, the Executive Manager – Finance reported on the recent downturn in the economy and advised that there was £66m less in the Pension Fund than reported. He said that markets do recover over time as was seen from the 2008 crash in markets. The Executive Manager – Finance said that it was hoped that the short term damage would recover in the coming months.

There followed some discussion around the stock market and the opportunity to buy affordable stock so that gains can be achieved as markets recover. The Executive Manager – Finance agreed and said that there had been opportunities in diversified growth and such opportunities will be part of the economic recovery.

The Executive Manager – Finance also explained how the Pension Fund is made up and that over the long term the Pension fund will recover.

During further discussion it was suggested that holding more cash would allow buy-in rather than having to wait for the upturn. The Executive Manager – Finance explained that cash is held within the portfolios and opportunities will be taken. He said that the recent downturn had taken everyone by surprise as there had been more interest in Brexit. He said that holding more cash means lower returns but the Committee takes decisions against risk. He said that for now the strategy is appropriate and it was time to weather the current situation and take the long term view.

The Chair added that KPMG would review the position going forward and advised that Fund Managers do have flexibility within their mandates. The Executive Manager – Finance added that portfolios are not entirely in passive funds with others being more active, but it is the role of the fund manager to take a forward looking approach.

Decision:

The Committee and Board NOTED the contents of the report.

The meeting concluded at 10.45am.

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Chair



Meeting(s):	Pension Fund Committee Pension Board	15 July 2020
Report Title:	Management Accounts for Pension Fund Committee: 2019/20 – Draft Outturn	
Reference Number:	F-024-F	
Author / Job Title:	Jamie Manson, Executive Manager - Finance	

1.0 Decisions / Action required:

- 1.1 That the Pension Fund Committee and Pension Board RESOLVES to note the Management Accounts showing the draft outturn position for 2019/20.

2.0 High Level Summary:

- 2.1 The purpose of this report is to enable the Pension Fund Committee and Pension Board to monitor the financial performance of the Pension Fund for the 2019/20 financial year. This report shows the draft outturn position of the Pension Fund for 2019/20, and is subject to final accounting and audit adjustments as part of the year-end accounts process.
- 2.2 The draft revenue outturn position for the Pension Fund for 2019/20 is an underachievement of net income of £199k (3.2%), which means that the Pension Fund has spent more than its approved budget.
- 2.3 Further detail on the draft outturn position can be found in Appendix 1.

3.0 Corporate Priorities and Joint Working:

- 3.1 There is a specific objective in the Corporate Plan that the Council will have excellent financial management arrangements to ensure that it continues to keep a balanced and sustainable budget and is living within its means. In addition, 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% funded position in order to ensure that the scheme remains affordable and sustainable in the future.

4.0 Key Issues:

- 4.1 On 5 March 2019 (Min Ref 06/19), the Pension Fund Committee approved the 2019/20 Pension Fund Budget. It is vital to the economic wellbeing of the Pension Fund that its financial resources are managed effectively and that net income is delivered in line with the budget, as any overspends or under-achievements of income could 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 it allows corrective action to be taken, where applicable.
4.3	At quarter 4, the Pension Fund is showing a draft under-achievement of net income of £199k (3.2%). There have been more and greater value lump sums than budget, along with more spend on transfers out and pension payments. There have also been more transfers in, AVC in and more investment income. Predicting individual choice is difficult and has significant impact and this is reflected in the variance between budget and actual for pension, lump sums and transfers in and out payments.
5.0 Exempt and/or confidential information:	
5.1	None.
6.0 Implications :	
6.1 Service Users, Patients and Communities:	None arising from this report.
6.2 Human Resources and Organisational Development:	None arising from this report.
6.3 Equality, Diversity and Human Rights:	None arising from this report.
6.4 Legal:	None arising from this report.
6.5 Finance:	<p>The Pension Fund Investment Strategy, approved in 2015/16, is currently under review with KPMG the Pension Fund's investment consultants. The aim of the strategy is to ensure that the Pension Fund is 100% funded by 2027.</p> <p>It is vital that the Pension Fund continues to receive a surplus of income over expenditure as it is a component of the strategy to become fully funded and keep the employers contributions at a manageable level. .</p> <p>Should the Pension Fund consistently under-achieve its net income budget, employer contributions may need to significantly increase in order to meet any shortfall. The success of the investment strategy, the performance of the fund managers and the cost of future liabilities, all of which are considered as part of the triennial fund valuations, are also factors that could have an effect on employer contributions.</p>
6.6 Assets and Property:	None arising from this report.

6.7 ICT and new technologies:	None arising from this report.	
6.8 Environmental:	None arising from this report.	
6.9 Risk Management:	<p>There are numerous risks involved in the delivery of the Pension Fund and awareness of these risks is critical to successful financial management.</p> <p>From a financial perspective, risks are an integral part of planning for the future, as assumptions and estimates are involved. These assumptions can be affected by many internal and external factors, such as supply and demand, which could have an adverse impact.</p> <p>The main financial risks for 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; • That bond yields fall, leading to a rise in value placed on liabilities; • That employers leave the scheme or the scheme closes to new members, which could be attributed to factors such as cost, liquidation or bankruptcy; • That a failure to recover unfunded payments from employers occurs, potentially leading to other employers having to increase their employer contributions to subsidise; • That a global stock market failure occurs; • That active fund managers under-perform against expectations. 	
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 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:	n/a	n/a

Contact Details:

Jacqueline Johnson, Senior Assistant Accountant, 01595 744625
 Jacqueline.johnson@shetland.gov.uk

Appendices:

Appendix 1 - Draft Outturn Position for 2019/20

Background Documents:

Pension Fund Budget Proposals 2019/20, Pension Fund Committee/Pension Board, 5 March 2019

<http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=23776>

Pension Fund Committee / Pension Board

1. Revenue Outturn Position 2019/20 (Quarter 4)

Budget v Projected Outturn at Q3 (Adv) / Pos £000	Pension Fund	Revised Annual Budget £000	Projected Annual Outturn £000	Budget v Projected Outturn at Q4 (Adv) / Pos £000
44	Employee Costs	270	230	40
10	Operating Costs	184	176	8
136	Investment Expenses	1,711	1,555	156
(753)	Benefits Payable	10,602	11,486	(884)
(69)	Transfers Out	550	631	(81)
129	Lump Sums	2,520	3,358	(838)
50	AVC Out	650	671	(21)
(453)	Total Expenditure	16,487	18,107	(1,620)
(398)	Contributions Received	(18,778)	(18,574)	(204)
811	Investment Income	(2,776)	(4,130)	1,354
171	Transfers In	(450)	(640)	190
0	AVC In	(650)	(731)	81
584	Total Income	(22,654)	(24,075)	1,421
131	Net Income	(6,167)	(5,968)	(199)

An explanation of the significant variances to budget for the Pension Fund at Quarter 4 is set out below.

1.1 Employee Costs – underspend of £40k (14.8%)

This underspend relates to vacancies within the Pension Section. The vacant Pensions Officer post was filled in February 2020.

1.2 Investment Expenses – underspend of £156k (9.1%)

This underspend relates to less than budgeted expenses on custody fees and consultancy costs. Schroders have decreased the number of large UK general property funds in the portfolio resulting in the reduction in custody fees, and the Pension Fund investment strategy review has not progressed as quickly as thought, resulting in a reduction in consultancy costs.

1.3 Benefits Payable – overspend of (£884k) (8.3%)

This overspend is due to a budgeting error. The 2019/20 budget was based on applying a CPI increase to the 2018/19 budget figure rather than the 2018/19 outturn figure, resulting in a lower budget figure for 2019/20.

1.4 Transfers Out – overspend of (£81k) (14.7%)

This overspend is due to more transfers out than budget. There were 18 transfers out at an average of £35k where the budget was for 10 transfers out at £55k.

1.5 Lump Sums – overspend of (£838k) (33.3%)

The value of lump sums payable to retirees varies depending on various factors. For example, length of service and salary and whether there is an automatic entitlement to a lump sum. Budgets are profiled based on historic averages. This does not take account of personal choice, such as when someone retires or whether they take a lump sum.

There have been 111 lump sums paid out to retirees totalling £3.011m, where the budget was for 116 lump sums at a total value of £2.140m. The remaining balance of the lump sums spend is made up of death benefits and refunds to leavers.

1.6 AVC In/Out – net underspend of £60k (60%)

This underspend is due to not all AVC Funds being taken as a lump sum. A member's AVC Fund can also be used to purchase annuity within the LGPS.

1.7 Contributions received – under achievement of (£204k) (1.1%)

This under achievement is mainly due to a portion of the employer contribution budget being based on the SIC budget. There are a number of vacancies included in the SIC budget which has resulted in an underachievement of employer contributions for the Pension Fund.

1.8 Investment Income – over achievement of £1,354k (48.8%)

This over achievement of investment income is down to income streams from two fund managers, which was greater than anticipated. Income has also been received from the overseas pooled property fund investment that was unbudgeted. The overseas property fund is in the process of being liquidated and the income is the proceeds of the sale of property. The proceeds from the overseas property sale will be reinvested by the fund manager.

1.9 Transfers in – over achievement of £190k (42.2%)

This overachievement is due to more transfers in than budgeted. There have been 33 transfers in at an average of £19.4k, where the budget was for 15 transfers in at £30k.



Shetland Islands Council

Agenda Item

2

Meeting(s):	Pension Fund Committee Pension Board	15 July 2020
Report Title:	Pension Fund Unaudited Accounts 2019/20	
Reference Number:	F-025-F	
Author / Job Title:	Executive Manager – Finance	

1.0 Decisions / Action required:

- 1.1 That the Pension Fund Committee and Pension Board:
 - a) Consider the 2019/20 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 2019/20 accounts.
- 1.2 That the Pension Fund Committee RESOLVES to approve the Annual Governance Statement 2019/20 that forms part of the accounts (Appendix 2).

2.0 High Level Summary:

- 2.1 The Local Authority Accounts (Scotland) Regulations 2014 require the Pension Fund to prepare and publish a draft set of accounts, including an annual governance statement, by 30 June each year.
- 2.2 Due to the Coronavirus pandemic, and in line with Schedule 6 paragraph 8(2) of the Coronavirus (Scotland) Act 2020, the Council is postponing the publication of the unaudited annual accounts to 20 July 2020.
- 2.3 The Local Authority Accounts (Scotland) Regulations 2014 require the unaudited accounts to be formally considered by the Pension Fund Committee before 31 August each year. The Pension Fund Committee would ordinarily meet to consider the unaudited accounts before the end of June, before submitting the unaudited accounts to the external auditor. As the Council has deferred the publication of its unaudited accounts, today's meeting of the Pension Fund Committee allows the Pension Fund Committee to meet that obligation.
- 2.4 The accounts are then subject to external audit by the appointed auditor, Deloitte LLP, and aim to approve those accounts for signature no later than 30 September 2020. The audited accounts are due to be presented to the Pension Fund Committee and Pension Board on 23 September 2020, however due to the Coronavirus pandemic this may be delayed and is dependent on both the Pension Fund and its external auditor adhering to pre-agreed audit timetable. In line with guidance issued by the Scottish Government, Local Government Finance Circular 10/2020, the Scottish Ministers consider it reasonable that a local authority publishes its audited Annual Accounts no later than 30 November 2020. Members will be advised if the September deadline cannot be met should the audit process encounter any further delays.

3.0 Corporate Priorities and Joint Working:

3.1	The preparation and presentation of the annual accounts is a key element of the Pension Fund's overall governance and reporting arrangements.
4.0 Key Issues:	
4.1	The unaudited accounts include the following primary financial statements:
<ul style="list-style-type: none"> • Pension Fund Account: shows all the income and expenditure for the Pension Fund for the year, such as contributions from employees and employers, transfers in from other pension funds and management expenses. It also shows realised gains on disposal of investments. It reports an overall decrease in available net assets of £36m. • Net Assets statement: shows the value of all assets and liabilities of the Pension Fund, including the value of investment assets, debtors and creditors, including benefits payable. The net asset statement does not account for the future liabilities of the Fund to pay pensions and benefits in the future. The net assets of the scheme were £461m at 31 March 2020. 	
4.2	The Management Commentary provides an overview of the most significant matters reported in the accounts. The key points are summarised below:
<ul style="list-style-type: none"> • In 2019/20, the rate of return on investments was -7.3% against the benchmark of -3.6%. Returns were positive throughout 2019, but by 31 March all asset categories had suffered a serious and sharp fall in the value of assets as a direct result of the uncertainty caused the by the Covid-19 pandemic. The value of the Pension Fund assets reached their lowest point in early April, before markets began to stabilise. • Membership of the Fund has increased by 343 since 2018/19. The net increase consists of 110 new pensioners and dependents, 100 new deferred members and an increase of 133 staff members paying into the Fund. 	
4.3	The Annual Governance Statement sets out how the Pension Fund is governed and the internal controls that are in place to manage risk. In addition, the Governance Compliance Statement sets out how the Pension Fund's governance arrangements comply with SPPA (Scottish Public Pensions Agency) best practice.
5.0 Exempt and/or confidential information:	
5.1	None.
6.0 Implications :	
6.1 Service Users, Patients and Communities:	None arising from this report.
6.2 Human Resources and Organisational Development:	None arising from this report.
6.3 Equality, Diversity and Human Rights:	None arising from this report.
6.4 Legal:	Section 12 of the Local Government (Scotland) Act 2003 requires the Council to observe proper accounting practice, including compliance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) issued

	<p>by CIPFA / LASAAC. The Code is based on International Financing Reporting Standards (IFRSs).</p> <p>Schedule 6 paragraph 8(2) of the Coronavirus (Scotland) Act 2020 allows the Council to postpone its publication of the unaudited annual accounts that are required to be published under The Local Authority Accounts (Scotland) Regulations 2014. If publication is postponed, a statement must be published to that effect on or before the date by which the report is due, or as soon as reasonably practicable after the date. The Council published this statement on 17 June 2020.</p>	
6.5 Finance:	None arising from this report.	
6.6 Assets and Property:	None arising from this report.	
6.7 ICT and new technologies:	None arising from this report.	
6.8 Environmental:	None arising from this report.	
6.9 Risk Management:	<p>The annual accounts are subject to external audit by 30 September 2020 in order to mitigate risk of material misstatement. The Local Authority Accounts (Scotland) Regulations 2014 require the Council to consider and aim to approve the audited accounts for signature no later than 30 September 2020. Due to the Coronavirus pandemic, completion of the external audit process may be delayed. In line with guidance issued by the Scottish Government, Local Government Finance Circular 10/2020, the Scottish Ministers consider it reasonable that a local authority publishes its audited Annual Accounts no later than 30 November 2020.</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 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:

Jacqueline Johnson, Senior Assistant Accountant, jacqueline.johnson@shetland.gov.uk
10 June 2020

Appendices:

Appendix 1: Shetland Islands Council Pension Fund Draft Annual Report and Accounts 2019/20

Appendix 2: Shetland Islands Council Pension Fund Annual Governance Statement 2019/20

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

Pension Fund Unaudited Annual Report and Accounts **2019/20**



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Management Structure

Administering Authority

Shetland Islands Council
Town Hall
Lerwick
Shetland
ZE1 0HB

Fund Custodian

The Northern Trust Company

Investment Advisor

Isio

Investment Managers

Blackrock
Schroders
M & G Investments
KBI Global Investors Limited
Newton Investment Management Limited

Fund Actuary

Hymans Robertson LLP

Banker

Bank of Scotland

AVC Providers

Prudential
Equitable Life (closed to new members)

Independent Auditor

Deloitte LLP

Website

www.shetlandpensionfund.org

Introduction

I am pleased to introduce the accounts of the Pension Fund.

This year, I am pleased to report that the Fund is valued at £461m and total membership of the Fund increased to 7,842. The total membership figure is the equivalent to a third of the Shetland population.

As a Pension Fund we have worked hard in the past year.

It continues to be a challenging and uncertain environment. We saw the continuing impact of a lack of progress on Brexit negotiations culminating in a change of UK Prime Minister and a General Election in December; the second General Election to be held since the 2016 referendum. Beyond uncertainty at the domestic level, the Fund has seen increased geopolitical uncertainties and more recently, we have seen the very significant impact of the Covid-19 pandemic on the Pension Fund in the first quarter of 2020. It is likely the Covid-19 pandemic will have a lasting impact going forward.

The impact of the pandemic is clearly seen in the fund valuation at the end of the year. It is a sharp decline but one that we expect to be reversed over the longer-term.

The national discussions on pension administration are still unresolved and continue to provide a degree of uncertainty. Our officers continue to engage with other LGPS schemes and promote a culture of continuous improvement and sharing of best practice.

As a Pension Committee, we continue to promote the status quo and in doing so highlight the good performance of our fund and our desire to retain control of local decision-making.

Thank you

Finally, I would like to thank the Members of the Pension Fund Committee, Pension Fund Board, officers within the Council, our advisers, and our Investment Managers for their hard work during the year and their ongoing commitment to ensuring the Fund performs well, along with sound administration and governance of the Fund.

Steven Coutts
Chair, Pension Fund Committee



Management Commentary

Welcome to Shetland Islands Council Pension Fund's Annual Report and Accounts for the year ended 31 March 2020. The purpose of the Management Commentary is to present an overview of the Pension Fund's financial performance during the year 2019/20 and to help readers understand its financial position at 31 March 2020. In addition, it outlines the main uncertainties facing the Pension Fund for the financial year 2019/20 and beyond.

Background

The Shetland Islands Council Pension Fund is part of the Local Government Pension Scheme (LGPS). It is administered by Shetland Islands Council for the purposes of providing pensions and other benefits for current members, deferred members, retired members and dependents of a range of Scheduled and Admitted bodies within Shetland.

The Pension Fund is governed by the Superannuation Act 1972 and is administered in accordance with the following legislation:

- the Local Government Pension Scheme (Scotland) Regulations 2018;
- the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014;
- the Local Government Pension Scheme (Governance) (Scotland) Regulations 2018; and
- The LGPS (Management and Investment of Funds) Regulations 2010.

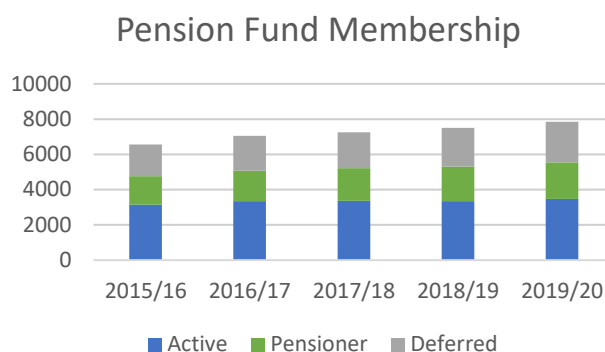
Teachers are not included as they are members of the Scottish Teachers' Pension Scheme.

Membership

The Pension Fund is made up of:

- **Active members** – are employees who currently contribute to the LGPS;
- **Retired members** – are in receipt of a pension, including spouses or dependents in receipt of a pension in respect of a former member; and

- **Deferred members** – are former active members who have elected to retain the rights in the LGPS until they become payable.



Employers with active members at 31 March 2020

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 (Visit Scotland)
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 2020

Admitted Bodies:

Shetland Enterprise Co Ltd (Highlands & Island Enterprise)

Employers pay regular monthly contributions to the Pension Fund, based on the salaries of active members. Where an employer has no active employees, but continues to participate in the Scheme, an annual monetary amount calculated

by the actuary covers the cost of ongoing and future pension payments.

Valuation

The triennial valuation was carried out at 31 March 2017, resulting in an actuarial value of the Pension Fund of £450m, an increase of £117m on the previous valuation at March 2014. This increase is due to better than expected asset returns and lower actual pay growth than anticipated.

The triennial valuation showed that the Pension Fund is 90% funded, with a deficit of £51m. This compares unfavourably to the 2014 valuation, which was 92% funded, with a deficit of £30m. The fall in funding level is due to a fall in real gilt yields, which had the impact of increasing the value of the Pension Fund liabilities (i.e. pensions payable in the future). This was offset by better than expected asset returns and lower costs.

Investment Review

Global economic review

Global markets experienced a largely positive 2019 following particularly poor performance in 2018. Markets returned positive returns throughout 2019, despite experiencing volatility arising from:

- ongoing trade tension between the US and China;
- uncertainty surrounding the UK's withdrawal from the European Union;
- political protests in Hong Kong; and
- political uncertainty in Italy and the UK.

The result of the UK general election provided clarity over the UK's position with regard to Europe, improving market confidence.

Throughout the year, the trade war continued between the United States and China. However, following talks and months of increasing hostility, the two nations signed the first phase of a long-awaited trade deal that covers a range of goods and services, including food and agriculture, technology, financial services, and matters relating to intellectual property. The signing of the deal de-escalated the significant tensions that

existed and paved the way for further negotiations that cover a much broader range of goods and services.

Closer to home, progress to agree the terms of the UK's withdrawal from the European Union stalled and led to a change in Prime Minister in July 2019. Following a period of further constitutional frustration, a General Election was held in December 2019, returning the Conservative Party to power with a working majority. The election result provided clarity over the UK's position on Europe and the markets responded positively to this clarity of direction. The UK proceeded to formally leave the European Union on 31 January 2020 and entered a Transitional Period, during which time the UK will abide by all existing EU laws, regulations and directives until 31 December 2020. There remains significant uncertainty about what kind of trading relationship the UK will have with the EU beyond December 2020, which is expected to be clarified through negotiations and a formal agreement before December 2020.

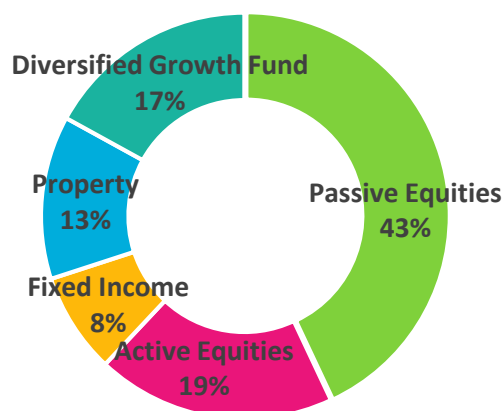
In the last quarter of 2019/20 between January and March 2020, the world began to experience the greatest public health emergency in recent history, caused by a coronavirus known as Covid-19, which has since been declared a pandemic and global health emergency of international concern. In response, national governments began to impose severe restrictions on normal economic activity, otherwise known as a 'lockdown', to suppress the transmission of the virus. Such restrictions have inevitably led to a severe scaling back, or complete closure of much economic activity across the world, which has had significant impact on market returns.

By 31 March 2020, all asset categories had suffered a serious and sharp fall in value of assets as a direct result of the uncertainty caused by the Covid-19 pandemic. The value of Pension Fund assets reached their lowest point in early April, before markets began to stabilise.

Investment Summary

What does the Pension Fund invest in?

Pension Fund Investment Portfolio by Asset Class



Equities

Almost two thirds of the Fund's investment portfolio is held as equity investments. An equity investment refers to the buying and holding of shares in a company which generates income in the form of dividends or capital gains when the shares are sold. The Fund uses the services of two investment fund managers to manage a large portfolio of equity investments in both UK-based and global companies:

- Blackrock manage the Fund's investments in UK and global equities; and
- KBI Global Investors manage the Fund's investments in global equities.

Fixed Income

Fixed income investments pay a steady rate of interest per year and are debt instruments issued by companies and governments. The Fund invests into a broad range of fixed income investments through an alternative credit mandate, which is managed by M & G Investments. The mandate is a multi-asset fund which invests in a mix of fixed income investments such as investment grade corporate bonds, leveraged loans, high yield bonds, asset backed securities and cash.

Property

The Fund invests in a range of real estate and property assets across the UK, with stakes in retail units, shopping centres, industrial units and offices. Investments are made through a variety

of property unit trusts and funds, which are managed by Schroders on the Fund's behalf.

Diversified Growth Fund

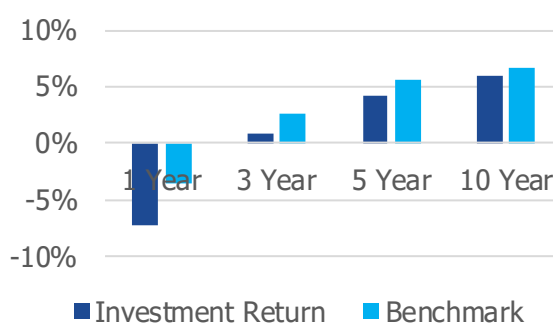
A diversified growth fund is an asset class that seeks to achieve similar returns to an equity investment but without the same risk of volatility. The growth fund does this by investing across a wide range of assets. The Fund's investments are a combination of traditional assets, such as government bonds and listed equities, and fixed income, such as private equity and commodities. Newton Investment Management manage the Diversified Growth Fund investments on the Fund's behalf.

Investment Performance

Investment performance is monitored against an agreed benchmark return on a quarterly and annual basis, however, the performance of fund managers over the longer-term is the ultimate measure of achievement.

For the year to 31 March 2020, Pension Fund assets collectively generated a return of -7.3%, a negative return that resulted in the contraction of the value of Pension Fund assets. This compares against a combined benchmark return of -3.6%. The Fund experienced significant volatility towards the end of the year, despite strong investment returns during the first 11 months of the year, with equity investments driving the strongest returns. Net Pension Fund assets at the end of the year totalled £460m, which is £36.4m less than the year before.

Pension Fund Investment Returns



Investment performance across the different asset classes reflects a mixed picture and

representative of the nature of the different types of investment.

The Fund's investments in equities, which are passively managed, returned -10.1%, which matched the agreed benchmark. Active global equity investments generated a negative return of -14.7% but this was well below the set benchmark of -5.8%.

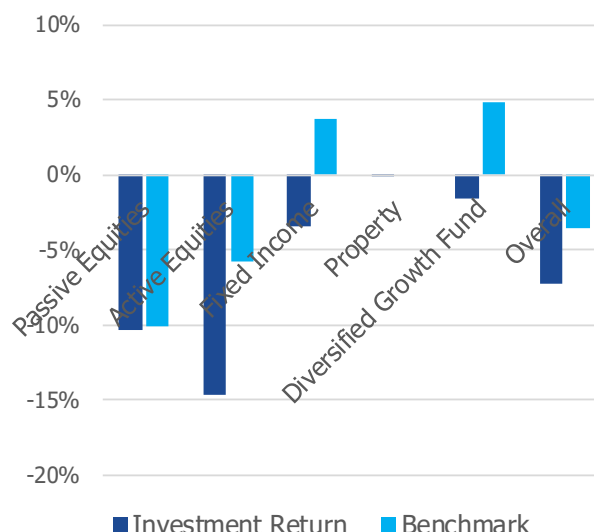
The Fund's investments in fixed income returned -3.5%, which was below the benchmark of 3.7%.

The diversified growth fund generated a return of -1.6%, which was below the set benchmark of 4.8%.

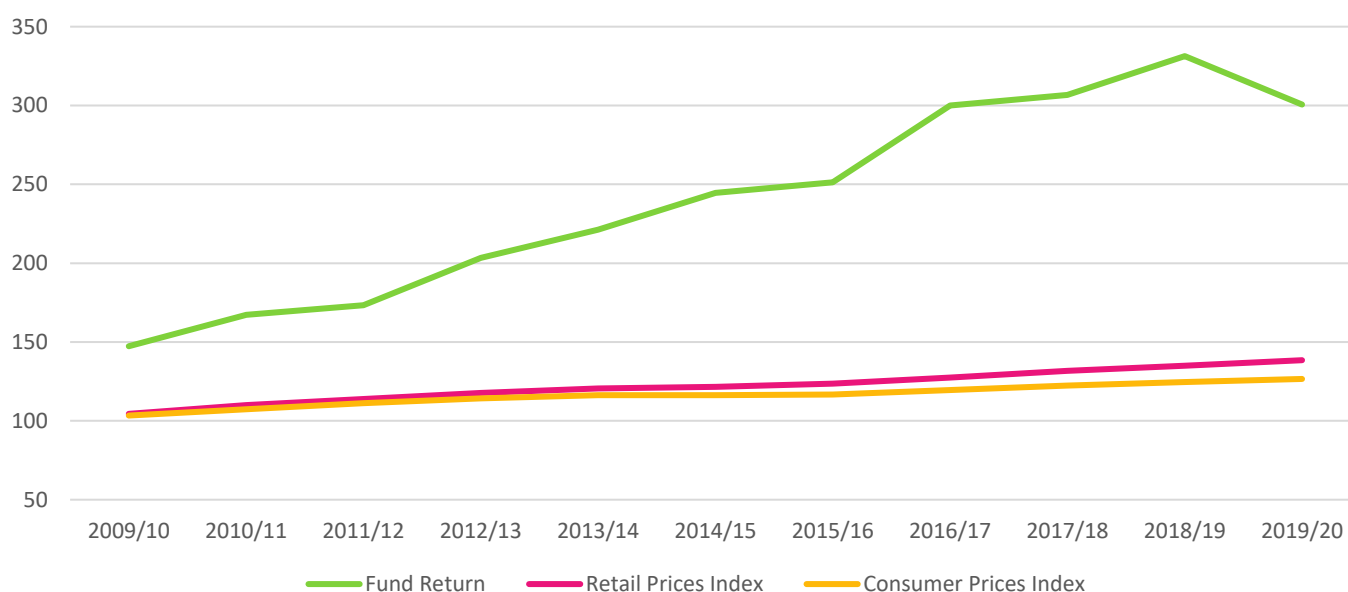
The Fund's property investment portfolio delivered a return of -0.1%, which was slightly behind of the agreed benchmark of 0%.

The chart below shows the Fund's investment performance over the last ten years versus inflation. Over the longer term, the Fund's assets have grown positively in value by 5.9% on an annualised basis. However, actual returns vary on an annual basis reflecting the volatile nature of the Fund's investment portfolio.

Investment Returns by Asset Class for year ended 31 March 2020



Investment Performance vs Inflation over 10 Years



Investment arrangements and policies

The Pension Fund has a range of arrangements and policies in place to ensure the Council, as the administering authority, fulfils its fiduciary duty to scheme members in maximising the Funds' investment returns balanced against an appropriate level of risk.

The Fund utilises the service of fund managers, who have delegated powers for the acquisition and realisation of investments. As part of their internal investment decision-making processes, fund managers 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.

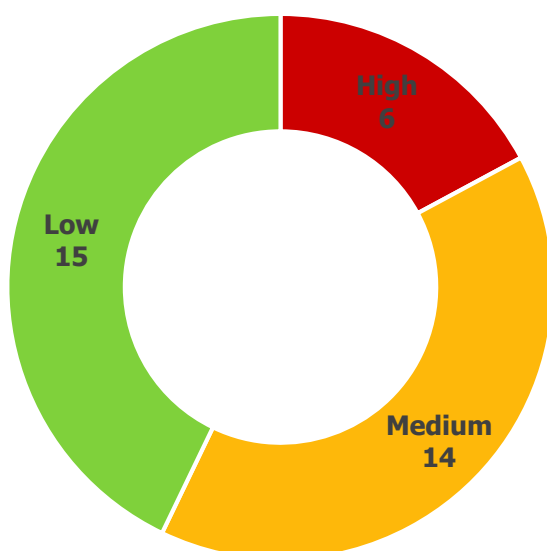
All the fund managers have signed up to the United Nations Principles on Responsible Investment Management. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios and must be given appropriate consideration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

The focus of the Pension Fund's **Investment Strategy** is to achieve a 100% funding level before the Pension Fund's incoming contributions equal the benefits payable, by 2027. Beyond this point, it is expected that benefit payments will exceed the level of contributions made by employers and employees into the Pension Fund. The investment strategy advocates a diversified approach to investments made across different asset categories in order to reduce the exposure to risk and volatility.

Risk

The Pension Fund maintains a risk register which is updated regularly. The latest iteration of the register contained a total of 35 risks, summarised by risk level in the following chart.

Summary of Risk Register



The key risks to the Fund are:

- staff unable to access workplace leading to staff downtime and loss of service delivery;
- fund 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 or cessation;
- failure in world stock markets; and
- underperformance by active fund managers.

The full risk register can be found at:

<https://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=23778>

The Pension Fund Committee and Pension Board are made aware of any changes, so that action can be taken to mitigate the risks.

Funding Strategy

The Net Assets Statement shows an decrease in net assets of the Pension Fund from £497m in 2018/19 to £461m in 2019/20. The Fund's investment strategy aims to achieve a fully funded Pension Scheme by 2027. The Funding Strategy and Investment Strategy are inextricably linked, in order for the Fund to meet all benefit payments as and when they fall due. 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 covering management of the Pension Funds require the administering authority to prepare, maintain and publish a written Funding Strategy Statement. A revised Funding Strategy Statement was adopted in March 2018,

as part of the triennial valuation process. Details of the Funding Strategy Statement are found in Note 17: Funding Arrangements, on page 38.

The Funding Strategy Statement can be found here:

<https://www.shetlandpensionfund.org/media/4480/funding-strategy-statement.pdf>.

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;
- to support the regulatory framework to maintain as nearly constant employee contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities.

The most recent actuarial valuation was carried out as at 31 March 2017. It showed that the Pension Fund is valued at £450m and 90% funded, with a deficit of £51m. The triennial valuation includes setting the employer contribution rates for the next three years. The primary employer contribution rate across the whole fund is 22.1%, with additional secondary rates that make up the final contribution rates payable by individual employers.

Statement of Investment Principles

The Pension Fund Committee and the Pension Board meetings on 26 October 2015 approved the current Shetland Islands Council Pension Fund Statement of Investment Principles. This statement includes administration details, the objective of the Pension Fund, types of investments, balance between different types of investment, risk, expected return on investments, realisation of investments, responsible investments, securities lending and compliance.

The Pension Fund also complies with the six Myners Principles, which were contained in a schedule to the Statement of Investment Principles.

The Statement of Investment Principles can be found here:

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

The Statement of Investment Principles is due to be updated following the conclusion of the Investment Strategy Review.

Performance Management

The Annual Accounts satisfy the requirements of the Local Government Pension Scheme (Scotland) Regulation 55 (1) of the Local Government Pension Scheme (Scotland) Regulations 2018 (as amended), to prepare a Pension Fund Annual Report for the financial year from 1 April 2019 to 31 March 2020. In addition, quarterly Management Accounts are presented to the Pension Fund Committee, which shows the year to date position and the projected year-end outturn.

Primary Financial Statements

The Annual Accounts summarise the Pension Fund's transactions for the year and its year-end position at 31 March 2020. 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 Code).

The two primary statements, the Pension Fund Account and Net Assets Statement, as at 31 March 2020, include a description of their purpose. Accompanying the two primary statements, are notes to the accounts, which set out the accounting policies adopted by the Pension Fund and provide more detailed analysis of the figures disclosed in 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 2019/20

The Pension Fund accounts present the full economic cost of providing Pension Fund services for 2019/20 and this shows a net expenditure of £36.4m. This differs from the draft outturn position, shown below. The draft outturn was

reported to the Pension Fund Committee and the Pension Board on 15 July 2020.

The report can be found on Shetland Islands Council's website.

Description	2019/20 Annual Budget £000	2019/20 Draft Outturn £000	2019/20 Variance £000
Total Expenditure	16,487	18,107	(1,620)
Total Income	(22,654)	(24,075)	1,421
Net Income	(6,167)	(5,968)	(199)

The main difference between the draft outturn and the final accounts is that the Pension Fund Account includes the value of the growth of the fund and income automatically reinvested into the fund. This income is not included in the table above.

Expenditure was higher than budgeted due to a greater number of lump sums paid out during the year than had been estimated. More people than anticipated retired during 2019/20 resulting in an increase in benefits payable. Income was higher than budgeted due to greater investment income than budgeted. Income was received from the overseas pooled property fund investment that was unbudgeted. The overseas property fund is in the process of being liquidated and the income is the proceeds of the sale of the property. The proceeds from the overseas property sale will be reinvested by the property manager.

Budgets were set for lump sums, transfers in and out, death benefits and all other income and expenditure. This was based on five-year averages. It is difficult to estimate these items accurately as there is a huge amount of personal choice or life events involved in what is received and paid out, and therefore these transactions cannot be fully predicted. Expenditure, such as lump sums and transfers are based on a number of variables and will be different for each individual transaction.

Administration Strategy

The Pension Fund's Pension Administration Strategy highlights the duties of, and sets the

performance for, both the Fund and all of the participating employers.

Employers must provide accurate information to the Pension Fund in a timely manner, to ensure that information provided to Scheme members is also accurate and timely. The information received from employers to the Pension Fund, such as new starts, leavers, retirements and deaths was delivered in a timely manner during 2019/20.

All employer contributions in 2019/20 were received by the 19th of the month following deduction.

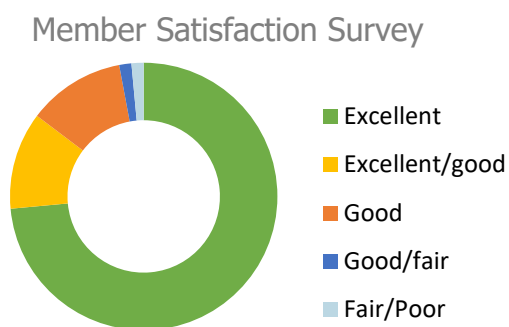
Administration Performance

Shetland Islands Council, as administering authority, is also committed to providing a high quality 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 participating in the Fund are invited to complete a customer satisfaction survey.

Ten employer surveys were returned which indicated 95% of respondents rated the service received as excellent and 5% rated the service as good.

The chart below shows the latest member satisfaction survey results.



As well as administering employer contributions, retirements and pension payments, the Pension Section also processes the pensioners' payroll.

The table below shows the summarised budget and spend for the Pension Fund's administration costs for 2019/20.

Administration Expenses	2019/20 Annual Budget £000	2019/20 Draft Outturn £000	2019/20 Variance £000
Staff Time Allocations	270	230	40
Supplies, Services & Systems	131	107	24
Printing & Publications	3	3	0
Total	404	340	64

Staff Time Allocations were underspent due to vacancies. A computer module was not purchased as anticipated, this led to the underspend on supplies services & systems.

The Pension Administration KPI's for 2019/20 are:

KPI's	Target	31 March 2020			31 March 2019		
		Number	Number within target	% within target	Number	Number within target	% within target
New starts	2 months from date of joining scheme	711	707	99%	564	547	97%
Leavers	2 months from leaving scheme	166	157	95%	195	191	98%
Transfer in quotes	2 months from date of transfer quotation	36	36	100%	25	24	96%
Transfer out quotes	3 months from date of request	29	29	100%	24	24	100%
Notifying members of benefits on retirement	1 month from date of retirement	130	130	100%	139	139	100%

KPI's (cont.)	Target	31 March 2020			31 March 2019		
		Number	Number within target	% within target	Number	Number within target	% within target
Retirement estimates	2 months from date of request	102	101	99%	58	54	93%
Calculation of dependants benefits	2 months from notification	35	35	100%	21	21	100%
Annual Benefits statement - to all active and deferred members	by 31st August each year	5,368	5,368	100%	5,532	5,532	100%
Contributions from employers	by 19th of month following deduction	120	120	100%	120	120	100%

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's 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 of 21 November 2019, the Custodian, Northern Trust, and Fund Manager, Schroders Investment Management both gave presentations to the Pension Fund Committee and Pension Board. Northern Trust's presentation was to inform the members and employers of the work they undertake on behalf of the Pension Fund. Schroder's presentation was to inform members and employers about the Pension Fund's property investment and its investment performance.

A group that includes Pension Fund Committee, Pension Board and officer representation undertakes an annual visit to each Fund Manager in April each year. The Fund Managers also supply

a quarterly audited performance review report and monthly valuation report.

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 its costs are reimbursed by the Pension Fund. The Councillors who are members of the Pension Fund Committee and Pension Board are also remunerated by Shetland Islands Council. They do not receive any additional allowance for being members of the Pension Fund Committee or Pension Board.

Details of Senior Councillors and Senior Employees remuneration can be found in the annual accounts of Shetland Islands Council, which are available on the Council's website.

Looking Ahead

Consultation on the future of Scottish LGPS Funds

The consultation about the structure of the Scottish LGPS, commissioned by the Scottish Scheme Advisory Board (SAB) during 2018/19 is still not concluded. The SAB have commissioned further work to explore the benefits of a fully-merged model. The results of the consultation were 68% in favour of status quo or collaboration, 2% for pooling and 30% for merger.

2020/21 Budget

The 2020/21 budget for the Pension Fund was approved on 12 March 2020. It shows a net income of £5.730m. A number of assumptions and historical trends are used to develop the budget for the Pension Fund. Due to the level of individual choice involved in choosing when to retire, the budget represents the most reasonable estimates of income and expenditure.

Pension Fund	2020/21 Approved Budget £000
Employee Costs	289
Operating Costs	212
Investment Expenses	1,583
Benefits Payable	11,548
Transfer Out	850
Lump Sums	2,250
AVC Out	600
Total Expenditure	17,332
Contributions Received	(18,406)
Investment Income	(3,606)
Transfer In	(450)
AVC In	(600)
Total Income	(23,062)
Net Income	(5,730)

Triennial Valuation

The Pension Fund will be subject to a triennial valuation in 2020, in line with LGPS regulations. The purpose of the valuation is to review the financial position of the Fund and set employer contribution rates for the next 3 years. The Fund's actuary will carry out a comprehensive valuation of the of the assets and liabilities of each individual employer and the Fund as a whole, as at 31 March 2020. Employer contribution rates can then be set that will allow each employer's liabilities to become fully funded over an agreed recovery period. The valuation is currently underway, and the outcome will be reported to the Pension Committee later in 2020.

Covid-19

Covid-19 is a new strain of coronavirus that has quickly spread across the globe and created a

public health emergency in almost every corner of the globe. Shetland has not been protected, despite an element of geographic isolation. The Covid-19 pandemic has significantly impacted the Council and the residents of Shetland, resulting in changes to the way services are delivered across the Isles.

From late March 2020, the Council enacted its business continuity plans in response to the restrictions that were imposed by the UK Government and Scottish Government. As a result, pensions administration, including payment of pensions, retirement lump sums and death gratuity grants have all been managed remotely with a minimal presence in the office to maintain workflow.

On 22 April, recommendations were made to a virtual meeting of the Full Council including reports that would ordinarily be presented to a number of the Council's committees. This adjustment to the Council's decision-making structure was introduced as a temporary measure to help Members and staff adhere to the UK and Scottish Government guidelines on social and physical distancing. The recommendations, which were approved by Members, included:

- the cancellation of all Council and committee meetings;
- adoption of a common reporting format to summarise the decisions taken, under existing emergency powers that grant delegated authority to officers; and
- measures to allow remote attendance at Council and Community Council meetings.

The recommendations made to the full Council apply equally to the Pension Fund Committee and Board. The temporary arrangements are kept under active review and may be extended or revoked as circumstances permit.

The Covid-19 pandemic resulted in the sudden and sharp deterioration in the valuation of Pension Fund assets due to the economic slowdown experienced as a result of restrictions and lockdowns across the world, and the uncertainty around how long restrictions would continue to constrain economic activity. Since early April, markets have begun to stabilise and

Pension Fund investments had recovered to £506m at the end of May 2020.

The deterioration in asset valuations is significant, but not catastrophic for the Fund. The timing however is noteworthy as the Fund is subject to a triennial valuation in 2020, as set out in the preceding section. The Fund's actuary is obliged to use asset valuations as at 31 March 2020, which coincides almost perfectly with the lowest asset valuations recorded. The setting of employer contributions will be influenced by the reduced asset valuations as at 31 March, although the actuary will also consider other actuarial assumptions, elements of the Funding Strategy and will of course take a long-term view that aligns with the long-term nature of the Pension Fund.

Although the Fund's investments have seen signs of recovery between April and June, there is the potential for a longer-term impact on the UK and global economies which is currently unknown, and may only be felt when nationally-funded economic support packages (such as job retention schemes, business grants and loans for example) come to an end later in the year.

.....
Steven Coutts
Leader of the Council
Chair of the Pension Fund Committee
15 July 2020

.....
Maggie Sandison
Chief Executive
15 July 2020

.....
Jamie Manson
Executive Manager - Finance
15 July 2020

Annual Governance Statement

Scope of responsibility

Shetland Islands Council is the Administering Authority for the Shetland Islands Council Pension Fund. The Council is responsible for ensuring that the Pension Fund:

- Conducts business in accordance with the law and proper standards;
- Safeguards and properly accounts for public money and assets under its control; and
- Utilises public money economically, efficiently and effectively.

In discharging these responsibilities, the Council is responsible for putting in place proper arrangements for the governance of its affairs and facilitating the effective exercise of its functions, including arrangements for the management of risk. The arrangements put in place by the Council therefore apply equally to the activities of the Pension Fund.

The Council has approved and adopted a Local Code of Corporate Governance, which is consistent with the principles of the CIPFA/SOLACE framework 'Delivering Good Governance in Local Government'. The Code is available on the Shetland Islands Council website. The Council's financial and management arrangements comply with the CIPFA Statement on the role of the Chief Financial Officer in local government. Furthermore, the Council has a statutory duty to make arrangements to secure best value under the Local Government in Scotland Act 2003.

The Local Code of Corporate Governance demonstrates the Council's commitment to achieving good governance and provides examples of how it complies with the governance standards recommended by CIPFA and SOLACE. The document is regularly reviewed and was last updated in June 2019.

Purpose of the governance framework

The governance framework consists of the systems, processes, culture and values by which the Pension Fund is directed and controlled, and the activities used to engage with and lead the community. It enables the Pension Fund to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate, cost effective services.

The system of internal control is a significant part of the governance framework and is designed to manage risk at acceptable levels, and provide reasonable, but not absolute, assurance that policies, aims and objectives can be delivered. The system of internal control is based on an ongoing process designed to identify and prioritise risks, and their associated impacts should they crystallise, and to manage them efficiently, effectively and economically.

The governance framework has been in place for the year ended 31 March 2020 and up to the date of approval of the Annual Accounts.

The governance framework

The governance framework adopted by the Council is consistent with the with the seven core principles of the revised 2016 CIPFA/SOLACE framework and is pictured below, showing each of the seven principles and how they interact with one another.

Principles A and B contain the overarching principles of good governance which percolate down through the remaining principles.



In addition to complying with the governance framework approved by the Council, the regulations that govern the administration of LGPS Funds in Scotland require each Administering Authority to publish a Governance Compliance Statement that sets out how their governance arrangements comply with best practice issued by the Scottish Ministers. The Pension Fund’s Governance Compliance Statement can be found on page 19. Where compliance does not meet the required standard, there is a requirement for Administering Authorities to set out any reasons for non-compliance in their Governance Compliance Statement.

Review of effectiveness

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

The review of the adequacy and effectiveness of the governance arrangements is informed by evidence from different sources:

- Internal management;
- Internal audit reviews;
- External audit reports; and
- Investment Fund Managers and the Custodian.

Internal management

Administration of the Pension Fund is directly within the remit of the Director of Corporate Services and assurance has been sought from the Director 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 2019/20, no areas of weakness or concern were identified.

In relation to the effectiveness of the Council's arrangements with regard 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 Council, incorporating a culture of accountability that has been developed throughout. The Pension Fund Committee oversees the business of the Pension Fund and the Administering Authority is supported by the Pension Board. The Audit Committee remains responsible for ensuring the effectiveness of the internal audit function and 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 scrutinised robustly. As well as an annual audit plan, the Committee can request one-off reviews to investigate particular issues if necessary. The role of Chief Internal Auditor is fulfilled by the Head of Audit and Inspection at Glasgow City Council, under an arrangement with Audit Glasgow that provides internal audit services to the Council.

Internal audit reviews

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 internal audit plan, based on an approved audit strategy which takes into account the audit universe and an annual assessment of known and potential risks.

External audit reports

External auditors assess the design and implementation of internal controls in operation within the Council as part of their annual audit work.

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.

Investment fund managers and the Custodian

The Custodian for the Pension Fund is the Northern Trust Company, who provide a global custody service. The custodian holds for safekeeping the Pension Fund's investment assets such as electronic certificates. The custodian also provides secure settlement of any global transactions that a Fund Manager may undertake, ensuring that all money and legal rights transfer to the appropriate customer as per the transaction in the correct timeframe. The custodian also provides other services such as reclaiming tax, short term cash investment, securities lending, collection of dividends and valuation reports.

All Fund Managers must be registered with, and comply with the Financial Conduct Authority. At the outset of any investment, the mandate details are agreed by the fund management and the Pension Fund, and documented in an Investment Management Agreement or an Application Form depending on the type of investment. These initial documents cover all aspects of the operation of the mandate, such as investment objectives and restrictions, custody and banking, fees and charges, reporting and communication and dealing arrangements. Any changes to the mandate must be agreed by both the fund management company and the Pension Fund.

Significant governance issues

The system of governance aims to provide reasonable, *but not absolute*, assurance that assets are safeguarded, transactions are authorised and properly recorded, material errors or irregularities are either prevented or detected within a timely period and significant risks impacting on the achievement of our objectives have been mitigated to an acceptable level. A review of the effectiveness of the governance framework has not identified any significant governance issues or control weaknesses in the Pension Fund's governance arrangements.

COVID-19

Covid-19 is a new strain of coronavirus that has quickly spread across the globe, prompting the World Health Organisation, on 11 March 2020, to declare the outbreak a pandemic and a public health emergency of international concern. The Covid-19 pandemic has significantly impacted the Council and the residents of Shetland, resulting in changes to the way services are delivered across the Isles.

The impact of the Covid-19 pandemic on the Pension Fund can be summarised under 4 areas:

- Service delivery & administration
- Governance arrangements;
- Assets and investments; and
- Longer-term consequences.

Service Delivery & Administration

The Council activated business continuity arrangements and put a range of measures in place to facilitate the continuity of service and to protect the wellbeing of staff and Pension Fund customers. Payment of pensions, retirement lump sums and death gratuity grants were prioritised as business-critical services which the Fund has been able to manage on a remote basis. Engagement with investment fund managers has continued from the outset of the pandemic, which gives assurance that the Fund's assets are being managed effectively.

Governance Arrangements

As set out in the earlier commentary, the Council introduced temporary measures to help staff and members adhere to national guidance on social and physical distancing, while enabling core business to be conducted safely. Council meetings have taken place virtually since April. The arrangements have been extended to allow the Pension Committee/Board to meet virtually.

Assets & Investments

The Covid-19 pandemic has resulted in a significant economic slowdown far greater than that of the global financial crash of 2008. The impact on the Pension Fund's investments has been significant, with all asset categories experiencing a contraction in value by 31 March 2020.

Despite the sudden and sharp falls in asset valuations, the Fund remains in a strong financial position. It remains in the growth phase of the Fund's lifecycle, meaning the Fund brings in more income than it pays out in member benefits. The Fund's cash-flow positive position means it does not need to consider selling assets to meet its liabilities. The Fund retains a diversified investment portfolio, held under management by different fund managers that are well placed to respond to investment opportunities as and when they arise.

The Fund's current Funding Strategy aims to maintain stable employer contribution rates while ensuring the long-term solvency of the Pension Fund and achieving a fully-funded position by 2027. The impact of the pandemic on asset valuations is unfortunate timing, especially as the Fund's asset valuations at year end coincide with the Fund's Triennial Valuation. As the valuation progresses, officers and the Pension Fund committee will engage with the actuary to ensure a balanced approach is taken when it comes to setting future employer contribution rates. An investment strategy review is also due to be finalised in 2020 and will take into account any amendments required to protect the Fund's long-term solvency.

Longer-term consequences

It is becoming clearer that the world will be living with Covid-19 for the foreseeable future. The consequences arising from the pandemic, from both a health and an economic perspective will be felt for years. While the Pension Fund's investments may recover the positive gains made up to March 2020, there remains uncertainty over the longer-term impact of Covid-19 on public sector funding, especially as UK public sector net debt reaches new historic levels.

Long-term health implications arising from Covid-19 are not yet fully known, which may have








consequences on the wider global economy and temper any efforts for societies across the world to resume 'normal' life.





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.

Governance Compliance Statement 2019/20

The Local Government Pension Scheme (Scotland) Regulations 2018 require each Administering Authority to publish a Governance Compliance Statement that sets out how their governance arrangements comply with best practice issued by the Scottish Ministers. The table below contains a self-assessment of the Fund's compliance with these principles and highlights any actions required to implement improvements.

Principle	Compliance	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.		The Pension Fund Committee has delegated responsibility for overseeing the management and administration of the LGPS and managing the investments of the Pension Fund.
Representatives of participating LGPS employers (scheduled and 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.		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).
Where a secondary committee or panel has been established, the structure ensures effective communication across both levels.		The Pension Fund Committee and Pension Board meet concurrently to aid easy and open communication.
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 therefore 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); and	i) 	i) Representation on both Pension Fund Committee and Pension Board.
ii) scheme members (including deferred and pensioner scheme members);	ii) 	ii) Representation on the Pension Board.
iii) where appropriate, independent professional observers; and expert advisors (on an ad-hoc basis).	iii) 	iii) Professional advisors (investment fund managers, investment advisors, actuary etc.) are regularly invited to attend Pension Committee and Board meetings.

Where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers, meetings and training and are given opportunities to contribute to the decision-making process, with or without voting rights.		Pension Board members have the same access to information, papers and training as Pension Fund Committee members.
Selection and role of lay members		
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.		Committee and Board members induction training provided during 2017/18, following the Scottish Local Government elections.
At the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.		'Declarations of Interest' is a standing item on all agendas.
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.		The Terms of Reference for both Pension Fund Committee and Pension Board sets out this principle.

.....
Steven Coutts
Leader of the Council
Chair of the Pension Fund Committee
15 July 2020

.....
Maggie Sandison
Chief Executive
Shetland Islands Council
15 July 2020

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 2018), 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 15 June 2020.

Signed on behalf of Shetland Islands Council.

.....
Steven Coutts
Leader of the Council
Chair of the Pension Fund Committee
15 July 2020

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 2020.

.....
Jamie Manson, CPFA
Executive Manager – Finance
Shetland Islands Council
15 July 2020

Pension Fund Account for year ended 31 March 2020

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

2018/19 £000	Notes	2019/20 £000	2019/20 £000
	Dealings with members, employers and others directly involved in the scheme		
(17,694)	Contributions 6	(18,573)	
(1,503)	Transfers in from other pension funds 7	(1,371)	
(1)	Other income	0	
(19,198)	Total Additions		(19,944)
14,509	Benefits payable 8	15,427	
525	Payments to and on account of leavers 9	719	
170	Other payments	31	
15,204	Total Withdrawals		16,177
(3,994)	Net (additions)/withdrawals from dealings with members		(3,767)
1,917	Management expenses 10		1,929
(2,077)	Net additions including Fund Management Expenses		(1,838)
	Return on investments		
(3,417)	Investment income 11	(4,130)	
(31,419)	(Profits) and losses on disposal of investments and changes in market value of investments 14b	42,400	
(34,836)	Net return on investments		38,270
(36,913)	Net (increase)/decrease in the net assets available for benefits during the year		36,432
(460,219)	Opening net assets of the scheme		(497,132)
(497,132)	Closing net assets of the scheme		(460,700)

Net Assets Statement as at 31 March 2020

The Net Assets Statement sets out the value, as at the Statement date, of all assets and current 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.

As at 31 March 2019 £000		Notes	As at 31 March 2020 £000
	Investment Assets		
495,465	Investment Assets	12	459,360
495,465	Total Investment Assets		459,360
	Current Assets		
54	Long-term debtors	18a	89
1,916	Debtors	18	1,633
1,788	Bank current accounts	18	1,572
3,758	Total Current Assets		3,294
	Current Liabilities		
(495)	Sundry creditors	20	(468)
(1,596)	Benefits payable	20	(1,486)
(2,091)	Total Current Liabilities		(1,954)
497,132	Net assets of the scheme available to fund benefits at the reporting period end		460,700

.....
 Jamie Manson, CPFA
 Executive Manager – Finance
 15 July 2020

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.

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 2018 (as amended);
- 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 are members of the Scottish Teachers' Pension Scheme.

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

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 shown below.

31 March 2019	Shetland Islands Council Pension Fund	31 March 2020
11	Number of employers with active members	11
	Number of employees in scheme:	
2,984	Shetland Islands Council	3,101
355	Other employers	371
3,339	Total	3,472
	Number of pensioners/dependants	
1,801	Shetland Islands Council	1,901
166	Other employers	176
1,967	Total	2,077
	Deferred pensioners	
1,826	Shetland Islands Council	1,907
367	Other employers	386
2,193	Total	2,293
7,499	Scheme Total	7,842

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 2018 (as amended) and range from 5.5% to 12% of pensionable pay for the financial year ending 31 March 2020. Employee contributions are topped

up by employers' contributions, which are set, based on triennial actuarial funding valuations. The actuarial valuation as at 31 March 2017 set these employers' contribution rates, which range from 17.2% to 40.6% 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 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 2019/20 financial year and its position at year-end as at 31 March 2020. The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2019/20, 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 26 basis, is disclosed at Note 18.

The accounts have been prepared on a going concern basis.

Note 3: Accounting Standards Issued and Adopted in year

The following accounting standards were new or amended in the 2019/20 Code:

- Amendments to IAS40 Investment Property: Transfers of Investment Property;
- Annual improvements to IFRS Standards 2014-2016 Cycle. IFRS 12 Disclosure of Interests in Other Entities: Clarification of the Scope of the Standard. IAS 28 Investments in Associates and Joint Ventures: Measuring an Associate or Joint Venture at Fair Value;
- IFRIC 22 Foreign Currency Transactions and Advance Consideration;
- IFRIC 23 Uncertainty over Income Tax Treatments; and
- Amendments to IFRS 9 Financial Instruments: Prepayment features with negative compensation.

The Code required implementation in the financial statements from 1 April 2019. There has not been any significant impact on the Pension Fund.

Note 4: Accounting Standards Issued not Adopted

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued, but not yet adopted. This applies to the adoption of the following new or amended standards within the 2020/21 Code:

- Amendments to IAS28 Investments in Associates and Joint Ventures: Long-term Interests in Associates and Joint Ventures;
- Annual Improvements to IFRS Standards 2015-2017 Cycle; and
- Amendments to IAS 19 Employee Benefits: Plan Amendment, Curtailment or Settlement.

The Code requires implementation in the accounts from 1 April 2020 and there is therefore no impact on the Pension Fund.

Note 5: 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 assumptions and estimates.

The table below highlights the approximate impact that a small change in the assumptions used would have on the liabilities of the fund:

Item	Uncertainties - Estimate	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, a 0.5% decrease in the real discount rate assumption would result in an increase in the pension liability of £75m. A 0.5% increase in salary increase rate assumption would increase the value of liabilities by approximately £11m, and a 0.5% increase in pension increase rate assumption would increase the liability by approximately £64m.

Note 6: Contributions Receivable

By category:

31 March 2019 £000		31 March 2020 £000
(13,481)	Employers - normal	(14,229)
(203)	Employers - augmentation	(103)
(4,010)	Members - normal	(4,241)
(17,694)	Total	(18,573)

By authority:

31 March 2019 £000		31 March 2020 £000
(15,356)	Administering authority	(16,072)
(128)	Scheduled bodies	(131)
(2,210)	Admitted bodies	(2,370)
(17,694)	Total	(18,573)

Note 7: Transfers in from Other Pension Funds

The total transfers received during the year are as follows:

31 March 2019 £000		31 March 2020 £000
(1,503)	Individual transfers in	(1,371)
(1,503)	Total	(1,371)

The Pension Fund received 53 transfers in during 2019/20 with an average value of £25,876, compared to 42 transfers in during 2018/19 with an average value of £35,781.

Note 8: Benefits Payable

By category:

31 March 2019 £000		31 March 2020 £000
10,807	Pensions	11,486
3,093	Commutation and lump sum retirement	3,682
609	Lump sum death benefits	259
14,509	Total	15,427

By authority:

31 March 2019 £000		31 March 2020 £000
12,889	Administering authority	13,529
129	Scheduled bodies	118
1,491	Admitted bodies	1,780
14,509	Total	15,427

Note 9: Payments to and on Account of Leavers

31 March 2019 £000		31 March 2020 £000
32	Refunds to members leaving service	88
493	Individual transfers	631
525	Total	719

Note 10: Management Expenses

31 March 2019 £000		31 March 2020 £000
386	Administration Expenses	340
38	Oversight and Governance Expenses	35
	Investment	
1,425	Management Fees	1,488
33	Performance Fees	34
35	Custody Fees	32
1,917	Total	1,929

Note 11: External Audit Costs

31 March 2019 £000		31 March 2020 £000
29	Payable in respect of external audit	25
29	Total	25

Note 12: Investment Income

31 March 2019 £000		31 March 2020 £000
(2,759)	Pooled investment vehicles	(3,416)
(9)	Interest on cash deposits	(21)
(649)	Other	(693)
(3,417)	Total	(4,130)

Note 13: Investments

Fair Value As at 31 March 2019 £000		Fair Value As at 31 March 2020 £000
183,335	Managed Funds	167,442
214,098	Unit Linked Insurance Policies	192,030
39,425	Fixed income unit trusts	38,023
52,367	Pooled property unit trusts	51,401
205	Unitised Liquidity Fund	206
1,952	Property Debt	2,243
4,076	Cash deposits	7,882
7	Property income due	133
495,465	Total investment assets	459,360

Note 13a - Reconciliation of movements in investments

	Market Value at 1 April 2019 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2020 £000
Investment Assets:					
Pooled funds - managed funds	182,944	0	(2)	(15,900)	167,042
- unit linked insurance policies	214,098	0	(21)	(22,047)	192,030
Fixed income unit trusts	39,425	1,005	0	(2,407)	38,023
Pooled property unit trusts	52,367	4,092	(3,036)	(2,022)	51,401
Unitised Liquidity Fund	205	0	0	1	206
Property Debt	1,952	316	0	(25)	2,243
Total Pooled Investment	490,991	5,413	(3,059)	(42,400)	450,945
Other investment balances:					
Diversified Growth income due	126				138
Fixed income due	265				262
Property income due	7				133
Cash income due	4,076				7,882
Net investment assets	495,465				459,360

	Market Value at 1 April 2018 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2019 £000
Investment Assets:					
Pooled funds - managed funds	171,290	0	(1)	11,655	182,944
- unit linked insurance policies	197,989	0	(2,992)	19,101	214,098
Fixed income unit trusts	39,157	764	0	(496)	39,425
Pooled property unit trusts	48,267	5,360	(2,417)	1,157	52,367
Unitised Liquidity Fund	203	0	0	2	205
Property Debt	0	1,952	0	0	1,952
Total Pooled Investment	456,906	8,076	(5,410)	31,419	490,991
Other investment balances					
Diversified Growth income due	121				126
Fixed income due	169				265
Property income due	108				7
Cash income due	2,116				4,076
Net investment assets	459,420				495,465

Indirect costs are incurred through the bid-offer spread on investments within pooled investment vehicles. The amount of indirect costs is not separately provided to the Scheme.

Note 13b - Analysis of Pooled Investment Vehicles

As at 31 March 2019 £000	Additional analysis	As at 31 March 2020 £000
102,381	Managed Funds	88,272
214,098	Unit Linked Insurance Policies	192,030
80,562	Diversified Growth	78,770
39,425	Alternative Credit	38,023
52,004	Pooled property unit trust (UK)	51,306
364	Pooled property unit trust (Overseas)	95
205	Unitised Liquidity Fund	206
1,952	Property Debt	2,243
490,991	Total Pooled Investment Vehicles	450,945

Note 13c - Analysis by Fund Manager

Market Value 31 March 2019			Market Value 31 March 2020	
£000	%		£000	%
211,314	43	BlackRock	192,248	43
61,391	12	Schroders	61,647	13
80,689	16	Newton Asset Management	78,908	17
102,381	21	Kleinwort Benson	88,272	19
39,690	8	M & G Investments	38,285	8
495,465	100	Total investment assets	459,360	100

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

Market Value 31 March 2019			Market Value 31 March 2020	
£000	%		£000	%
88,389	18	Aquila Life UK equity index	71,923	16
39,425	8	M & G Alpha Opp Fd AGBP	38,023	8
102,381	21	KBI 1 Dividend Plus	88,272	19
80,562	16	Newton Real Rtrn X ACC NAV	78,770	17
122,914	25	Aquila Life World EX UK Fund Series 1	117,313	26

Note 14: Fair Value Hierarchy

Asset and liability valuations have been classified into three levels according to the quality and reliability of information used to determine their fair values. Transfers between levels are

recognised in the accounts in the year in which they occur.

Level 1

Assets and liabilities at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as Level 1

comprise quoted equities, quoted fixed securities, quoted index linked securities and unit trusts.

Level 2

Assets and liabilities at Level 2 are those where quoted market prices are not available, for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value.

Level 3

Assets and liabilities at Level 3 are those where at least one input that could have a significant effect

on the instrument's valuation is not based on observable market data.

The following table provides an analysis of the financial assets of the pension fund, grouped into Levels 1 and 2, based on the level at which the fair value is observable. The Pension Fund has no Level 3 investments.

As at 31 March 2019 £000	Fair value through profit and loss	As at 31 March 2020 £000
4,475	Level 1	8,415
490,990	Level 2	450,945
495,465	Net Investment assets	459,360

Basis of Valuation

The basis of valuation for each class of investment asset is set out below. There has been no change in the valuation techniques used during the year. All assets have been valued using fair value techniques that represent the highest and best price available at the reporting date.

Description of Asset	Valuation hierarchy	Basis of valuation	Observable / unobservable inputs	Key sensitivities affecting valuations
Market quoted investments	Level 1	Published bid market price ruling on the final day of the accounting period	Not required	Not required
Exchange traded pooled investments	Level 1	Closing bid value on published exchanges	Not required	Not required
Pooled investments - overseas unit trusts and property funds	Level 2	Closing bid price where bid and offer prices are published Closing single price where single price published	NAV-based pricing set on a forward pricing basis	Not required

Note 15: Financial Instruments

Note 15a - 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.

As at 31 March 2019				As at 31 March 2020		
Fair value through profit £000	Receivables £000	Financial liabilities £000		Fair value through profit £000	Receivables £000	Financial liabilities £000
			Financial assets			
			Pooled funds			
183,209	0	0	- managed funds	167,304		
214,098	0	0	- unit linked insurance policies	192,030		
39,425	0	0	Fixed income unit trusts	38,023		
52,367	0	0	Pooled property unit trusts	51,401		
204	0	0	Unitised liquidity funds	206		
1,952	0	0	Property debt	2,243		
127	0	0	Diversified growth	138		
4,076	1,788	0	Cash	7,882	1,572	
7	0	0	Property income due	133		
0	1,916	0	Debtors		1,633	
495,465	3,704	0	Total Financial assets	459,360	3,205	0
			Financial liabilities			
0	0	(2,091)	Creditors	0	0	(1,954)
0	0	(2,091)	Total Financial liabilities	0	0	(1,954)
495,465	3,704	(2,091)	Total	459,360	3,205	(1,954)

Note 15b - Net gains and losses on financial instruments

As at 31 March 2019 £000	Financial assets	As at 31 March 2020 £000
(31,419)	Fair value through profit and loss	42,400
(31,419)	Total	42,400

Note 15c - Value of financial instruments

As at 31 March 2019		Financial assets	As at 31 March 2020	
Book value £000	Market value £000		Book value £000	Market value £000
344,170	491,389	Fair value through profit and loss	355,696	459,360
344,170	491,389	Total	355,696	459,360

Note 16: 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 2019/20 reporting period:

Asset Type	Potential market movements (+/-)
UK Equities	27.5%
Overseas Equities	28.0%
Property	14.2%
Cash	0.3%
Diversified Growth	13.8%
Alternative Credit	8.7%

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 shown in the following table (the prior year comparator is shown below).

Asset Type	Value as at 31 March 2020 £000	Percentage Change %	Value on Increase £000	Value on Decrease £000
Cash and cash equivalents	7,882	0.30%	7,906	7,858
Investment portfolio assets:				
UK Equities	71,923	27.5%	91,702	52,144
Global Equities (ex UK)	205,585	28.0%	263,149	148,021
Property	56,777	14.2%	64,839	48,715
Diversified Growth	78,908	13.8%	89,797	68,019
Alternative Credit	38,285	8.7%	41,616	34,954
Total assets	459,360		559,009	359,711

Asset Type (Restated)	Value as at 31 March 2019 £000	Percentage Change %	Value on Increase £000	Value on Decrease £000
Cash and cash equivalents	4,281	0.50%	4,302	4,260
Investment portfolio assets:				
UK Equities	88,389	16.6%	103,062	73,716
Global Equities (ex UK)	225,294	16.9%	263,369	187,219
Property	57,122	14.3%	65,290	48,954
Diversified Growth	80,689	12.5%	90,775	70,603
Alternative Credit	39,690	7.3%	42,587	36,793
Total assets	495,465		569,385	421,545

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 are set out below:

As at 31 March 2019 £000		As at 31 March 2020 £000
	Asset type	
4,281	Cash and cash equivalents	7,882
1,788	Cash balances	1,572
39,425	Fixed income unit trusts	38,023
45,494	Total	47,477

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 2020 £000	Change in year in the net assets available to pay benefits	
		+100 BPS £000	-100 BPS £000
Cash and cash equivalents	7,882	79	-79
Cash balances	1,572	16	-16
Fixed income unit trusts	38,023	380	-380
Total change in assets available	47,477	475	-475

Asset Type	Carrying amount as at 31 March 2019 £000	Change in year in the net assets available to pay benefits	
		+100 BPS £000	-100 BPS £000
Cash and cash equivalents	4,281	43	-43
Cash balances	1,788	18	-18
Fixed income unit trusts	39,425	394	-394
Total change in assets available	45,494	455	-455

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 2020 and as at the previous period end.

As at 31 March 2019 £000		As at 31 March 2020 £000
	Asset type	
225,294	Pooled Funds - overseas equities	205,585
39,690	Pooled Property Unit Trusts - overseas	38,285
127	Diversified Growth Fund	138
265,111	Total	244,008

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 2020 £000	Change to net assets available to pay benefits	
		+10.0% £000	-10.0% £000
Pooled Funds - overseas equities	205,585	226,144	185,026
Pooled Property Unit Trusts - overseas	38,285	42,114	34,456
Diversified Growth Fund	138	152	124
Total change in assets available	244,008	268,410	219,606

Asset Type	Carrying amount as at 31 March 2019 £000	Change to net assets available to pay benefits	
		+10.0% £000	-10.0% £000
Pooled Funds - overseas equities	225,294	247,823	202,765
Pooled Property Unit Trusts - overseas	39,690	43,659	35,721
Diversified Growth Fund	127	140	114
Total change in assets available	265,111	291,622	238,600

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 2020 was £9.454 (31 March 2019: £6.069m). This was held with the following institutions:

As at 31 March 2019 £000		As at 31 March 2020 £000
4,270	Fund manager	
11	Schroders cash	4,869
	BlackRock cash	3,013
1,788	Bank current	
	Bank of Scotland Plc	1,572
6,069	Total	9,454

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 2020, the value of illiquid assets was £56.8m, which represented 12.4% of the Pension Fund assets (31 March 2019: £57.1m, which represented 11.5% 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 17: Funding Arrangements

In line with the Local Government Pension Scheme (Scotland) Regulations 2014 (as amended), 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 2017.

The funding policy is set out in the Pension Fund's Funding Strategy Statement (FSS), dated February 2018.

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; 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.

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 2014 was at 31 March 2017. This valuation revealed that the Pension Fund's assets, which at 31 March 2017 were valued at £450m, were sufficient to meet 90% (£333m and 92% at 31 March 2014 valuation) of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2017 valuation was £51m (2014 valuation: £30m).

The common rate of contribution payable by each employing authority under regulation 32(4)(a) of the 2014 Regulations for the period 1 April 2018 to 31 March 2021 is 22.1% 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 2018 to 31 March 2021 were set in accordance with the Pension Fund's funding policy as set out in its Funding Strategy Statement.

During this period, the employers' rate due by Shetland Islands Council is 20.8% per annum for each of the three years.

Copies of the 2017 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 in the valuation

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, at 8 North Ness Business Park, Lerwick.

Method

The valuation approach recognises the uncertainties inherent in the valuation process. The actual cost of future benefits is unknown, due to the long time period. The first process in calculating the valuation is to set a funding target, which defines the target amount of assets to be held to meet future cashflows. Next, a time horizon is set over which the funding target is to be reached. Finally, a contribution is set to give a sufficiently high likelihood to meet the funding target over the time horizon. The calculations separately identify past service and future service costs.

Assumptions

The assumptions are required to place value on the benefits earned to date and the benefits that will be earned in the future. To this end, the assumptions fall broadly into two categories; financial assumptions and demographic assumptions. Financial assumptions relate to the size of members' benefits, and information affecting these assumptions are discount rate, price inflation, which affects benefit increases, and salary increases. Demographic assumptions relate to longevity of current pensioners and future pensioners.

A market-related approach was taken when valuing the liabilities, for consistency with the valuation of the Fund assets at their 31 March 2017 market value.

The key financial assumptions adopted for the 2017 valuation were as follows:

Financial assumptions	% per annum
Discount rate	3.5%
Salary increase assumption	3.0%
Benefit increase assumption (CPI)	2.4%

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. An allowance for future improvements in mortality based on the CMI 2016 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.25% per annum. Based on these assumptions, the average future life expectancies at age 65 are as follows:

Mortality assumption at age 65	Males	Females
Current Pensioners	21.4 yrs	23.2 yrs
Future Pensioners	22.7 yrs	25.0 yrs

Commutation assumption

An allowance is included for future retirements to elect to take 50% of the maximum additional tax-free cash up to HMRC limits for pre-April 2009 service and 75% of the maximum tax-free cash post-April 2009 service.

50:50 Option assumption

It is assumed that 1.0% of members (uniformly distributed across the age, service and salary range) will choose the 50:50 option. This is where members pay 50% of contributions in return for 50% of benefits. Employers still pay the full contribution.

Note 18: 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 26 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 17). 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 2020 was £639m (31 March 2019: £710m). 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 2017.

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:

As at 31 March 2019 % p.a.	Year ended	As at 31 March 2020 % p.a.
2.5	Inflation/pension increase rate	1.9
3.1	Salary increase rate	2.4
2.4	Discount rate	2.3

Note 19: Current Assets

As at 31 March 2019 £000		As at 31 March 2020 £000
	Debtors:	
452	Contributions due - employees	366
1,463	Contributions due - employers	1,209
0	Transfer values receivable	0
1	Sundry debtors	0
0	Prepayments	58
1,788	Bank current accounts	1,572
3,704	Total	3,205

Note 19a: Long Term Debtor

As at 31 March 2019 £000		As at 31 March 2020 £000
	Long Term Debtors	
54	Reimbursement of lifetime tax allowance	89
54	Total	89

Note 20: Unfunded Pension

As at 31 March 2019 £000		As at 31 March 2020 £000
718	Added years pension	734

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 by the employer and not the Pension Fund.

Note 21: Current Liabilities

As at 31 March 2019 £000		As at 31 March 2020 £000
(495)	Sundry creditors	(468)
(1,596)	Benefits payable	(1,486)
(2,091)	Total	(1,954)

Note 22: Contingent Liabilities

McCloud Judgement

There is still uncertainty over the impact of the McCloud judgement which came about after two employment tribunal cases were brought against the government in relation to the reformed 2015 public service pension schemes.

In the unfunded schemes, transitional protection enabled some members to remain in the pre-2015 schemes after 1 April 2015 until retirement or the end of a pre-determined tapered protection period. The Court of Appeal ruled that the transitional protections gave rise to unlawful discrimination. The legal process is ongoing with the Government currently seeking permission to appeal the ruling of the Court of Appeal. It is therefore not possible to quantify at this stage the impact that this may have.

GMP Equalisation

Following a High Court ruling from 26 October 2016, all defined benefit pension schemes must equalise guaranteed minimum pension (GMP) for men and women. There is insufficient data at present to estimate reliably the impact this will have on scheme liabilities.

Bad Debt

A provision of £0.133m for a bad debt for non recovery of contributions was created. The employer is not backed by a guarantee.

Note 23: Additional Voluntary Contributions

As at 31 March 2019 £000		As at 31 March 2020 £000
5,268	Prudential	5,069
47	Equitable Life	46
5,315	Total	5,115

AVC contributions of £0.560m were paid directly to Prudential during the year (2018/19: £0.649m).

In accordance with regulation 4 (2) (b) of the Local Authority Government Pension Scheme (Management of Funds) (Scotland) Regulations 2010, AVCs are not included in the Pension Fund financial statements.

Note 24: 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 £0.350m (2018/19: £0.395m) 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 £0.034m (2018/19: £0.033m) 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 £11.486m (2018/19: £10.807m). 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 £12.394m to the Pension Fund (2018/19: £11.903m).

Governance

Three members of the Pension Fund Committee receive pension benefits from the Shetland Islands Council Pension Fund. These and other committee members 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.

Membership is as follows.

Pension Fund Committee Membership
Steven Coutts (Chair)
Alistair Cooper
Stephen Leask
Robbie McGregor
George Smith
Theodore G C Smith
Ryan Thomson
Emma Louise Macdonald
Ian Scott
Pension Board Membership
Malcolm Bell
John Fraser
Amanda Hawick (resigned 27/11/2019)
Stephen Flaws (appointed 21/01/2020)

Note 25: Changes in Actuarial Present Value of Promised Retirement Benefits

Actuarial Present Value of Promised Retirement Benefits	Vested Benefits £000	Total £000
Balance at 31 March 2020	639	639
Decrease in value during 2019/20	(71)	(71)
Balance at 31 March 2019	710	710
Increase in value during 2018/19	88	88
31 March 2018	622	622

Note 26: 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, if required. 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 17. This estimate is subject to significant

variances based on changes to the underlying assumptions.

Note 27: Events after the Balance Sheet Date

The annual accounts were authorised for issue on 15 July 2020. Events taking place after this date are not reflected in the financial statements or notes. Where events taking place before this date provided information about conditions existing at 31 March 2020, the figures in the financial statements and notes have been adjusted in all

material respects to reflect the impact of this information. The Covid-19 pandemic has had a substantial impact on the Pension Fund's investments. Investments reduced to a value of £459m at 31 March 2020 before recovering to £506m at the end of May 2020.

Note 28: 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 7 and 9).

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** is recognised in the Pension Fund account as it accrues.
- **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.

- **Changes in the 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 costs relating to staff of the pension administration team are charged direct to the Pension Fund. Associated management, accommodation and other overheads are apportioned to the Pension Fund in accordance with Council policy.

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.

Where fees are netted off quarterly valuations by investment managers, these expenses are shown in Note 10 and grossed up to increase the change in value of investments.

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, is 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 outlined in the following paragraphs.

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 and triennial 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 18).

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 23).

M Contingent Liabilities

A contingent liability arises where an event has taken place prior to the year-end giving rise to a possible financial obligation whose existence will only be confirmed or otherwise by the occurrence of future events. Contingent liabilities can also arise in circumstances where a provision would be made, except that it is not possible at the balance sheet date to measure the value of the financial obligation reliably.

Contingent liabilities are not recognised in the net asset statement but are disclosed by way of narrative in the notes.

Appendix 1:

Actuarial Statement for 2019/20

This statement has been prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2018. 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 (FSS), dated March 2018. 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'/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 (NB 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; 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. Asset-liability modelling has been carried out which demonstrates that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is at least a 66% likelihood that the Fund will return to full funding over 14 years.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014 was as at 31 March 2017. This valuation revealed that the Fund's assets, which at 31 March 2017 were valued at £450 million, were sufficient to meet 90% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2017 valuation was £51 million.

Each employer had contribution requirements set at the valuation, with the aim of achieving full funding within a time horizon and probability measure as per the FSS. Individual employers' contributions for the period 1 April 2018 to 31 March 2021 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 2017 valuation report.

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 and inflation 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 2017 valuation were as follows:

Financial assumptions	31 March 2017
Discount rate	3.5%
Salary increase assumption	3.0%
Benefit increase assumption (CPI)	2.4%

The key demographic assumption was the allowance made for longevity. The life expectancy assumption was based on the Fund's Vita Curves alongside future improvements based on the CMI 2016 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	22.1 years	24.0 years
Future Pensioners*	23.9 years	26.1 years

*Currently aged 45

Copies of the 2017 valuation report and Funding Strategy Statement are available on request from the Administering Authority to the Fund.

Experience over the period since 31 March 2017

Markets were disrupted by COVID 19 which resulted in difficult market conditions towards the end of the 2019/20 financial year. As a result, the funding level of the Fund as at 31 March 2020 has reduced versus that reported at the previous formal valuation.

The next actuarial valuation will be carried out as at 31 March 2020. The Funding Strategy Statement will also be reviewed at that time.



Douglas Green FFA
For and on behalf of Hymans Robertson LLP
2 June 2020

Hymans Robertson LLP
20 Waterloo Street, Glasgow, G2 6DB

Annual Governance Statement

Scope of responsibility

Shetland Islands Council is the Administering Authority for the Shetland Islands Council Pension Fund. The Council is responsible for ensuring that the Pension Fund:

- Conducts business in accordance with the law and proper standards;
- Safeguards and properly accounts for public money and assets under its control; and
- Utilises public money economically, efficiently and effectively.

In discharging these responsibilities, the Council is responsible for putting in place proper arrangements for the governance of its affairs and facilitating the effective exercise of its functions, including arrangements for the management of risk. The arrangements put in place by the Council therefore apply equally to the activities of the Pension Fund.

The Council has approved and adopted a Local Code of Corporate Governance, which is consistent with the principles of the CIPFA/SOLACE framework 'Delivering Good Governance in Local Government'. The Code is available on the Shetland Islands Council website. The Council's financial and management arrangements comply with the CIPFA Statement on the role of the Chief Financial Officer in local government. Furthermore, the Council has a statutory duty to make arrangements to secure best value under the Local Government in Scotland Act 2003.

The Local Code of Corporate Governance demonstrates the Council's commitment to achieving good governance and provides examples of how it complies with the governance standards recommended by CIPFA and SOLACE. The document is regularly reviewed and was last updated in June 2019.

Purpose of the governance framework

The governance framework consists of the systems, processes, culture and values by which the Pension Fund is directed and controlled, and the activities used to engage with and lead the community. It enables the Pension Fund to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate, cost effective services.

The system of internal control is a significant part of the governance framework and is designed to manage risk at acceptable levels, and provide reasonable, but not absolute, assurance that policies, aims and objectives can be delivered. The system of internal control is based on an ongoing process designed to identify and prioritise risks, and their associated impacts should they crystallise, and to manage them efficiently, effectively and economically.

The governance framework has been in place for the year ended 31 March 2020 and up to the date of approval of the Annual Accounts.

The governance framework

The governance framework adopted by the Council is consistent with the with the seven core principles of the revised 2016 CIPFA/SOLACE framework and is pictured below, showing each of the seven principles and how they interact with one another.

Principles A and B contain the overarching principles of good governance which percolate down through the remaining principles.



In addition to complying with the governance framework approved by the Council, the regulations that govern the administration of LGPS Funds in Scotland require each Administering Authority to publish a Governance Compliance Statement that sets out how their governance arrangements comply with best practice issued by the Scottish Ministers. The Pension Fund’s Governance Compliance Statement can be found on page 20. Where compliance does not meet the required standard, there is a requirement for Administering Authorities to set out any reasons for non-compliance in their Governance Compliance Statement.

Review of effectiveness

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

The review of the adequacy and effectiveness of the governance arrangements is informed by evidence from different sources:

- Internal management;
- Internal audit reviews;
- External audit reports; and
- Investment Fund Managers and the Custodian.

Internal management

Administration of the Pension Fund is directly within the remit of the Director of Corporate Services and assurance has been sought from the Director 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 2019/20, no areas of weakness or concern were identified.

In relation to the effectiveness of the Council's arrangements with regard 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 Council, incorporating a culture of accountability that has been developed throughout. The Pension Fund Committee oversees the business of the Pension Fund and the Administering Authority is supported by the Pension Board. The Audit Committee remains responsible for ensuring the effectiveness of the internal audit function and 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 scrutinised robustly. As well as an annual audit plan, the Committee can request one-off reviews to investigate particular issues if necessary. The role of Chief Internal Auditor is fulfilled by the Head of Audit and Inspection at Glasgow City Council, under an arrangement with Audit Glasgow that provides internal audit services to the Council.

Internal audit reviews

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 internal audit plan, based on an approved audit strategy which takes into account the audit universe and an annual assessment of known and potential risks.

External audit reports

External auditors assess the design and implementation of internal controls in operation within the Council as part of their annual audit work.

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.

Investment fund managers and the Custodian

The Custodian for the Pension Fund is the Northern Trust Company, who provide a global custody service. The custodian holds for safekeeping the Pension Fund's investment assets such as electronic certificates. The custodian also provides secure settlement of any global transactions that a Fund Manager may undertake, ensuring that all money and legal rights transfer to the appropriate customer as per the transaction in the correct timeframe. The custodian also provides other services such as reclaiming tax, short term cash investment, securities lending, collection of dividends and valuation reports.

All Fund Managers must be registered with, and comply with the Financial Conduct Authority. At the outset of any investment, the mandate details are agreed by the fund management and the Pension Fund, and documented in an Investment Management Agreement or an Application Form depending on the type of investment. These initial documents cover all aspects of the operation of the mandate, such as investment objectives and restrictions, custody and banking, fees and charges, reporting and communication and dealing arrangements. Any changes to the mandate must be agreed by both the fund management company and the Pension Fund.

Significant governance issues

The system of governance aims to provide reasonable, *but not absolute*, assurance that assets are safeguarded, transactions are authorised and properly recorded, material errors or irregularities are either prevented or detected within a timely period and significant risks impacting on the achievement of our objectives have been mitigated to an acceptable level. A review of the effectiveness of the governance framework has not identified any significant governance issues or control weaknesses in the Pension Fund's governance arrangements.

COVID-19

Covid-19 is a new strain of coronavirus that has quickly spread across the globe, prompting the World Health Organisation, on 11 March 2020, to declare the outbreak a pandemic and a public health emergency of international concern. The Covid-19 pandemic has significantly impacted the Council and the residents of Shetland, resulting in changes to the way services are delivered across the Isles.

The impact of the Covid-19 pandemic on the Pension Fund can be summarised under 4 areas:

- Service delivery & administration
- Governance arrangements;
- Assets and investments; and
- Longer-term consequences.

Service Delivery & Administration

The Council activated business continuity arrangements and put a range of measures in place to facilitate the continuity of service and to protect the wellbeing of staff and Pension Fund customers. Payment of pensions, retirement lump sums and death gratuity grants were prioritised as business-critical services which the Fund has been able to manage on a remote basis. Engagement with investment fund managers has continued from the outset of the pandemic, which gives assurance that the Fund's assets are being managed effectively.

Governance Arrangements

As set out in the earlier commentary, the Council introduced temporary measures to help staff and members adhere to national guidance on social and physical distancing, while enabling core business to be conducted safely. Council meetings have taken place virtually since April. The arrangements have been extended to allow the Pension Committee/Board to meet virtually.

Assets & Investments

The Covid-19 pandemic has resulted in a significant economic slowdown far greater than that of the global financial crash of 2008. The impact on the Pension Fund's investments has been significant, with all asset categories experiencing a contraction in value by 31 March 2020.

Despite the sudden and sharp falls in asset valuations, the Fund remains in a strong financial position. It remains in the growth phase of the Fund's lifecycle, meaning the Fund brings in more income than it pays out in member benefits. The Fund's cash-flow positive position means it does not need to consider selling assets to meet its liabilities. The Fund retains a diversified investment portfolio, held under management by different fund managers that are well placed to respond to investment opportunities as and when they arise.

The Fund's current Funding Strategy aims to maintain stable employer contribution rates while ensuring the long-term solvency of the Pension Fund and achieving a fully-funded position by 2027. The impact of the pandemic on asset valuations is unfortunate timing, especially as the Fund's asset valuations at year end coincide with the Fund's Triennial Valuation. As the valuation progresses, officers and the Pension Fund committee will engage with the actuary to ensure a balanced approach is taken when it comes to setting future employer contribution rates. An investment strategy review is also due to be finalised in 2020 and will take into account any amendments required to protect the Fund's long-term solvency.

Longer-term consequences

It is becoming clearer that the world will be living with Covid-19 for the foreseeable future. The consequences arising from the pandemic, from both a health and an economic perspective will be felt for years. While the Pension Fund's investments may recover the positive gains made up to March 2020, there remains uncertainty over the longer-term impact of Covid-19 on public sector funding, especially as UK public sector net debt reaches new historic levels.

Long-term health implications arising from Covid-19 are not yet fully known, which may have








consequences on the wider global economy and temper any efforts for societies across the world to resume 'normal' life.





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.

Governance Compliance Statement 2019/20

The Local Government Pension Scheme (Scotland) Regulations 2018 require each Administering Authority to publish a Governance Compliance Statement that sets out how their governance arrangements comply with best practice issued by the Scottish Ministers. The table below contains a self-assessment of the Fund's compliance with these principles and highlights any actions required to implement improvements.

Principle	Compliance	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.		The Pension Fund Committee has delegated responsibility for overseeing the management and administration of the LGPS and managing the investments of the Pension Fund.
Representatives of participating LGPS employers (scheduled and 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.		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).
Where a secondary committee or panel has been established, the structure ensures effective communication across both levels.		The Pension Fund Committee and Pension Board meet concurrently to aid easy and open communication.
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 therefore 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); and	i) 	i) Representation on both Pension Fund Committee and Pension Board.
ii) scheme members (including deferred and pensioner scheme members);	ii) 	ii) Representation on the Pension Board.
iii) where appropriate, independent professional observers; and expert advisors (on an ad-hoc basis).	iii) 	iii) Professional advisors (investment fund managers, investment advisors, actuary etc.) are regularly invited to attend Pension Committee and Board meetings.

Where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers, meetings and training and are given opportunities to contribute to the decision-making process, with or without voting rights.		Pension Board members have the same access to information, papers and training as Pension Fund Committee members.
Selection and role of lay members		
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.		Committee and Board members induction training provided during 2017/18, following the Scottish Local Government elections.
At the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.		'Declarations of Interest' is a standing item on all agendas.
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.		The Terms of Reference for both Pension Fund Committee and Pension Board sets out this principle.

.....
Steven Coutts

Leader of the Council

Chair of the Pension Fund Committee

15 July 2020

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Maggie Sandison

Chief Executive

Shetland Islands Council

15 July 2020



Meeting(s):	Pension Fund Committee Pension Board	15 July 2020 15 July 2020
Report Title:	Pension Fund Management Annual Investment Review 2019/20	
Reference Number:	F-034-F	
Author / Job Title:	Executive Manager - Finance	

1.0	Decisions / Action required:
1.1	<p>That the Pension Fund Committee and Pension Board NOTE:</p> <ul style="list-style-type: none"> the performance of BlackRock was equal to the benchmark in 2019/20; the underperformance of the benchmark and target by KBI Global investors in 2019/20; the underperformance of the fixed benchmark by Newton in 2019/20; the underperformance of the benchmark and target by Schroders in 2019/20; the underperformance of the fixed benchmark by M&G in 2019/20.
2.0	High Level Summary:
2.1	The purpose of this report is to inform the Pension Fund Committee and Pension Board on the position and performance of the Pension Fund's external investments, with fund managers for the financial year 2019/20.
2.2	The Pension Fund's investments decreased in value by £38 million over the 2019/20 financial year and now have an overall value at the end of March 2020 of £459 million. The investment return for the Pension Fund in 2019/20 was -7.3%.
2.3	Over the 2019/20 financial year BlackRock were equal to their benchmark aim, KBI Global Investors, Newton, Schroders and M&G all underperformed their benchmarks. See additional information in Appendix 1.
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	The annual review shows that the Fund Manager's annual return figures have been negatively affected by the coronavirus pandemic during the last quarter of the financial year. This has also impacted on active fund manager's performance against benchmark over the financial year. There is still a lot of concern in the markets about the coronavirus pandemic but the investment markets have seen a steady recovery since the financial year end.
4.2	Market volatility is to be expected over short time periods but over the long term the general market trend is positive. There is no immediate action recommended to be taken from these results.
4.3	A review of the Pension Fund Investment Strategy is currently underway with KPMG (now called Isio) the Pension Fund's investment consultants. The findings and recommendations from the review will be reported at a later date.
4.4	This report is an annual review of how the markets and fund managers have performed. All of the Pension Fund's investments are invested for the long term in line with the 2014 Pension Fund investment strategy.
5.0	Exempt and/or confidential information:
5.1	None
6.0	Implications :
6.1 Service Users, Patients and Communities:	The monitoring of fund manager performance is a means of providing reassurance to members and employers that the fund is being managed appropriately for the long term sustainability objectives and to ensure that monies will be available to fund future pension benefits.
6.2 Human Resources and Organisational Development:	None
6.3 Equality, Diversity and Human Rights:	None
6.4 Legal:	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.
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</p>

	<p>objectives.</p> <p>It is not likely that the Pension Fund can expect a positive investment return from its investments every year but having robust governance and monitoring in place, alongside a diversified investment strategy, 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 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.</p>
6.7 ICT and new technologies:	<p>None</p>
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</p>

	their objectives with those of society at large.	
6.9 Risk Management:	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.	
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. The Pension Board will determine the areas they wish to consider.</p>	
6.11 Previously considered by:	None	

Contact Details:

Colin Bain, Treasury Accountant
Telephone: 01595 744616
E-mail: colin.bain@shetland.gov.uk

Appendices:

Appendix 1 - Pension Fund Management Annual Investment Review 2019/20

Background Documents:

None

Pension Fund Management Annual Investment Review 2019/20

1.0 Background

- 1.1 This report forms part of the Pension Fund's governance arrangements where the Pension Fund Committee and Pension Board will receive an annual investment report for 2019/20 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 2019/20. The report looks at the performance of the Pension 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 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.
- 1.5 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.
- 1.6 A review of the Pension Fund Investment Strategy is currently underway with KPMG (now called Isio), the Pension Fund's investment consultants. The findings and recommendations from the review will be reported at a later date.

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 2020 of £459 million. Their specific mandates and current percentage allocations are as follows:

Manager	Fund	% of Assets
BlackRock	Equity	42
KBI Global Investors	Equity	19
Newton	Diversified Growth	17
Schroders	Property	14
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 2019/20.
- 2.3 The external investments of the Pension Fund are co-ordinated by the Council's Treasury function. The Council's investments 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 7 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 23% over the last 5 years.
- 2.6 The Managers, type of mandate and market value are listed below:

Manager	Market Value £ million	
	2020	2019
BlackRock	192	211
KBI Global Investors	88	103
Newton	79	81
Schroders	62	63
M&G	38	39
Total	459	497

- 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 2019/20 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 2019/20 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 2020 and as a comparison the previous financial year.

	Pension Fund £ million	
	2019/20	2018/19
Opening Value	497	459
Additions/(Withdrawals)	3	2
Investment Return	(41)	36
Closing Value	459	497

- 2.11 During 2019/2020 the overall value of the Pension Fund's investments decreased by £38 million.
- 2.12 There was a negative investment return over the 2019/20 financial year of £41 million. The major contributor to this fall in value was the Pension Fund's equity investments, as all of the major equity markets fell during 2019/20.

2.13 The £3 million of additions during 2019/20 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 2019/20 market performance by asset class is set out below:

		%
Equities:	UK	-18.5
	North America	-3.7
	Europe (Ex UK)	-8.3
	Japan	-1.9
	Pacific	-19.8
	Emerging Market	-13.5
Bonds:	UK Index Linked Gilts	2.4
	UK Corporate	1.4
Property		0.0
Cash		0.8

2.15 The best performing sector in 2019/20 was bonds with UK Index Linked Gilts producing a return of 2.4%, followed by corporate bonds at 1.4%. Equity markets produced a large range of returns from the Pacific Region returning -19.8% to Japan with -1.9% but all equity markets were negative over the financial year due to the impact of the Coronavirus over the last couple of months of 2019/20. Cash returns remain low due to the current low UK interest rate position.

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 North America equity scenario in 2019/20 where a fund manager is asked to outperform the North American market by 2% would equate to an -1.7% 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 (Cash) + 4%.

2.18 While this report reviews performance in 2019/20, the start of the 2020/21 financial year has seen equity markets start to recover as countries have seen their lockdown measures having an effect, plus countries have used various monetary options to help stimulate their economies. At the end of May 2020 the Pension Fund's investments had a value of £510 million (unaudited).

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); 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 – which incorporates manager risk).
- 3.4 With an active investment the Pension Fund can set a target return, this 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 began in 1988 but is now one of the largest global fund managers with 70 offices in 30 countries. Through BlackRock's purchase of BGI in 2009 they took over the Pension Fund's mandate with BGI. As the original mandate was a passive equity mandate it was easily transferred to BlackRock.
- 3.6 BlackRock's passive mandate was reorganised in 2014 as part of the new Pension Fund investment strategy with performance monitoring starting in January 2015.
- 3.7 BlackRock's fund now has a benchmark of 47% UK equities and 53% 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 2019/20 and also on a cumulative basis over a five-year investment period.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Annualised Fund Return (%)
2019/20	-10.1	0.0	-10.1
Five years 15/16 to 19/20	27.6	0.9	5.0
The performance v benchmark figure gives the percentage that the fund has out or underperformed the benchmark.			

- 3.10 BlackRock returned -10.1% in 2019/20, which was equal to the benchmark return. This shows that the fund has matched the returns of the markets the fund invests into.
- 3.11 BlackRock's mandate is split 53%:47% between Global and UK equities. Both investment sectors produced negative returns with global equities returning -4.9%, and UK equities returning -18.5%. These are passive investments which track their respective market returns, and if the markets fall or rise the passive investment will track the fall or rise on the market.
- 3.12 On a cumulative basis over the five year rolling monitoring period the fund is 0.9% above the benchmark return, which is 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 27.6%, which equates to a return of 5.0% 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 have their headquarters 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 3.0% per annum.
- 3.17 The following table sets out in summary the performance of KBI versus the benchmark and the performance target in 2019/20 and on a cumulative basis over a five year investment period.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Performance v Target (%)	Annualised Fund Return (%)
2019/20	-14.7	-9.4	-12.4	-14.7
Five years 15/16 to 19/20	22.2	-13.1	-25.0	4.1
<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 14.7% in 2019/20 which was 9.4% below the benchmark and 12.4% below the target. These are poor figures from KBI for 2019/20 as compared to the market return. KBI continue to find the current market sentiment towards certain growth stock sectors frustrating, which they spoke about when they last presented to the Pension Meeting in March 2019, as it is detrimental to their performance.
- 3.19 On a cumulative basis over the five year monitoring period KBI are below the benchmark and the target, but the fund has increased in value by 22.2%, which equates to a return of 4.1% per annum.
- 3.20 This is an active equity fund based on dividend returning shares with a bias towards value shares in the market. The issue is that the current market is being driven by large growth focused companies, such as large technology companies which have fared well recently during the coronavirus pandemic, and as they don't pay dividends they are not in KBI's portfolio. KBI are confident that the current growth focus of the equity markets cannot continue and will shift back to more sensible value based investing, which will benefit their investment strategy.

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 2019/20 and on a cumulative basis over a five year investment period.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Annualised Fund Return (%)
2019/20	-1.6	-6.1	-1.6
Five years 15/16 to 19/20	7.2	-14.2	1.4
The performance v benchmark figure gives the percentage that the fund has out or underperformed the fixed benchmark return.			

- 3.26 Newton returned -1.6% in 2019/20, which was 6.1% below the benchmark. Until the last quarter of the financial year Newton were ahead of the benchmark but most investment classes fell sharply in the last quarter which hit Newton's performance. The mixed asset class nature of the fund with Newton did protect it from some of the larger equity market falls.
- 3.27 On a cumulative basis over the five year monitoring period Newton are -14.2% below the benchmark. Newton continues to take a cautious outlook on the global economic situation. Their strategy remains to preserve the capital value of the fund while trying to focus on harnessing return from various different resources available to them.

- 3.28 The unconstrained nature of the investment gives flexibility to Newton to swiftly implement any investment decisions. Newton are seeking to capitalise on opportunities that will emerge from various asset classes as market uncertainty, dislocations, and countries fiscal stimulus measures take effect over the coming months.

Schroders

- 3.29 Schroders were awarded a £20 million Property Mandate in March 2007 with the first investments commencing in July 2007.
- 3.30 Schroders invests into property via a fund of funds approach where they invest in various different property funds to spread investment risk. Currently Schroders are investing in 17 different property funds. The fund is mainly invested in the UK with one small fund holding in Europe.
- 3.31 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.
- 3.32 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 0.2% of the overall mandate.
- 3.33 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.
- 3.34 The following table sets out in summary the performance of Schroders versus the benchmark and the performance target in 2019/20 and on a cumulative basis over a five-year investment period.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Performance v Target (%)	Annualised Fund Return (%)
2019/20	-0.1	-0.1	-1.1	-0.1
Five years 15/16 to 19/20	33.8	1.1	-3.8	6.0
The performance v benchmark figure gives the percentage that the fund has out or underperformed the benchmark return (market indices).				

The performance v target figure gives the percentage that the fund has out or underperformed the set target.

- 3.35 The Property Fund with Schroders in 2019/20 decreased in value by 0.1%, which was 0.1% below the benchmark return and 1.1% below the target. The impact of the coronavirus and the ensuing lockdown has had a negative impact on real estate investments. The retail and leisure sectors are suffering in the lockdown while central London after a few poor years is now becoming more interesting due to the low values now being seen.
- 3.36 One aspect of the coronavirus is that valuers have applied “Material Uncertainty” caveats to their valuations at the end of the financial year, which in effect means that they are unable to accurately price real estate assets as they could no longer rely on previous market experience to form an opinion of value in the current market. This puts a degree of uncertainty on their valuations and some valuers have marked down property values in the current circumstances. This is unusual but hopefully just a short term situation.
- 3.37 On a cumulative basis over the five year monitoring period Schroders are above the benchmark by 1.1% although below the target, but the fund has increased in value by 33.8%, which equates to a return of 6.0% per annum.
- 3.38 During 2019/20 Schroders have built up a cash position to invest into new strategies to take advantage of opportunities that may arise. At the end of the financial year Schroders had £5.1 million in cash which is about 8.1% of the overall fund value. Property is a long term investment and although there may be further valuation falls in the near term the portfolio is positioned into sectors that are expected to outperform over the longer term.

M&G

- 3.39 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.
- 3.40 M&G investment management was a wholly owned subsidiary of the listed financial services group, Prudential. The Prudential group has now split into two separate companies, and M&G is now called M&G Prudential and they cover the UK based insurance and asset management operations of the original Prudential group. M&G have stated that this will have minimal effect on their business, and as the Pension Fund’s investment consultants have no immediate concerns with this announcement as M&G has always retained a high degree of autonomy from the parent company.
- 3.41 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.

- 3.42 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.
- 3.43 The following table sets out in summary the performance of M&G versus the benchmark in 2019/20 and on a cumulative basis over a five-year investment period.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Annualised Fund Return (%)
2019/20	-3.5	-7.0	-3.5
Five years 15/16 to 19/20	7.1	-10.2	1.4
The performance v benchmark figure gives the percentage that the fund has out or underperformed the fixed benchmark return.			

- 3.44 M&G returned -3.5% in 2019/20 which was below the benchmark. This return is a combination of the various sectors that M&G invest into. M&G were above benchmark before the final quarter of the financial year but bonds also fell in value during the last quarter with industrial and financial sectors falling the most.
- 3.45 On a cumulative basis over the five year monitoring period M&G are 10.2% below the benchmark. The fund has over the period increased in value by 7.1% which equates to a return of 1.4% per annum. Recent market turbulence has created a number of interesting opportunities across the fixed income market and M&G have been purchasing bonds which look undervalued. Further volatility will be seen in the short term but M&G believe that focussing on fundamentals will generate good performance over the medium term.

4.0 Investment Governance

- 4.1 During 2019/20 the Pension Fund Committee and Pension Board received 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 Fund 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 2019/20 Schroders fund managers along with the Pension Fund's custodian Northern Trust gave presentations to the Pension Fund Committee and Pension Board.

5.0 Conclusions

- 5.1 BlackRock achieved their aim of equalling the equity benchmark return during 2019/20. Over the five year period BlackRock are close to the equity benchmark return.
- 5.2 KBI underperformed the equity benchmark and target during 2019/20. Over the five year period KBI are under the equity benchmark.
- 5.3 Newton underperformed the fixed benchmark during 2019/20. Over the five year period Newton are under the fixed benchmark.
- 5.4 Schroders underperformed the UK property benchmark during 2019/20. Over the five year period Schroders are above the property benchmark.
- 5.5 M&G underperformed their fixed benchmark during 2019/20. Over the five year period M&G are under the fixed benchmark.
- 5.6 All of the fund managers had positive investment returns at the end of December 2019. The quarter to March 2020 saw a severe fall in most investment sectors due to the coronavirus, with equities falling the furthest. This has affected the return figures at the end of the financial year, but some fund managers have used the situation to reorganise part of their investments and to position their funds for the long term. The investment markets have steadily recovered since the financial year end.
- 5.7 Bonds and cash were the only investment areas that produced positive returns in 2019/20 with all of the main global equity markets having negative returns. This culminated in a fall in value of £38 million to the Pension Fund's investments during the 2019/20 financial year. The Pension Fund's investments returned -7.3% over 2019/20 and ended the financial year with a valuation of £459 million.



Meeting(s):	Pension Fund Committee / Pension Board	15 July 2020
Report Title:	Pension Fund – Risk Register	
Reference Number:	F-035-F	
Author / Job Title:	Executive Manager - Finance	

1.0 Decisions / Action required:

- 1.1 That Pension Fund Committee and Pension Board NOTE the contents of the report and the current Risk Register.

2.0 High Level Summary:

- 2.1 This report presents the current Pension Fund Risk Register, and highlights any recent changes.

3.0 Corporate Priorities and Joint Working:

- 3.1 Management of risk is a fundamental aspect of good governance. The risk register is an integral part of effectively managing and administering of the Pension Fund on behalf of its members.

4.0 Key Issues:

- 4.1 The Council is responsible for the good governance and administration of the Shetland Islands Council Pension Fund.
- 4.2 In addition to the complex regulation and legislation that surrounds the administration of Pension Funds, there are a range of other risks that the Pension Fund faces and manages
- 4.3 The current Pension Fund Risk Register is attached at Appendix 1. The Register sets out each risk and the associated likelihood and impact of each risk identified.
- 4.4 For reference purposes, the risk matrix used by the Council is included on the last page of the Appendix. Risk scores are calculated by multiplying the estimated likelihood and impact of each risk, which then allows a risk rating to be applied.
- 4.5 The Council updated its approach to profiling its risks in May 2019 (Min ref. 27/19) which introduced an 'extreme' risk, to ensure the Council's most significant risks are more visible. Each risk on the Pension Fund risk register is therefore rated as Extreme, High, Medium or Low.
- 4.6 The register now records 32 risks:

- 3 are considered as extreme risk
- 8 are considered as high risk
- 12 are considered as medium risk, *and*
- 9 are considered as low risk.

These classifications reflect current control measures and mitigations in place.

4.7 Since the last presentation of the risk register, each risk has been reviewed in terms of its likelihood and potential impact. In some cases, risk scores have remained consistent; however the risk rating may have changed following the introduction of the revised risk matrix and the additional 'extreme' risk rating. The column on the right hand side of the risk register indicates whether the risk rating has moved upwards or downwards.

4.8 The risk register does not contain a specific risk relating to the Coronavirus pandemic. This is because the Pension Fund already faced risks in the areas that the pandemic has impacted upon, such as:

- business continuity and delivery of essential services
- valuations of assets and investments over the longer-term
- performance of investment fund managers
- assumptions relating to longevity/mortality of scheme membership

These risks are separately identified on the risk register, as risks that are already managed by the Pension Fund. At this stage, we do not consider that additional mitigation measures are required, but will keep the situation under review as the longer-term implications of the pandemic become clearer and if specific measures are required.

4.9 The risk register will continue to be reviewed regularly and reported to the Pension Fund Committee and Pension Board as part of the Council's performance reporting arrangements.

5.0 Exempt and/or confidential information:

5.1 None.

6.0 Implications :

6.1 Service Users, Patients and Communities:	Effectively managing risk safeguards the benefits payable to members of the Pension Fund through sound governance.
6.2 Human Resources and Organisational Development:	None.
6.3 Equality, Diversity and Human Rights:	None.
6.4 Legal:	There are no direct legal implications arising from this report however, legal advice and legal remedies will be sought and used whenever deemed appropriate.

6.5 Finance:	There are no direct financial implications arising from this report. Where risks materialise they may result in financial implications for the Pension Fund, the Administering Authority (Shetland Islands Council) and/or the scheme employers.
6.6 Assets and Property:	Managing risks in relation to the governance and control of the assets held by the Pension Fund for the effective long-term benefit of its members is crucial. Identification of the key risks and the controls is the basis of this report.
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. BlackRock, Newton, Kleinwort Benson, Schroders and M&G have all signed up to the United Nations Principles on Responsible Investment.</p> <p>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>
6.9 Risk Management:	There are many risks involved in the administration of the Pension Fund. These are set out in Appendix 1 of this report.
6.10 Policy and Delegated Authority:	<p>All functions and responsibilities relating to the Council's role as administering authority for Shetland Islands Council Pension Fund are now discharged by the Pension Fund Committee.</p> <p>The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the</p>

	<p>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:	Last reported to the Pension Committee / Pension Board on 5 March 2019.	

Contact Details:

Jamie Manson

Executive Manager – Finance

jamie.manson@shetland.gov.uk

Appendices:

Appendix 1 – Pension Fund Risk Register

Background Documents:

None

Shetland Islands Council Pension Fund Risk Register

Updated July 2020

Ref	Category	Risk Description	Potential Consequences	Mitigating Controls	Residual Risk Score (Likelihood x Impact)			Change
					L	I	Score & Rating	
1	Operational	Pension Administration system failure	Staff downtime, loss of service delivery	System is hosted externally with back-up in separate location Technical support for maintenance and development provided by in-house ICT team and external supplier where necessary	1	3	3 Low	-
2.	Operational	Unable to access workplace	Staff downtime, loss of service delivery	Business Continuity Plan in place for the Finance team, which includes Pension Fund administration activities.	5	3	15 High	-
3.	Operational	Overpayment of pension benefits	Audit criticism, legal challenge, reputational damage , cost and potential non-recovery	All pension payments signed off by a senior pensions officer – segregation of duties in place for staff processing lump sums	2	2	4 Low	-
4.	Operational	Failure to carry out annual check of member records	Incorrect pension payments, incorrect assessment of actuarial liabilities	All employers required to submit data on a monthly and annual basis. Data is independently checked by the Pensions Administration team.	1	2	2 Low	-
5.	Operational	Failure to carry out effective member tracing	Incorrect pension payments, incorrect assessment of actuarial liabilities	Tracing services utilised: <ul style="list-style-type: none"> Faraday Tracing Service National NI Database The national “Tell us once” scheme 	1	2	2 Low	-

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6.	Operational	Fraud/Negligence	Overpayment, unauthorised payments, system corruption, audit criticism, reputational damage	All pension payments are signed off by a senior pensions officer – segregation of duties in place for staff processing lump sums	2	2	4 Low	-
7.	Operational	Failure to recruit, retain and develop staff	Reduction in service delivery, poor operation of risk management controls	On-going review of staffing requirements and training, with particular focus on developing new ways to train staff when working from home.	2	3	6 Medium	▲
8.	Operational	Poor record keeping	Undermines service delivery, incorrect assessment of actuarial liabilities	Annual check of all member records undertaken prior to issuing Annual Benefit Statements. This is also facilitated by the Pensions Administration System provider, providing common and conditional data reports.	2	3	6 Medium	▲
9.	Financial Management	Increases in bond values result in increased Pension liabilities (as pension liabilities are linked to bond values)	Increase in employer contributions	Consider potential impact with actuary once initial results are known from the triennial valuation that is currently underway.	5	5	25 Extreme	▲
10.	Financial Management	Pay and price inflation valuation assumptions over the longer-term	Increase in employer contributions and/or increasing deficits between pension assets and liabilities	Consider potential impact with actuary once initial results are known from the triennial valuation that is currently underway.	3	3	9 Medium	▲
11.	Financial Management	Employers leaving scheme/closing to new members due to cost or cessation	Residual liabilities could fall to other scheme employers	Monitor scheme employers, maintain regular dialogue and report as necessary	5	4	20 Extreme	▲

Shetland Islands Council Pension Fund Risk Register

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12.	Financial Management	Failure to recover unfunded payments from employers, e.g. compensatory added years; cessation debt	Residual liabilities could fall to other scheme employers	Pensions Administration team monitor payments received and will escalate failed employer payments to Executive Manager - Finance	2	3	6 Medium	▲
13.	Financial Management	Employee contributions incorrectly collected or deducted	Increase in employer contributions to meet unfunded position	Annual check of active member records	3	2	6 Medium	▲
14.	Financial Management	Variation in early retirement strategies by scheme employers	Pressure on cash flow	On-going discussions with scheme employers about Funding issues and organisational plans	3	4	12 High	▲
15.	Financial Management	Negligence, fraud and or default by investment managers	Loss of value of the Fund, reputational damage	Fund management monitoring, SAS 70 reports and appropriate clauses in all scheme documentation	2	5	10 High	▲
16.	Financial Management	Failure of Global Custodian	Loss of investments or control of investment	Regular meetings with global custodian, receipt of SAS 70 reports and monitoring, through Global Custodian magazines. To be included in annual report to Pensions Committee on service providers	2	5	10 High	▲
17.	Financial Management	Breach of Council's VAT threshold	Loss of Council partial exemption	Ongoing discussion with SIC on exemption.	1	3	3 Low	-
18.	Financial Management	Failure to monitor investment managers and assets	Audit criticism, legal challenge, reputational damage	Monthly reports from managers, quarterly assessment of investment performance of fund, triennial actuarial valuation, meetings and face to face presentations from managers and quarterly funding updates reported to Pensions Committee.	1	3	3 Low	-
19.	Financial Management	Failure of internal control of fund suppliers	Audit criticism, legal challenge, reputational damage	Sign off by a senior officer for all purchases of goods, monitoring of supplier costs. Budget monitoring reports to Pensions Committee	3	3	9 Medium	-

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20.	Investment	Delay in funding investment managers	Loss of investment return and impact on employer contribution rates	Control of Pension Fund cash management; Reporting quarterly to Pensions Committee	1	5	5 Medium	▼
21.	Investment	Significant disruption of global stock markets	Increase in employer contribution rates	Diversification of scheme assets, global approach, multiple fund managers, investment strategy review following outcome of triennial valuation	4	5	20 Extreme	▲
22.	Investment	Under performance by active managers	Increase in employer contribution rates	Quarterly assessment of investment performance of fund, triennial actuarial valuation and quarterly funding updates reported to Pensions Committee	3	5	15 High	-
23	Investment	Pension Fund investments fail to deliver returns in line with actuarial assumptions required to meet the valuation of the long-term liabilities	Increase in employer contributions	Quarterly assessment of investment performance of fund, triennial actuarial valuation and quarterly funding updates reported to pensions committee. Pension Fund investment strategy review, due to be finalised once results of Triennial Valuation are known.	3	5	15 High	-
24.	Investment	Abnormal changes in longevity/mortality of Pension Fund members	Increase in employer contributions	Actuarial assessment every three years undertake scheme specific analysis. Pension Fund participates in Club Vita, which provides longevity risk informatics to support pension funds' risk management strategy	2	3	6 Medium	-
25.	Governance & Regulation	Failure to comply with statute and regulations: <ul style="list-style-type: none"> • Pensions Act • LGPS Regulations • HMRC Regulations 	Error, audit criticism, legal challenge, reputational damage	Review of compliance with regulations - ongoing	3	3	9 Medium	-

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26.	Governance & Regulation	Potential risks and conflicts of interest between SIC and SIC Pension Fund	Audit criticism, legal challenge, reputational damage	Advice provided by EM – Governance & Law (Monitoring Officer)	3	3	9 Medium	-
27.	Governance & Regulation	Breach of Data Protection – theft or loss of data	Audit criticism, legal challenge, reputational damage	Internal control and procedures for management of data. Management of records is the subject of further work regarding new general Data Protection Regulations (GDPR).	3	3	9 Medium	-
28.	Governance & Regulation	Failure to comply with FOI requests	Audit criticism, legal challenge, reputational damage	Expenditure Team Leader / Treasury Accountant responsible for FOI requests and meeting deadline for information requests	2	2	4 Low	-
29.	Governance & Regulation	Failure to meet annual audit deadlines	Audit criticism, legal challenge, reputational damage	EM – Finance responsible for all internal and external audit requirements	2	3	6 Medium	-
30.	Governance & Regulation	Failure to monitor AVC arrangements	Audit criticism, legal challenge, reputational damage	Maintain regular contact with AVC provider	2	2	4 Low	-
31.	Governance & Regulation	Failure to monitor and assess advisors' performance	Poor investment decisions leading to reduced investment returns	Regular contact with advisors, compare and contrast feedback from other specialists	2	5	10 High	▲
32.	Governance & Regulation	Failure to monitor employer covenants	Residual liabilities could fall to other scheme employers	On-going discussions with scheme employer of funding issues	2	5	10 High	▲

Shetland Islands Council Pension Fund Risk Register

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Estimating risk likelihood and severity: Shetland Islands Council Risk Matrix

Step One - Look at the text in the box below and decide which descriptor of likelihood best matches your estimation of this particular risk/event.

Descriptor	Description
5 Almost certain	I would not be at all surprised if this happened within the next twelve months; I would expect this to happen
4 Likely	It is probable that this will occur sometime in the coming year
3 Possible	I think this could maybe occur in the next year
2 Unlikely	I would be mildly surprised if this occurred in the next year; it is unlikely to happen
1 Rare	I would be very surprised to see this happen in the next twelve months; it is very unlikely to happen

Step Two - Find the most realistic outcome for the risk you have identified and move down the left hand column to establish its value. Most risks will have potential impacts under more than one column.

HAZARD	Personal Safety	Property loss or damage	Failure to provide Statutory Service or breach of legal requirements	Financial Loss or Increased cost of Working	Personal Privacy Infringement	Environmental	Community / stakeholders / organisation	Reputation
Insignificant 1	Minor injury or discomfort to an individual	Negligible property damage	Reported to HSE, Stage 2 complaint	<£10k	Isolated personal detail revealed	Licensable activity occurring without authorisation but not causing pollution	Inconvenience to an individual or small group	Contained within Service Unit
Minor 2	Minor injury or discomfort to several people	Minor damage to one property	HSE investigation Complaint requiring investigation	£10k to £100k	Isolated sensitive data revealed	Death of invertebrates/ >10 fish, minor visible pollution, minor damage to commercial activity	Impact on an individual or small group	Contained within Service

Shetland Islands Council Pension Fund Risk Register

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HAZARD	Personal Safety	Property loss or damage	Failure to provide Statutory Service or breach of legal requirements	Financial Loss or Increased cost of Working	Personal Privacy Infringement	Environmental	Community / stakeholders / organisation	Reputation
Significant 3	Major injury to an individual/ range of moderate injuries to more than one person	Significant damage to small building or minor damage to several properties from one source	Litigation, claim or fine to £250k HSE Improvement Notice served Complaint referred to Ombudsman	£100k to £500k	Several persons details revealed	Environmental damage to > 1km ² Death of 10-100 fish, long term localised harm/ widespread short-term harm to environment, Significant visible pollution/ damage to commercial activity	Impact on a local community. Impact on Council Service	Local public or press interested
Major 4	Major injury to several people or death of an individual	Major damage to critical building or serious damage to several properties from one source	Litigation, claim or fine £250k to £1m imposed HSE Prohibition Notice served Adverse report from External Advisor	£500k to £1m	Several persons' sensitive /personal details revealed	Death of animals, substantial harm to human health, wide-spread/ long-term harm, loss/ closure of shellfish/drinkin g// bathing water, extensive damage/ closure of agriculture/	Impact on several communities. Impact on whole organisation	National public or press interest,

Shetland Islands Council Pension Fund Risk Register

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HAZARD	Personal Safety	Property loss or damage	Failure to provide Statutory Service or breach of legal requirements	Financial Loss or Increased cost of Working	Personal Privacy Infringement	Environmental	Community / stakeholders / organisation	Reputation
						commercial activities		
Extreme 5	Death of several people	Total loss of critical building(s)	Multiple civil or criminal actions. Litigation, claim or fine above £1m or custodial sentence	>£1m	All personal details revealed for many	Permanent damage to a nationally significant population/ to site of special interest	Impact on the whole of Shetland	Senior officer(s) and /or members dismissed/ disqualified. Central takeover of authority

The Risk Score is determined by multiplying likely IMPACT by LIKELIHOOD.

Risk Ratings are determined by the Risk Score:

Risk Score	Rating	Colour-coded Rating
1-4	Low	Green
5-9	Medium	Amber
10-16	High	Red
20-25	Extreme	Purple

Impact	Extreme	5	10	15	20	25
	Major	4	8	12	16	20
	Significant	3	6	9	12	15
	Minor	2	4	6	8	10
	Insignificant	1	2	3	4	5
		Rare	Unlikely	Possible	Likely	Almost Certain
Likelihood						