

SMITH & NEPHEW UK PENSION FUND



Trustees' report

2018/19



Welcome

It is a pleasure to present your latest newsletter from the trustees of the Smith & Nephew UK Pension Fund. It provides an update on the fund's year to 30 September 2018, including a summary taken from the formal report and accounts, along with details about the fund's investments.

The latest full actuarial valuation of the fund, looking at the position at 30 September 2018, has now been completed. I am pleased to report that there has been an improvement in the funding position since the previous full valuation in 2015, and no additional contributions from the company are required under the current valuation assumptions. You can read the results of the valuation in the summary funding statement on page 10.

Last year, the trustees appointed Mercer as the pension administrator for the fund and their contact details can be found on the back page. I am pleased to tell you that there is a new website for fund members and more details can be found on page 7.

I hope you find this year's report useful and informative. If you have any comments or suggestions, or if you would like more information, please get in touch using the contact details on the back page.

Lucy Fuller

Chair of the trustees

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The fund account

The table shows the money going into and out of the fund during the year to 30 September 2018.

This summary has been taken from the trustees' annual report and accounts, which have been independently audited by RSM UK Audit LLP who confirm that they show a true and fair view of the fund's financial transactions for the year.

If you would like to see a copy of the full report and accounts, you can request one from the fund administrator.

	2018 £'000	2017 £'000
INCOME		
Employer contributions*	0	1,101
Employer deficit contributions	18,800	18,800
Member contributions	0	156
Additional voluntary contributions	0	4
Other income	1	27
TOTAL	18,801	20,088
EXPENDITURE		
Benefits paid	(15,958)	(14,972)
Payments to and on account of leavers	(44,228)	(20,057)
Advisers' and administrative expenses	(1,071)	(1,293)
TOTAL	(61,257)	(36,322)
INCOME LESS EXPENDITURE	(42,456)	(16,234)
INVESTMENT RETURNS		
Net investment income	10,406	9,129
Change in market value	5,501	(10,415)
TOTAL	15,907	(1,286)
Net decrease in the fund during the year	(26,549)	(17,520)
MARKET VALUE OF ASSETS AT 30 SEPTEMBER	661,094	687,643

*The fund closed to future accrual on 31 December 2016, when normal employer and members' contributions ceased.

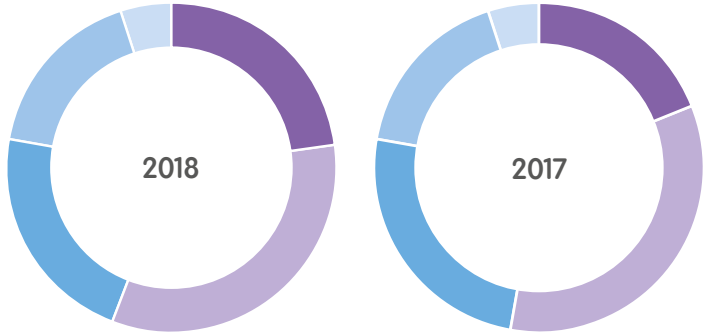
Investment report

It is the responsibility of the trustees to invest the fund's assets. Taking advice from their professional investment adviser, they regularly review the fund's investment policy which is set out in a formal document called the Statement of Investment Principles (SIP).

In December 2017, the trustees agreed a new de-risking strategy which was reflected in the overall investment policy. In September 2018, a further de-risking transaction was initiated to reflect an improvement in the fund's estimated funding position.

SPLIT OF INVESTMENTS AS AT 30 SEPTEMBER

		2018	2017
LIABILITY MATCHING PORTFOLIO	LDI	23%	19%
	Buy-in policy	33%	34%
	TOTAL	56%	53%
GROWTH PORTFOLIO	Equities	22%	25%
	Diversified growth	17%	17%
	Absolute return	5%	5%
	TOTAL	44%	47%



HOW ARE THE ASSETS INVESTED?

The fund's assets are split between the growth portfolio, which includes equities and bonds, and the matching portfolio, which comprises Liability Driven Investments (LDI) and the bulk annuity policies with Rothesay Life.

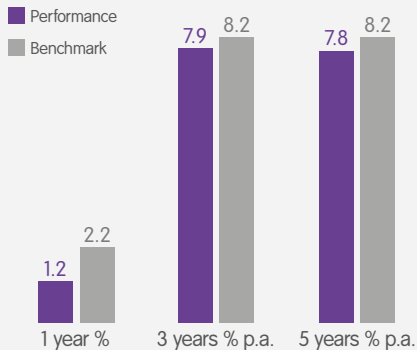
LDI aims to reduce the fund's exposure to risk from inflation and interest rate fluctuation, while generating income to pay benefits to members.

INVESTMENT PERFORMANCE

During the year to 30 September 2018 the fund achieved a modest positive return of 1.2%, driven to a large extent by strong returns from the fund's equity allocation.

However, the fund failed to keep pace with its benchmark return of 2.2%. The main reason for this underperformance was the fund's LDI portfolio, whereby allocations to assets other than UK government bonds held performance back compared to the portfolio's benchmark.

Investment performance of the fund over the one-year, three-year and five-year periods to 30 September 2018:



BULK PURCHASE ANNUITY

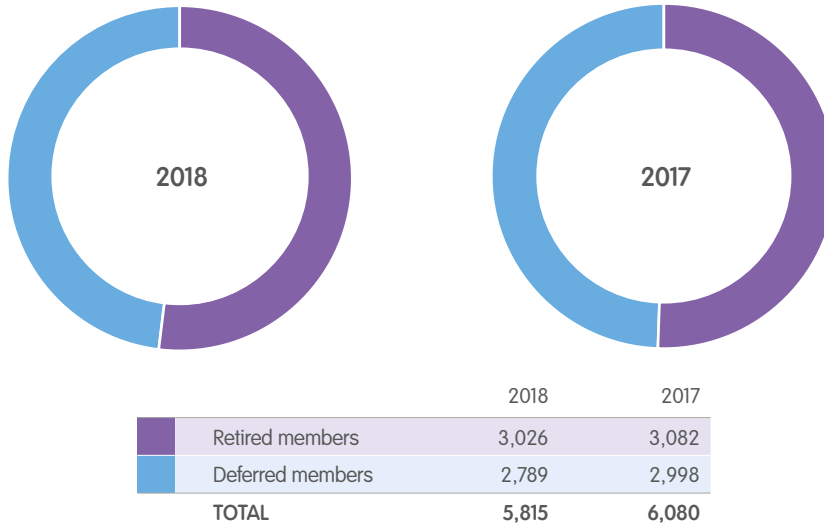
Following the purchase of the bulk annuity in May 2017, Rothesay Life carried out a data audit of the liabilities included within the policy, incorporating any changes to member circumstances since the purchase. As a result, a partial refund of the premium to the value of £0.9 million was paid to the fund in January 2019.



Membership

As at 30 September 2018, there were approximately 5,800 members in the fund. As the fund closed to future accrual in 2016, there are no longer any active members.

Retired members include dependants and those members in receipt of a spouse's pension.



PENSION INCREASES

Pensions in payment are increased on 1 October in line with inflation as measured by the Retail Prices Index (RPI) in the previous August, to a maximum of 5%. In October 2018, pensions in payment were increased by 3.2%.

News update

ONEVIEW – THE NEW FUND WEBSITE

Mercer, the fund administrator, has been developing a website for the fund which will enable you to access information about your pension entitlement, which we hope you will find useful in your personal financial planning.

www.merceroneview.co.uk/smith-nephew

You should have received a letter from Mercer earlier in the year with details on how you can access this new website, OneView. If you have not received this and would like to access your fund information online, please contact Mercer who will be able to provide you with these details.



OneView options – deferred members

If you have not yet started to receive your pension entitlement from the fund, some of the options available to you on OneView include:

- your deferred benefit statement which shows your pension entitlement* as at the date you left pensionable service.
- an estimate of your retirement benefits including any tax-free cash lump sum payable from your minimum retirement age, or at any selected later date up to your normal retirement date.
- an estimate of the Cash Equivalent Transfer Value (CETV) of your pension if you were to transfer this benefit to another pension arrangement (available until your normal retirement date).
- a selection of videos which show options for you to consider regarding your pension benefits.

OneView options – pensioners

If you have started to receive your pension, some of the options available to you on OneView include:

- access to your payslips
- details of your P60.

*this pension receives pension increases in line with the rules of the fund, between the date you left pensionable service and the date your pension commences.

News update CONTINUED

FUND BENEFITS IN THE EVENT OF YOUR DEATH BEFORE YOUR PENSION COMMENCES

It is important to note that the only benefit payable from the fund if you were to die before commencement of payment of your pension (while you are a deferred member) would be a refund of the contributions you have made. **In particular, no spouse's pension would be payable if you died before your pension started.** A spouse's pension only becomes payable from the fund once you have started to draw your pension.

There are two options currently available to you before commencement of payment of your pension:

1. Take an early retirement pension before your normal retirement age

Your pension would be reduced to reflect the fact that this would be paid for longer than if you were to take your pension at normal retirement age. The level of the spouse's pension payable on death after retirement would also be reduced, as this is calculated as a proportion of your pension.

An estimate of the early retirement benefits payable can be calculated using the OneView website for any current or future retirement date. This estimate would include any tax-free cash lump sum and the pension that would then be payable to your spouse on death in retirement.

2. Take a Cash Equivalent Transfer Value (CETV) to another pension scheme

Under this option, a cash payment would be made to a pension scheme of your choice in lieu of your benefits in the fund. The government introduced more retirement options in 2015 and you may have more flexibility over

how you take your benefits if you transfer out of the fund, although this does not necessarily mean this is right for you and your circumstances.

An illustration of the current CETV available from the fund can be calculated using the OneView website. Please note that these are only illustrations and are not guaranteed.

If the value of your CETV is over £30,000, there is a legal requirement for you to take appropriate independent financial advice before you can transfer your benefits out of the fund.

You have the right to take a CETV from the fund, until one year before your normal retirement age. After this date, agreement from the employer and trustees is required. However, this is usually granted when transferring to a suitable pension arrangement.

The trustees have also agreed to allow fund members to take a partial transfer of their benefit from the fund. Further details on this option are available from the fund administrator.

Under current pension legislation the minimum retirement age from a pension arrangement is age 55. If you ceased pensionable service in the Fund after 3 June 1997, you may have an entitlement to an earlier minimum retirement age of 50 from the Smith & Nephew UK Pension Fund. Please contact the Fund administrator for more information.

DON'T LET A SCAMMER ENJOY YOUR RETIREMENT

We would like to remind members to continue to be vigilant about pension scams. Scammers can be articulate and financially knowledgeable with credible websites, testimonials and materials that are hard to distinguish from the real thing.

In January 2019, a ban on pensions cold calling was introduced. If someone contacts you out of the blue about your pension, it is best simply to hang up. The Pensions Regulator's advice includes:

- reject unexpected offers
- check who you are dealing with
- don't be rushed or pressured into making a decision
- get impartial information and advice.

You can find out more at
www.pension-scams.co.uk



Summary funding statement

This summary funding statement tells you about the latest funding position of the fund, based on the latest actuarial valuation as at 30 September 2018. We use the term 'funding' as a way of comparing the money already in the fund with the amount we need to pay the future benefits. We send you a summary funding statement at least once a year.

HOW DOES THE FUND WORK?

We use the fund's assets to pay benefits to members, as set out in the rules and summarised in the fund's booklet. The assets are held separately from the company. We do not allocate any of the fund's assets to individual members, apart from their additional voluntary contributions and share options, if this is appropriate.

The company does not currently need to pay additional contributions into the fund. The funding level is reviewed regularly, and company contributions may restart in the future if the amount needed to pay benefits is less than the value of the assets available in the longer term.

WHAT IS AN ACTUARIAL VALUATION?

At least every three years, the fund actuary investigates the financial position of the fund by comparing the value of the assets with the amount needed to pay benefits. This is called an actuarial valuation. The main purpose is to help set the level of contributions that the fund needs to receive to pay members' benefits now and in the future.

As part of the valuation, the actuary works out a target level of assets. This is an estimate of the amount of money needed to pay benefits as they fall due. If the fund's assets are lower than the target level, extra contributions may be needed to pay for the shortfall.

The most recent actuarial valuation was carried out as at 30 September 2018.

HOW IS THE TARGET LEVEL OF ASSETS WORKED OUT?

There are different ways of working out the target level of assets. One approach is to estimate how much money we need to pay the benefits already earned so far, assuming the fund continues. This is called the 'ongoing' basis. To make this assessment, the actuary has to make a number of assumptions about what will happen in the future: how long people will live, what inflation will be, how the fund's assets will be invested and what returns will be earned on those investments. Each of the assumptions made will affect the target level of assets.

Another approach is to estimate how much an insurance company would charge to take on responsibility of paying the benefits which are due. We call this the 'solvency' basis. If the company wanted to completely close the fund, we could insist on a final contribution from them to make sure that the fund has enough money on this basis.

WHAT WERE THE RESULTS OF THE 2018 ACTUARIAL VALUATION?

	Ongoing basis (£ million)	Solvency basis (£ million)
Target level of assets	£664 million	£735 million
Actual level of assets	£660 million	£660 million
Shortfall in assets	£4 million	£75 million
FUNDING LEVEL	99%	90%

Following the 2018 valuation, the fund had a small deficit of £4 million. The company does not currently need to pay additional contributions during 2019 to fund this shortfall.

The actuary produces an updated report annually to help us monitor the funding position in the years between formal actuarial valuations. We have to do this by law. An update will be included in the Trustees' report next year.

WHAT IF THE COMPANY COULDN'T PAY THE NECESSARY CONTRIBUTIONS?

There is nothing to suggest that this will be the case. The company does not need to pay any further contributions as the small deficit on the ongoing basis as at the valuation date has been paid into the fund. However, a formal guarantee remains in place between Smith & Nephew plc and the trustee. This guarantees the obligations of Smith & Nephew UK Limited (the fund's principal employer) and the fund's other employers to make payments to the fund. However, in the unlikely event that the company did become insolvent, we would use the assets of the fund at the time to secure benefits.

If there was a shortfall in the assets on the solvency basis, we would not have enough to secure the benefits in full for all members. In these circumstances, the Pension Protection Fund (PPF), which was set up in April 2005, would make sure that all members receive a level of benefits set out in law. You can find out more about the benefits payable from the PPF at www.pensionprotectionfund.org.uk.

IS THERE ANYTHING ELSE I NEED TO KNOW?

We are required to verify that the company has not taken any money out of the fund in the last 12 months and that the Pensions Regulator has not intervened in the running of the fund. We are happy to confirm this.

Running the fund

The fund is managed on behalf of all the members by a board of trustees. Some of the trustee directors are appointed by the company and some are nominated by the members. There is also an independent trustee director.

YOUR TRUSTEE DIRECTORS

COMPANY APPOINTED	Lucy Fuller, Chair Bob Newcomb Joanna Sheppard
INDEPENDENT	Carol Woodley, Woodley Pension Trustees Ltd
MEMBER NOMINATED	Len Pendle David Webster

CONTACT US

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FUND ADVISERS

FUND SECRETARY	Inside Pensions Ltd
PRINCIPAL COMPANY	Smith & Nephew UK Ltd
FUND ACTUARY	Clive Wellsted FIA, Lane Clark & Peacock LLP
INVESTMENT ADVISER	Lane Clark & Peacock LLP
INVESTMENT MANAGERS	Newton Asset Management BMO Global Asset Management GMO LLC Henderson Global Investors M&G Investment Management Ltd
BULK ANNUITY PROVIDER	Rothsay Life Ltd
AUDITOR	RSM UK Audit LLP
SOLICITOR	Mayer Brown International LLP
BANKER	HSBC Bank plc
PENSION ADMINISTRATOR	Mercer Ltd