Smith & Nephew UK Pension Fund

Trustees' report 2017/18

Welcome

Welcome to your newsletter from the trustees of the Smith & Nephew UK Pension Fund, providing you with an update on the progress of the fund during the year to 30 September 2017, including information on how the money in the fund is invested.

In the summary funding statement on pages 8 to 10, there is an update from the fund actuary on the valuation of the fund, looking at the position as at 30 September 2017. I am pleased to report that there has been an improvement in the funding level to 91% since the last full valuation in 2015.

Last year, the trustees carried out an in-depth review of the administration services available and in June, Mercer became the new pension administrator for the fund. You can find more information about Mercer, along with how to get in touch with them, on page 7. The trustees are working with Mercer to develop a new website for the fund which will provide you with up to date information about your pension benefits and retirement options. We will send you more information about this later in the year.

Finally, there are some changes to the trustee board to tell you about. In December, Andy Russell resigned as a trustee director and the company has appointed Joanna Sheppard from May 2018. I would like to thank Andy for his hard work and service to the fund in the last three years.

I hope you find this year's report interesting and useful. If you have any comments or suggestions, or would like more information, please contact us using the details shown on the back cover.

Lucy Fuller - Chair of the trustees

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The fund account

For the year to 30 September 2017, the money coming into the fund (contributions and investments) and the money going out (members' benefits and fund expenses) is shown in the table.

This information is a summary that has been taken from the trustees' annual report and accounts. These have been audited by RSM UK Audit LLP, an independent accountancy firm, who confirm that they show a true and fair view of the fund's financial transactions.

If you would like to see a copy of the full report and accounts, you can request one using the contact details on the back cover.

	2017 £'000	2016 £'000
Income		
Employer contributions*	1,101	5,054
Employer deficit contributions	18,800	18,800
Augmentations	0	200
Member contributions*	156	713
Additional voluntary contributions	4	42
Other income	27	208
Total	**20,088**	**25,017**
Expenditure		
Benefits paid	(14,972)	(22,114)
Payments to and on account of leavers	(20,057)	(15,747)
Advisers' and administrative expenses	(1,293)	(1,336)
Total	**(36,322)**	**(39,197)**
Income less expenditure	**(16,234)**	**(14,180)**
Investment returns		
Net investment income	9,129	8,638
Change in market value	(10,415)	126,805
Total	**(1,286)**	**135,443**
Net increase in the fund during the year	(17,520)	121,263
Market value of assets at 30 September	**687,643**	**705,163**

*Normal employer and members' contributions ceased after 31 December 2016, when the fund closed to future accrual. Normal employer and members' contributions for 2016 have been restated for consistency.

Investment report

The trustees are responsible for investing the fund's assets. Together with their professional advisers, they regularly review the investments and make changes as appropriate. The fund's assets are invested in a broad range of investment types, which includes equities (company shares) and government bonds (gilts).

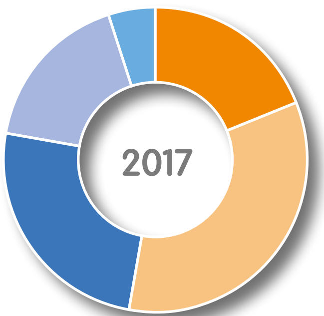
How are the assets invested?

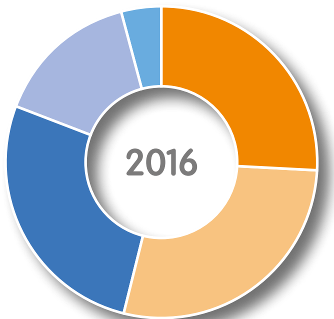
During the year, the trustees agreed a new de-risking strategy and the statement of investment principles was updated in July 2017 to reflect this.

The fund's investments continue to be split between a 'growth portfolio', designed to increase the value of the fund's assets over time, and a 'matching portfolio', designed to generate income to pay pensions and benefits to members as they become due.

Split of investments as at 30 September

		2017	2016
Liability matching portfolio	LDI	19%	26%
	Buy-in policy	34%	28%
	Total	**53%**	**54%**
Growth portfolio	Equities	25%	27%
	Diversified growth	17%	15%
	Absolute return	5%	4%
	Total	**47%**	**46%**



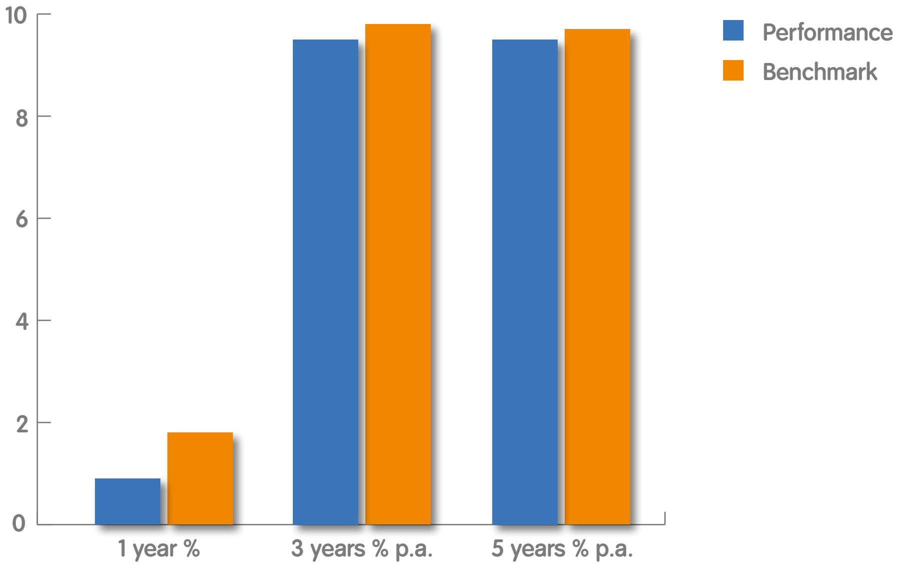


Investment performance

During the year to 30 September 2017, the fund achieved a return of 0.9%, underperforming the benchmark for the period of 1.8%. The main factors influencing the year's investment return were:

- underperformance of the Newton Diversified Growth Fund (DGF), which was partially offset by;
- outperformance from the GMO DGF and the M&G Alpha Opportunities Fund.

On a three-year basis, the fund achieved a return of 9.5%, compared with the benchmark of 9.8%, and on a five-year basis, a return of 9.5%, compared with the benchmark of 9.7%.



Have you paid AVCs?

If you have paid additional voluntary contributions (AVCs), don't forget to review your annual statement to make sure your investments are on track with your plans for retirement.

Your AVCs are held in an individual account, which is separate from the main fund, and are designed to secure additional defined contribution (DC) benefits. When you retire, you can use your AVCs to top up your pension savings or take them as a cash lump sum.

To find out more about your options for taking your DC benefits at retirement, the government has a useful, free information service at: **www.pensionwise.gov.uk**

Bulk purchase annuity

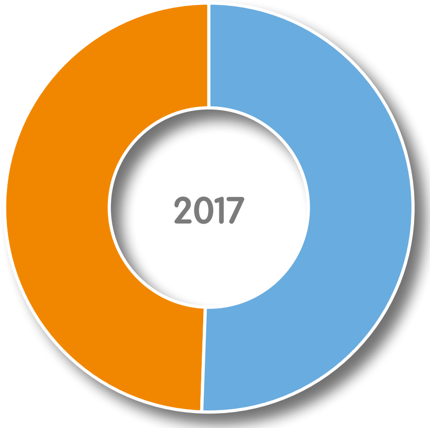
In May 2017, the trustees made a second bulk purchase annuity (BPA) from Rothesay Life. This is an insurance policy that covers a significant proportion of the pensioner members who have retired since the previous BPA was purchased in 2013.

Membership

As at 30 September 2017, there were approximately 6,000 members in the fund. Following the closure of the fund to future accrual on 31 December 2016, there are no longer any active members.

Those members who still work for the company have become deferred members of the fund with their benefits preserved until their retirement. They have all been offered membership of the company's defined contribution pension arrangement.

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



	2017	2016
Active members	-	364
Retired members	3,082	3,090
Deferred members	2,998	2,753
Total	**6,080**	**6,207**

News update

Mercer – the fund's new administrator

Following the trustees' review of administration services, Mercer was appointed from June 2017 to manage the fund. If you have a question about the fund or your retirement benefits, you can contact Mercer by:

Email: smithandnephew.pensions@mercer.com

Telephone: 0330 102 7570 (9am to 5pm, Monday to Friday). Please note, outside these hours and during public holidays, you can leave a message on a confidential answering service and Mercer will call you back during the next business day.

Write to: Smith & Nephew UK Pension Fund, Mercer Limited, PO Box 434, Westgate House, 52 Westgate, Chichester PO19 3ZU

Going online

Mercer is in the process of creating a website for the fund: **www.merceroneview.co.uk/smith-nephew**

Video guides on benefits and options for members whose pension has not yet started can be found at: **smith-nephew-member-guides.lcp.uk.com** (password: VideoGuides)

Pension increases

Pensions in payment are guaranteed to increase 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 2017, pensions in payment were increased by 3.9%.

A word of warning – have you been cold called?

We would like to remind members that pension scams are still prevalent. Scammers are after your pension pot and know that you can now access your savings in new ways. A recent survey revealed that almost one fifth of people aged over 50 (1.5 million individuals) were targeted by pension scammers between April and July last year.

If someone contacts you unexpectedly, claiming to be able to help you access your pension before the age of 55, it is likely to be a scam. The Pensions Regulator has published the following warning signs to be aware of:

1. a free pension review
2. the promise of guaranteed returns on your investment
3. low tax/tax-free rates, including tax-free lump sums
4. exotic-sounding and/or overseas investments
5. pressure to sign up quickly to avoid missing out

You can find out more about pension scams, including what to do if you think you're being targeted at: **www.pension-scams.co.uk**.

Summary funding statement

This is your summary funding statement, which tells you how the funding position has changed since the last formal valuation of the fund was carried out in September 2015. It is based on the actuary's update as at 30 September 2017. We use the term 'funding' as a way of comparing the money already in the fund with the amount needed to pay the future benefits. We provide you with a statement like this each 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 continues to pay contributions into the fund. The level of contributions varies as the amount needed to pay benefits in the longer term may change. Contributions are no longer paid by members since the fund closed to future accrual at the end of 2016.

What is an actuarial valuation?

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 the shortfall.

The next actuarial valuation of the fund will be carried out 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 the responsibility of paying the benefits which are due. We call this the 'solvency basis'. If the company wanted to completely wind up the fund and cease any further financial obligation to it, we could insist on a final contribution to make sure the fund has enough money on this basis.

What were the results of the 2015 actuarial valuation?

30 September 2015	Ongoing basis	Solvency basis
Target level of assets	£685 million	£797 million
Actual level of assets	£582 million	£582 million
Shortfall	£103 million	£215 million
Funding level	85%	73%

Following the 2015 valuation, we agreed a contribution plan with the company to pay for the shortfall using the ongoing basis. Under this plan, the company will continue to pay contributions of £18.8 million each year, with the aim of clearing the shortfall by September 2021.

How has the position changed since the 2015 actuarial valuation?

30 September 2017	Ongoing basis
Target level of assets	£756 million
Actual level of assets	£687 million
Shortfall	£69 million
Funding level	91%

In the years between formal actuarial valuations, the actuary produces a funding update. We have to do this by law. The update on the funding position as at 30 September 2017 showed a shortfall of £69 million – a funding level of 91% (on the ongoing basis). The funding position has improved as a result of better-than-expected investment returns and the deficit contributions paid by the company.

Summary funding statement continued

What if the company couldn't pay the necessary contributions?

There is nothing to suggest that this will be the case. A formal guarantee is 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 into 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 members' 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) would make sure that all members receive a level of benefits set out in law. In return for this protection, all eligible pension schemes pay a levy each year to the PPF. You can find out more at **www.pensionprotectionfund.org.uk**.

In line with legislation, as part of the valuation of the fund every three years, the trustees appoint an independent adviser to assess the financial strength of the company and its ability to continue to meet its obligations to the fund. The trustees also assess the funding and investment risks in a formal and integrated framework, alongside the company's ability to pay the necessary contributions. This integrated risk management is considered best practice by the Pensions Regulator.

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 Andy Russell (to December 2017) Joanna Sheppard (from May 2018)
Independent	Carol Woodley, Woodley Pension Trustees Limited
Member nominated	Len Pendle (from April 2017) David Webster (reappointed July 2017)
Fund secretary	Rachael Fortescue, Inside Pensions Limited
Principal company	Smith & Nephew UK Limited

Fund advisers

The trustees have appointed the following professional advisers to help them run the fund.

Fund actuary	Clive Wellsteed 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 Limited
Bulk annuity provider	Rothesay Life Limited
Auditor	RSM UK Audit LLP (from October 2017) Ernst & Young LLP (to October 2017)
Solicitor	Mayer Brown International LLP
Banker	HSBC Bank plc (from June 2017)
Pension administrator	Mercer Limited (from June 2017)

Contact us

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