The Thirty Third Annual Report of the

DEVONPORT ROYAL DOCKYARD PENSION SCHEME

for the year
1 April 2019 -
31 March 2020

100007338

Contents

1. Trustee Report

1.1 Introduction

Trustee

The sole Trustee of the Devonport Royal Dockyard Pension Scheme is Devonport Royal Dockyard Pension Trustees Limited (the Trustee).

The Board of Directors of the Trustee Company is as follows:-

Chairman	K Goodman	(Company appointed director, appointed as Chairman from 12 August 2019)
	M Graesser	(resigned 11 August 2019)
Company appointed Directors	R Margetts	
	P Jones	
	H Johnson	
	C James	(appointed 4 October 2019)
Member nominated Directors	T Fraser	
	D Smith	(resigned 31 December 2019)
	M Carey	(resigned 31 May 2019)
	M Oates	
	D Little	
	D Metters	(appointed 12 June 2019)
	M Jackson	(appointed 1 January 2020)
Pensioner and deferred members' appointee	J Varney	
Independent Director	The Trustee Corporation Limited, represented by R Gravill	

Officers and Advisers

Secretary	:	T Claffey
Auditor	:	Ernst & Young LLP
Bankers	:	HSBC
Scheme Actuary	:	C Vaughan-Williams, Aon Hewitt
Investment Consultants	:	Mercer Investment consulting
Investment Managers	:	Arrowgrass (appointed May 2013)
		Aviva (appointed September 2007)
		BlackRock (appointed November 2010)
		BlueCrest (appointed May 2013, until September 2019)
		Cambridge Associates (appointed October 2017)
		CBRE (appointed November 2010)
		Colchester (appointed April 2019)
		CQS (appointed September 2013)
		GMO (appointed February 2014)
		H20 (appointed December 2014)

		Janus Henderson Global Investors (appointed March 2008) ICG-Longbow (appointed October 2011) Insight Investment (appointed October 2010) Kiltearn Partners (appointed June 2015, until April 2019) King Street (appointed October 2018) Legal & General Investment Management (appointed September 2018) M&G (appointed August 2014) Man Group (appointed November 2018) MFS (appointed November 2010, until April 2019) Marshall Wace (appointed October 2018) Oakhill (appointed September 2016) Patrizia Property Investment Managers LLP (formerly Rockspring) (appointed August 2014) Stone Harbor (appointed December 2010, until April 2019) T Rowe Price (appointed November 2012)
AVC Investment Manager	:	Utmost Life and Pensions (previously Equitable Life Assurance Society)
Investment Custodian	:	Northern Trust
Legal advisers	:	Pinsent Masons LLP
		Sackers & Partners LLP
Pensions Administrator	:	Babcock Marine (Rosyth) Limited

Address for Enquiries

Enquiries about the Scheme should be addressed to the:-

Pensions Administrator
Devonport Royal Dockyard Pension Scheme
Babcock International Group
Rosyth Business Park
Rosyth
Dunfermline
Fife KY11 2YD

Tel: 01383 412131 Email:~marine.pensions@babcockinternational.com

1.2 Report of the Trustee

The Trustee presents the thirty third annual report and accounts of the Scheme covering the Scheme year ended 31 March 2020. The report and accounts are prepared and audited in accordance with the Audited Accounts Regulations made under sections 41(1) and (6) the Pensions Act 1995. The Auditor's Statement about Contributions and the Trustee's Summary of Contributions are set out on pages 21 and 22 respectively.

Establishment

The Scheme was established by a Trust Deed dated 2 April 1987. A new consolidated Trust Deed was executed on 27 May 2015.
The Scheme is approved by HMRC as a retirement benefits scheme for the purposes of Chapter I Part XIV of the Income and Corporation Taxes Act 1988 and is treated as an 'exempt approved scheme' for the purposes of Section 592 of that Act with effect from 6 April 1987.

Until the cessation of contracting-out on 5 April 2016 members were contracted-out of the additional component of the Second State Pension Scheme under a certificate issued by the HMRC National Insurance Contributions Office.

The Board of the Trustee Company consists of twelve Directors. The Chairman and four Directors are appointed by Devonport Royal Dockyard Limited (The Principal Employer). There are five member nominated Directors and one nominated by the pensioner and deferred members. The other Director is an independent Director who joined the Board on 1 September 2003. The Independent Director is The Trustee Corporation Limited, represented by R Gravill.

Membership of the Board of the Trustee Company

The Principal Employer may, by deed, remove from office any Trustee Director of the Scheme, appoint one or more new Trustee Directors in the place of any Trustee Director who for any reason ceases to be a Trustee Director of the Scheme or appoint (without limitation as to number) an additional Trustee Director or additional Trustee Directors of the Scheme. There are special provisions governing the removal and appointment of the Independent Director.

Directors' Involvement

The Board of Directors of the Trustee Company meet on a quarterly basis to consider matters relating to the administration and investment policy of the Scheme.

An Investment Committee met regularly during the year to oversee investments and maintain liaison with the investment managers. The Committee was also responsible for monitoring performance in the overall context of the Board's investment strategy and for implementing investment policy recommendations as agreed by the Board. Until September 2019 this role was carried out by the Babcock cross scheme Investment Sub Committee. Following cessation of that Committee's activities the Scheme's own Investment Committee was established.

An Operations & Finance Sub Committee meets at least two weeks before each quarterly Trustee meeting to oversee operational governance and Scheme compliance issues.

The Retirement Sub Committee meets monthly to consider applications for and payments of medical ill-health retirement, death in retirement and death in service benefits, where nominated beneficiaries and dependants exist.

The members of the Trustee Board Sub Committees are as follows:

Investment	J Varney, R Gravill, P Jones (from 26 September 2019), H Johnson (from 26 September 2019)
Retirement	T Fraser, D Smith (until 31 December 2019), H Johnson, M Oates (from 1 January 2020)
Operations & Finance	D Smith (until 31 December 2019), H Johnson (until 31 December 2019), R Margetts, R Gravill, T Fraser, C James (from 1 January 2020)

Trustee Board Meeting Attendance

Name	Attendance at Trustee Board Meetings
Chairman	
M Graesser	1 out of 1
K Goodman	4 out of 4
Independent Trustee	
R Gravill	4 out of 4
Member Nominated Directors	
T Fraser	3 out of 4
D Smith	2 out of 3
J Varney	4 out of 4
M Carey	0 out of 0
M Oates	2 out of 4
D Little	3 out of 4
D Metters	4 out of 4
M Jackson	1 out of 1
Company Appointed Directors	
R Margetts	4 out of 4
P Jones	4 out of 4
H Johnson	3 out of 4
C James	1 out of 1

Remuneration

The Directors, except for the Independent Corporate Trustee Director, the Pensioner and Deferred Member Nominated Trustee Director, and one of the Company Appointed Directors, do not receive any remuneration from the pension Scheme. A fixed fee of £22,500 per annum (2019: £22,500) plus disbursements, for attendance at and preparation for regular Trustee meetings, has been agreed with the Independent Corporate Trustee Director, plus payment for additional time spent on Trustee matters outside of regular meetings. A payment for Board and Committee meetings is paid to the Pensioner and Deferred Member Nominated Trustee Director for each attendance. A fixed annual fee of £12,000, plus expenses, is paid to the Company Appointed Director paid by the Scheme. Any other remuneration and expenses due to the Trustee Directors are paid by the employer company.

Scheme Management

The Trustee has overall responsibility for the administration and development of the Scheme. The Directors call upon the services of their specialist advisers detailed in the Introduction, and of the Pensions Administrator as the need arises.

Statement of Trustee's Responsibilities for the Financial Statements

The financial statements, which are prepared in accordance with UK Generally Accepted Accounting Practice, including the Financial Reporting Standard applicable in the UK (FRS102) are the responsibility of the Trustee. Pension scheme regulations require, and the Trustee is responsible for ensuring, that those financial statements:

- show a true and fair view of the financial transactions of the Scheme during the Scheme year and of the amount and disposition at the end of the Scheme year of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Scheme year; and

- contain the information specified in Regulation 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, including making a statement whether the financial statements have been prepared in accordance with the relevant financial reporting framework applicable to occupational pension schemes.

In discharging the above responsibilities, the Trustee is responsible for selecting suitable accounting policies, to be applied consistently, making any estimates and judgments on a prudent and reasonable basis, and for the preparation of the financial statements on a going concern basis unless it is inappropriate to presume that the Scheme will not be wound up.

The Trustee is also responsible for making available certain other information about the Scheme in the form of an annual report.

The Trustee also has a general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to it to safeguard the assets of the Scheme and to prevent and detect fraud and other irregularities, including the maintenance of an appropriate system of internal control.

The Trustee is responsible under pensions legislation for preparing, maintaining and from time to time reviewing and if necessary revising a schedule of contributions showing the rates of contributions payable towards the Scheme by or on behalf of the employer and the active members of the Scheme and the dates on or before which such contributions are to be paid. The Trustee is also responsible for keeping records in respect of contributions received in respect of any active member of the Scheme and for adopting risk-based processes to monitor whether contributions are made to the Scheme by the employer in accordance with the schedule of contributions. Where breaches of the schedule occur, the Trustee is required by the Pensions Acts 1995 and 2004 to consider making reports to The Pensions Regulator and the members.

Signed for and on behalf of the Trustee

Trustee Director

Date 29.9.20

Changes in the Scheme rules

There were no changes in the Scheme rules during the year.

Membership

There was a decrease from 1,803 to 1,599 in the number of active members during the year.

Pensions in payment increased from 5,840 to 5,884 and the number of deferred pensioners decreased from 2,657 to 2,532.

Under a bulk transfer, members who had been transferred from the Principal Civil Service Pension Scheme in September 2002, were transferred back to the Civil Service Pension Scheme. In May 2019 105 such pensioner members transferred, with 7 deferred members following in July 2019.

A detailed analysis of the Scheme membership with comparable figures for the previous year can be found in Section 1.4 of this Report.

Pension Increases

Pensions in payment and deferred pensions for Transferred Members (former Civil Servants) were increased from April 2019 in line with the Consumer Price Index (CPI) for the 12 months to September 2018. The increase applied was 2.4%. The equivalent increase applied in April 2020, reflecting CPI for the 12 months to September 2019, was 1.7%.

Deferred pensions for all other members increase in line with statutory requirements.

Cash Equivalents

Seventy members chose to transfer their benefits to other suitably approved pension arrangements and the Trustee confirms that the cash equivalents or transfer-out values were calculated in accordance with the Pension Schemes Act 1993 (as amended by the Pensions Act 1995).

Transfer values payable represented the full value of the member's preserved benefit entitlement and were calculated in accordance with the relevant legislation and on the advice of the actuary. The rules of the Scheme do not provide for any material discretionary benefits, and no allowance has been made for them.

Incoming transfers from other pension arrangements are not accepted by the Scheme with the exception of approved inter-group transfers from the Babcock International Group Pension Scheme, Rosyth Royal Dockyard Pension Scheme or Babcock Naval Services Pension Scheme.

GMP Equalisation

As advised in last year's Annual report, on 26 October 2018 the High Court handed down a judgment involving the Lloyds Banking Group's defined benefit pension schemes. The judgment concluded that the schemes should be amended to equalise pension benefits for men and women in relation to Guaranteed Minimum Pension benefits ('GMPs'). The Trustee of this Scheme is aware that the judgment will also affect the Scheme. There are a number of possible methods by which equalisation may be achieved and the Trustee continues to participate in a working party with the other principal Babcock pension schemes and the employer in order to establish a suitable approach.

Accounting guidance has been issued in response to the ruling and this requires that, where material, the obligation in respect of backdating benefits and related interest should be recognised as a liability in the financial statements. The Scheme Actuary has estimated the value of backdated benefits arising from this judgment. The Trustee has determined the amount not to be material for the financial statements, and as such no provision has been made for it in the financial statements.

Actuarial Review

The Scheme is subject to regular actuarial review, usually every three years. The most recent full actuarial review was carried out as at 31 March 2017. The results confirmed that the funding level of the Scheme in relation to benefits accrued up to the valuation date was 91% with a deficit of £177 million. The next full actuarial review, as at 31 March 2020, is currently being undertaken. The Trustee also receives an annual update to the valuation. The Report on Actuarial Liabilities on page 47 provides details of the update as at 31 March 2019.

The Actuary is required to make a statement under the Pensions Act 2004 confirming that the calculation of the Technical Provisions is consistent with regulations and with the Trustee's Statement of Funding Principles.

Regulations made under the Pensions Act 2004 require a Schedule of Contributions to be agreed between the Trustee and the employer following each actuarial valuation, and for that Schedule to be certified by the Actuary. The most recent such Actuary's Certificate is reproduced on page 46 of this report.

Contributions

Contributions in the year were payable in accordance with the Schedule of Contributions certified by the Actuary on 1 October 2018 and reflecting the results of the 2017 valuation.

Member contributions were made at 7.75% until 30 September 2019 (higher rates being payable by members with earnings exceeding £60,000 per annum) and the employer paid 24.55% of capped pensionable pay. From 1 October 2019 member contributions increased to 9.5% (higher rates being payable by members with earnings exceeding £60,000 per annum) and employer contributions reduced correspondingly, to 22.8%. For members opting to adopt the 1/132 accrual rate, employee and employer contributions were 6% and 13.7% respectively. Note that, where employee contributions are made under salary sacrifice arrangements, they are classified as employer contributions in the financial statements.

To ensure that the statutory funding objective is met and to eliminate the shortfall revealed by the 2017 valuation the Trustee and the employer agreed that seven additional contributions of £18.6 million per annum would be payable on or before 1 October each year from 2018 to 2024.

The employer also makes contributions in order to meet the expenses of the Scheme based upon an administration budget agreed each year and reimburses the annual PPF levy. In addition, the employer makes contributions to address the funding gap arising from the longevity swap.

Additional Voluntary Contributions (AVCs)

There is provision for active members to pay AVCs to the Babcock Retirement Savings Scheme in order to increase their pension benefits. Such AVCs are administered by the Babcock International Group Pension Scheme.

The legacy AVC policies held by the Trustee were transferred from Equitable Life to Utmost Life and Pensions on 1 January 2020.

COVID-19

The arrival of the COVID-19 pandemic in the first quarter of 2020 has had a significant global impact and presented challenges for the Scheme through the volatility of investment markets and operational difficulties due to office closures. The Scheme has responded to the situation by:

- preparing and implementing contingency plans from an early stage, both to allow the Trustee board to continue to operate effectively, and to allow the administration team to continue providing a high standard of service to members through remote working arrangements. All key third party advisers were also contacted and their contingency plans assessed and found to be robust, and have proved to be so in practice.
- monitoring the ongoing effects on funding. The initial impact is considered to be relatively modest at around 5% on a Technical Provisions basis during March 2020, with part of that fall being recovered since. The impact will be incorporated into the triennial valuation as at 31 March 2020 currently being undertaken, alongside other Scheme developments.
- monitoring the effect on its investments, which have not been severely impacted, reflecting the benefits of both a well diversified portfolio and the liability hedging strategy in place.
- monitoring the effect on the covenant provided by the employer, which is considered to be relatively modest, given the nature of its business. The Trustee has no reason to believe that the employer cannot continue to pay contributions as they fall due.
- Communication with members in order to reassure them that their benefits (with the exception of AVCs) are not directly affected by the volatility in the investment markets.

In summary, the Trustee has responded proactively to the challenges presented by the COVID-19 crisis in order to minimise its effects and is confident that it can continue to meet its key objective of paying member benefits on time and in full on a long term basis. Having given due consideration to the above, the Trustee considers that the Scheme remains a going concern for the foreseeable future.

1.3 Investment report

1. Introduction and Governance

Summary of Scheme Investment structure

The overall investment policy of the Scheme is determined by the Trustee having taken advice from their advisers, Mercer Limited. The Trustee is responsible for determining the investment strategy and manager appointments after taking appropriate advice. The Trustee has delegated the day-to-day management of investment to professional investment managers. These managers, undertake, within restrictions in the contractual documentation, the day-to-day management of the asset portfolio, including the full discretion for stock selection.

The Trustee has produced a Statement of Investment Principles (“SIP”) in accordance with Section 35 of the Pensions Act 1995, the Occupational Pension Scheme’s (Investment) Regulations 2005 and subsequent legislation. The SIP has been updated over the year to incorporate new legislative requirements on policies covering financially material considerations, non-financial matters, exercising of voting rights and engagement activities. Further details are outlined later in this report. A copy of the SIP is available on request.

2. Employer Related Investments

Under the Pensions Act 1995 particular types of investment are classed as “employer-related investments”. Under laws governing employer related investments (ERI) not more than 5% of the current value of scheme assets may be invested in ERI (subject to certain exceptions). In addition, some ERI is absolutely prohibited, including an employer related loan or guarantee. In September 2010 the prohibition of Employer Related Investments was extended to cover pooled funds, excluding funds held in life wrappers.

The Trustee reviews its allocation to employer-related investments on an ongoing basis and is satisfied that the proportion of the Scheme’s assets in employer-related investments does not exceed 5% of the market value of the assets during the year to 31 March 2020, nor does the Scheme hold any prohibited employer related investments; the Scheme therefore complies with legislative requirements. This will continue to be monitored going forward.

3. Market Background (Year to 31 March 2020)

Investment Markets[1]

Following a strong 2019, investment markets started 2020 with the worst quarter since the end of 2008, as the global economy went through an unprecedented synchronised shutdown in light of the COVID-19 crisis.

Over 2019, the global economy continued its expansion, led by the US which saw a tightening labour market, rising wages and consumer confidence, fuelled by the business-friendly stance of the Trump

[1] Statistics sourced from Thomson Reuters Datastream unless otherwise specified.

administration even though trade tensions took some toll on business confidence. Japan, the UK and continental Europe saw more measured growth even though economic data from continental Europe over the year has been hinting at a continued slowdown. In the UK, the outcome of the 2019 election was well received by markets, though uncertainty over how Brexit proceedings will unfold still remains. Headwinds for emerging markets began to soften in early 2019, with improvement on the trade front. In Q1 2020, however, the global economy entered what is expected to be the most severe downturn since the Great Depression while oil prices collapsed simultaneously as a price war between Russia and Saudi Arabia escalated while global demand collapsed simultaneously. Unprecedented monetary easing and fiscal programmes not seen since World War II cushioned the blow somewhat.

The second quarter of 2019 was volatile but global equity markets ended the quarter on a positive note in both US Dollar and Sterling terms. The third quarter saw a sell-off during August 2019 amid global slowdown fears as well as continued trade tensions. The correction was not as severe as in late 2018 and global equity markets recovered in the end, finishing the third quarter pretty much flat in US Dollar terms but positive in Sterling terms. Equity markets then rallied in the fourth quarter as progress on the trade front, as well as the prospect of prolonged easy monetary conditions on a global level, lifted sentiment. Unhedged UK investors saw most of these gains offset by the strong Sterling appreciation, which accompanied the outcome of the December General Election, which was generally well received by markets. The COVID-19 pandemic which originated in China in December 2019 and started to spread globally from the second half of the first quarter of 2020 prompted governments to shut down entire countries including the US, UK and most of Europe. The abrupt halt in business activities and collapse in corporate earnings prompted investors to flee equity markets and shift into safe haven assets with the result being the worst equity sell-off since 2008 even though Sterling weakening against US Dollar offset losses somewhat for unhedged UK investors.

Bond markets performed well in 2019 in both US Dollar and Sterling terms amidst more dovish central bank rhetoric and a cutting cycle initiated by the Fed that continued up to the end of the third quarter of 2019. Unprecedented monetary easing measures across the globe with the Bank of England cutting the benchmark rate to 0.1% on 19 March 2020 and reinitiating quantitative easing led to a government bond rally in the first quarter of 2020 as yields fell to the lowest level in history across the globe. Amidst the general market volatility the uncertainty about the future of RPI has been weighing on the index linked gilt market. It is difficult to isolate the impact of the uncertainty around RPI from general market uncertainty, such as the potential deflationary impact of COVID-19 or the potentially inflationary impact of monetary easing. Inflation linked government bonds globally have fallen in value relative to nominal assets. A consultation on the future of RPI was launched in March and whilst some market participants took heart in that it recognised that converting RPI to CPIH would have an impact on index linked gilt holders, the general consensus appears to remain that RPI will converge to CPIH from 2025 or 2030 without any spread adjustment being applied to compensate index linked gilt holders (and other recipients of RPI linked payments). The findings of the consultation and a decision from the government are expected later this year.

UK Property saw moderate returns relative to other risk assets over 2019 but the market was severely impacted by the COVID-19 crisis in March 2020, with heightened market volatility leading to material uncertainty clauses being added to valuations at the date this report is written. In-line with other risk assets, property values experienced significant falls over the first quarter, with buildings let to non-food retail, hotels and leisure tenants worst affected, while those with long-term secure income are proving more resilient thus far.

Equity Markets

At a global level, developed markets as measured by the FTSE World index, returned -6.0%. Meanwhile, a return of -13.0% was recorded by the FTSE All World Emerging Markets index.

At a regional level, European markets returned -8.0% as indicated by the FTSE World Europe ex UK index. At a country level, UK stocks as measured by the FTSE All Share index returned -18.5%. The FTSE USA index returned -2.3% while the FTSE Japan index returned -2.1%. The considerable underperformance of UK equities is attributed to the index's large exposure to oil, gas and basic materials.

Equity market total return figures are in Sterling terms over the 12-month period to 31 March 2020.

Bonds

UK Government Bonds as measured by the FTSE Gilts All Stocks Index, returned 9.9%, while long dated issues as measured by the corresponding Over 15 Year Index had a return of 17.6% over the year as the longer end of the nominal yield curve fell by more than the shorter end. The yield for the FTSE Gilts All Stocks index fell over the year from 1.36% to 0.66% while the Over 15 Year index yield fell from 1.48% to 0.75%.

The FTSE All Stocks Index-Linked Gilts index returned 2.2% with the corresponding over 15-year index exhibiting a return of 2.0%. Falling inflation expectations offset falling nominal yields to an extent, cushioning the fall of real yields somewhat which explains the underperformance of index-linked gilts relative to nominal gilts.

Corporate debt as measured by the Bank of America Merrill Lynch Sterling Non-Gilts index returned 1.7%.

Bond market total return figures are in Sterling terms over the 12-month period to 31 March 2020.

Property[2]

Over the 12-month period to 31 March 2020, the IPD UK All Property Index made limited gains, with returns of 0.14% in Sterling terms. Due to the impact of the COVID-19 pandemic, there has been a fall in transactions and impacts on rental income which have made the majority of conveyors include 'material uncertainty' clauses in Q1 2020 reports. The CBRE Property Fund in which the Scheme invests is currently being wound down.

Currencies

Over the 12-month period to 31 March 2020, Sterling depreciated by 2.6% against the US Dollar from \$1.30 to \$1.24. Sterling depreciated by 7.2% against the Yen from ¥144.23 to ¥133.86. Sterling depreciated against the Euro by 4.8% from €1.16 to €1.13 over the same period.

4. Investment Policies and Objectives

The main priority of the Trustee when considering the investment policy is to ensure that the benefits payable to members are met as they fall due. In seeking to do so, they have established the following objectives:

- To ensure that the Scheme's benefit obligations can be met.
- That, overall, there is a high level of security of benefits.

When designing the investment arrangements, the Trustee consider the requirements of legislation, the funding objectives for the Scheme and their views on the covenant of the Sponsor.

[2] Statistics sourced from MSCI Investment Property Database

Financially and Non-Financially Material Matters in the Selection, Retention and Realisation of Investments, the Exercising of Rights Attached to Investments and Engagement Activities

The Trustee believes that environmental, social, and corporate governance (“ESG”) factors may have a material impact on investment risk and return outcomes, and that good stewardship can create and preserve value for companies and markets as a whole. The Trustee also recognises that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly may require explicit consideration. The Trustee takes a pragmatic approach to ESG issues and considers the materiality in terms of both risk and return.

The Trustee has given appointed investment managers full discretion in evaluating ESG factors, including climate change considerations, and exercising voting rights and stewardship obligations attached to the investments, in accordance with their own corporate governance policies and current best practice, including the UK Corporate Governance Code and UK Stewardship Code. The Trustee encourages the Scheme’s investment managers to comply with the UK Stewardship Code.

The Trustee has communicated to the investment managers (via the Investment Committee) clear expectations that the Scheme’s investment managers consider the risks and return opportunities that may arise by considering ESG factors within their overall investment processes.

The Trustee considers how ESG, climate change and stewardship is integrated within investment processes in appointing new investment managers and monitoring existing investment managers.

The Trustee also considers the investment consultant’s assessment of how each of the investment managers embed ESG into their investment process and how the managers’ responsible investment philosophy aligns with the Trustee’s responsible investment policy. This includes the investment managers’ policy on voting and engagement. The Trustee will use this assessment in decisions around selection, retention and realisation of manager appointments.

The Trustee can regularly review the decisions made by their managers, including voting history (in respect of equities) and engagement activity, and can challenge such decisions to try to ensure the best long term performance over the medium to long term. In addition, the Trustee carries out regular reviews of the managers’ ESG policies and actively engages with investment managers to better understand their processes.

The Trustee has not currently set any investment restrictions on the appointed investment managers in relation to particular products or activities. Investment managers are aware that their continued appointment is based on their success in delivering the mandate for which they have been appointed to manage. If the Trustee is dissatisfied, then they will look to replace the manager.

Member views are not taken into account in the selection, retention and realisation of investments.

Investment Portfolio

Over the year under review, the Scheme has made changes to the investment manager structure and benchmark allocation. A high level summary is provided below.

Manager	Mandate	Allocation (£m)		Summary of Changes
		Start	End	
MFS	Global Equity	69.3	-	Disinvested during the period
Kiltearn	Global Equity	49.0	-	Disinvested during the period
Stone Harbor	Emerging Market Debt	18.7	-	Disinvested during the period
Insight	Global Equity (ex-UK)	84.5	-	Disinvested during the period
Colchester	Emerging Market Debt	-	32.4	Invested during the period
Longbow	Fund V (Real Estate Debt)	-	13.5	Invested during the period
Insight	Global Equity	-	57.2	Invested during the period

Source: Investment Managers and Mercer.
Figures may not sum to total due to rounding.

Asset Allocation

The Trustee invest in segregated portfolios, pooled investment vehicles and derivative contracts. The Trustee has authorised the use of derivatives by the investment managers for efficient portfolio management purposes including to reduce certain investment risks such as interest rate risk and inflation risk. The principal investment in derivatives is gilt repurchase agreements, interest rate and inflation swaps in the liability matching portfolio; total return swaps and futures in the return seeking portfolio.

The following table provides more detail on the distribution of the Scheme's assets.

Manager/Asset Class	Actual Asset Allocation			
	Start of Year (£m)	End of Year (£m)	Start of Year (%)	End of Year (%)
MFS - Global Equity	69.3	-	3.6	-
Kiltearn - Global Equity	49.0	-	2.5	-
Insight - Global Equity [(a)]	-	57.2	-	3.1
Insight - Global Equity (ex-UK) [(a)]	84.5	-	4.4	-
Insight - Global Minimum Volatility Equity [(a)]	41.1	29.0	2.1	1.5
T. Rowe Price - Emerging Markets Equity	48.7	21.5	2.5	1.1
Global Equity	**292.5**	**107.8**	**15.2**	**5.7**
Stone Harbor - Emerging Market Debt	18.7	-	1.0	-
Colchester - Emerging Market Debt	-	32.4	-	1.7

Manager/Asset Class	Start of Year (£m)	End of Year (£m)	Start of Year (%)	End of Year (%)
Emerging Market Debt	**18.7**	**32.4**	**1.0**	**1.7**
GMO - GTAA	11.8	29.8	0.6	1.6
Arrowgrass - Multi-Strategy	21.3	3.9	1.1	0.2
Marshall Wace - Multi-Strategy	27.9	28.0	1.5	1.5
Man Group - Multi-Strategy	27.9	26.6	1.4	1.4
King Street - Multi-Strategy	27.1	12.9	1.4	0.7
BlueCrest - Multi-Strategy	0.1	0.1	0.0	0.0
Total Multi-Strategy	**116.2**	**101.3**	**6.0**	**5.4**
CQS - Multi-Asset Credit	32.8	28.2	1.7	1.5
Oak Hill - Multi-Asset Credit	47.0	42.2	2.4	2.2
Total Multi-Asset Credit	**79.8**	**70.4**	**4.2**	**3.7**
BlackRock - Property	26.5	17.9	1.4	1.0
CBRE - Property	15.9	14.7	0.8	0.8
Longbow - Fund III (Real Estate Debt)	5.8	5.3	0.3	0.3
Longbow - Fund V (Real Estate Debt)	-	13.5	-	0.7
Patrizia (ex-Rockspring) - Property	5.7	4.4	0.3	0.2
Property	**53.9**	**55.8**	**2.8**	**3.0**
Total Growth Portfolio (ex-Equity Futures)	**561.2**	**367.6**	**29.2**	**19.6**
Equity Futures Exposure	-183.9	-	-9.6	-
Total Growth Portfolio (inc-Equity Futures)	**377.3**	**367.6**	**19.6**	**19.6**
LGIM - Global Buy and Maintain	136.2	133.6	7.1	7.1
Insight - Global Buy and Maintain	141.0	138.5	7.3	7.4
Janus Henderson - Global Buy and Maintain	39.6	37.6	2.1	2.0
Total Global Buy and Maintain	**316.9**	**309.8**	**16.5**	**16.5**
Insight - Liquid Asset Backed Securities	32.8	32.7	1.7	1.7
Total Asset-Backed Securities	**32.8**	**32.7**	**1.7**	**1.7**
M&G - Absolute Return Bonds	48.8	46.2	2.5	2.5
H2O - Absolute Return Bonds (Adagio)	36.9	34.8	1.9	1.9
H2O - Absolute Return Bonds (Allegro)	19.0	12.7	1.0	0.7
Total Absolute Return Bonds	**104.7**	**93.8**	**5.4**	**5.0**
M&G – Secured Finance	134.1	124.2	7.0	6.6
Aviva - HLV Property	84.2	151.6	4.4	8.1
Cambridge Associates - Private Debt	8.2	23.5	0.4	1.3
Insight - Matching [b]	681.7	773.5	35.5	41.2

Manager/Asset Class	Start of Year (£m)	End of Year (£m)	Start of Year (%)	End of Year (%)
Total Low Risk and Matching Portfolio	**1,362.7**	**1,509.0**	**70.9**	**80.4**
Equity Futures Cash Exposure	182.6	-	9.5	-
Total	**1,922.6**	**1,876.7**	**100.0**	**100.0**

Source: Investment Managers and Mercer.
Figures may not sum to total due to rounding.
[(a)] *Includes exposure to Insight's equity swaps.*
[(b)] *Excludes exposure to Insight's equity swaps and includes margin posted to Insight's equity futures.*

Investment Performance (Net of Fees)

Manager/Asset Class	For the Year		Last 3 Years	
	Fund (%)	B'mark (%)	Fund (% p.a.)	B'mark (% p.a.)
Insight - Global Equity [(a)]	-13.3	-13.3	-	-
Insight - Global Minimum Volatility Equity	-3.0	-3.0	5.1	5.1
T. Rowe Price - Emerging Markets Equity	-9.9	-13.2	1.4	-1.0
GMO - GTAA	-1.7	4.4	1.5	4.2
Arrowgrass - Multi-Strategy	-20.0	4.4	-6.7	4.2
Marshall Wace - Multi-Strategy	-1.6	4.4	-	-
Man Group - Multi-Strategy	-4.6	4.4	-	-
King Street - Multi-Strategy	-12.6	4.4	-	-
BlueCrest - Multi-Strategy	0.0	4.4	2.7	4.2
CQS - Multi-Asset Credit	-14.0	4.4	-2.6	4.2
Oak Hill - Multi-Asset Credit	-10.3	4.4	-2.2	4.2
Colchester - Emerging Market Debt [(a)]	-6.0	-2.9	-	-
BlackRock - Property	-1.2	0.0	4.4	4.8
CBRE - Property	-4.2	0.0	3.7	4.8
Longbow - Fund III (Real Estate Debt)	3.0	4.4	8.7	4.2
Longbow - Fund V (Real Estate Debt) [(a)]	10.6	3.6	-	-
Patrizia (ex-Rockspring) - Property	-12.2	4.4	3.5	4.2
Total Growth Portfolio [(b)]	**-7.6**	**4.3**	**-0.6**	**4.1**
LGIM - Global Buy and Maintain	-2.1	-1.9	-	-
Insight - Global Buy and Maintain	-1.9	-1.8	0.9	1.0
Janus Henderson - Global Buy and Maintain	-4.4	-4.2	-0.3	-0.2
Insight - Liquid Asset Backed Securities	-0.6	0.8	0.4	0.6

Manager/Asset Class	For the Year		Last 3 Years	
	Fund (%)	B'mark (%)	Fund (% p.a.)	B'mark (% p.a.)
M&G - Secured Finance	-5.4	0.8	-	-
M&G - Absolute Return Bonds	-3.5	0.8	0.1	0.6
H2O - Absolute Return Bonds (Adagio)	-5.6	0.8	3.0	0.6
H2O - Absolute Return Bonds (Allegro)	-33.3	0.8	-	-
Aviva - HLV Property	6.3	4.6	7.3	-2.0
Cambridge Associates - Private Debt	8.1	-12.8	-	-
Total Low Risk Portfolio [c]	**-3.1**	**2.3**	**0.5**	**2.1**
Matching Portfolio	£84.4m	£87.5m	£203.7m	£189.8m
Total	**1.5**	**4.5**	**3.8**	**4.5**

Figures shown are based on performance provided by the Investment Managers, Mercer estimates and Thomson Reuters Datastream.
[a] Last year performance shown since inception. Inception dates for performance measurement purpose taken as 10 October 2019 for Insight (Global Equity), 12 April 2019 for Colchester and 31 May 2019 for Longbow (Fund V).
[b] Includes Equity futures.
[c] After allowing for corporate bond interest rate exposure being hedged out by Insight.

Over the period under review, the DB Section underperformed its composite benchmark over the 1 year and 3 year periods by 3.0% and 0.7% p.a. respectively, returning 1.5% and 3.8% p.a.

Custodial Arrangements

The custodian is responsible for the safekeeping, monitoring and reconciliation of documentation relating to the ownership of listed investments. The majority of the Scheme's assets are invested in pooled funds. Where assets are invested in pooled funds, the Investment Managers are responsible for appointing custodians.

The Trustee has appointed Northern Trust for the safekeeping of the Scheme's Liability Driven Investment (LDI) assets and Synthetic Equity Portfolios with Insight, as well as the Buy and Maintain portfolios managed by LGIM.

In addition, Northern Trust has been appointed by the Trustee as global custodian to provide it with a full and complete record of all holdings (including pooled and segregated mandates but excluding longevity swaps and AVC's).

The Trustee Directors are responsible for ensuring the Scheme's assets continue to be securely held. They review the custodial arrangements from time to time and the Scheme Auditor is authorised to make whatever investigations they deem are necessary as part of the annual audit procedure.

1.4 Membership Statistics

	2019/20	2018/19
Active members		
Active members as at 1 April	**1,803**	**2,050**
Less		
Leavers taking deferred pensions	(87)	(131)
Members who died in service	(4)	-
Members who took early retirement	(49)	(50)
Members who retired under early retirement reserve	(33)	(40)
Members granted ill health retirement	(6)	(10)
Members who retired at normal retirement age or later	(25)	(16)
Active members as at 31 March	**1,599**	**1,803**
Pensioners		
Pensioners as at 1 April	**5,840**	**5,996**
Add		
New pensioners/dependants during year	347	305
Less		
Commutations	(24)	(264)
Bulk transfer to Civil Service Pension Scheme	(105)	-
Pensioners who died and children who left during year	(174)	(197)
Pensioners as at 31 March	**5,884**	**5,840**
Deferred Pensioners		
Deferred pensioners as at 1 April	**2,657**	**2,842**
Add		
New deferred pensioners during year	87	131
Internal divorce transfer credits	3	1
Less		
Bulk transfer to Civil Service Pension Scheme	(7)	(131)
Deferred pensioners taking subsequent transfers	(70)	(66)
Deferred pensioners who died	(9)	(8)
Deferred pensioners who became pensioners	(129)	(112)
Deferred pensioners as at 31 March	**2,532**	**2,657**

1.5 Financial Development of the Scheme

The financial development of the Scheme over the year is presented in summarised form as follows:-

	£000s
The total of contributions receivable from members and the employer plus transfer values and other income received during the year	50,636
Benefits payable	(63,043)
Payments to and on account of leavers	(31,333)
Other Payments	(403)
Administrative expenses	(2,167)
Net amount withdrawn and to be deducted from the accumulated Fund	(46,310)
Investment and other income, less expenses	29,123
Change in the market value of the Fund's assets	(33,649)
Net movement for the year	(50,836)
The value of the Fund at the beginning of the year	1,861,574
The value of the Fund at 31 March 2020	**1,810,738**

Trustee Director ....

Secretary

Dated ....29.9.20..

2. Auditor's Reports

2.1 Independent auditor’s report to the Trustee of the Devonport Royal Dockyard Pension Scheme

Opinion

We have audited the financial statements of the Devonport Royal Dockyard Pension Scheme for the year ended 31 March 2020 which comprise the Fund Account, the Statement of Net Assets and the related notes 1 to 30, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’.

In our opinion, the financial statements:

- show a true and fair view of the financial transactions of the Scheme during the year ended 31 March 2020, and of the amount and disposition at that date of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the year;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including FRS 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’; and
- contain the information specified in Regulation 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, made under the Pensions Act 1995.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor’s responsibilities for the audit of the financial statements section of our report below. We are independent of the Scheme in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC’s Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Trustee’s use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Trustee has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Scheme’s ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The other information comprises the information included in the Annual Report set out on pages 1 to 47, other than the financial statements, our auditor’s report thereon and our auditor’s statement about contributions. The Trustee is responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

Independent auditor's report to the Trustee of the Devonport Royal Dockyard Pension Scheme (continued)

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Responsibilities of the Trustee

As explained more fully in the statement of Trustee's responsibilities set out on page 5, the Trustee is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Trustee determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements the Trustee is responsible for assessing the Scheme's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Trustee either intends to wind up the Scheme or to cease operations, or has no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the Scheme's Trustee, as a body, in accordance with the Pensions Act 1995 and Regulations made thereunder. Our audit work has been undertaken so that we might state to the Scheme's Trustee those matters we are required to state to it in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme's Trustee as a body, for our audit work, for this report, or for the opinions we have formed.

Ernst & Young LLP

Statutory Auditor
Reading
Date 29 SEPTEMBER 2020

2.2 Independent auditor's statement about contributions to the Trustee of the Devonport Royal Dockyard Pension Scheme

We have examined the summary of contributions to the Devonport Royal Dockyard Pension Scheme in respect of the Scheme year ended 31 March 2020 to which this statement is attached.

In our opinion contributions for the Scheme year ended 31 March 2020 as reported in the summary of contributions and payable under the schedule of contributions have, in all material respects, been paid at least in accordance with the schedule of contributions certified by the Scheme actuary on 1 October 2018.

Scope of work on Statement about Contributions

Our examination involves obtaining evidence sufficient to give reasonable assurance that contributions reported in the summary of contributions on page 22 have, in all material respects, been paid at least in accordance with the schedule of contributions. This includes an examination, on a test basis, of evidence relevant to the amounts of contributions payable to the Scheme and the timing of those payments under the schedule of contributions.

Respective responsibilities of Trustee and auditor

As explained more fully in the Statement of Trustee's Responsibilities, the Scheme's Trustee is responsible for preparing, and from time to time reviewing and if necessary revising, a schedule of contributions and for monitoring whether contributions are made to the Scheme by the employer in accordance with the schedule of contributions.

It is our responsibility to provide a Statement about Contributions paid under the schedule of contributions and to report our opinion to you.

Use of our statement

This statement is made solely to the Scheme's Trustee, as a body, in accordance with regulation 4 of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, made under the Pensions Act 1995. Our audit work has been undertaken so that we might state to the Scheme's Trustee those matters we are required to state to it in an auditor's statement and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme's Trustee as a body, for our work, for this statement, or the opinions we have formed.

Ernst & Young LLP

Statutory Auditor
Reading
Date 29 September 2020.

3. Trustee's Summary of Contributions

Summary of Contributions payable under the schedule in respect of the year ended 31 March 2020

This Summary of Contributions has been prepared by, or on behalf of, and is the responsibility of the Trustee. It sets out the employer and member contributions payable to the Scheme for the year ended 31 March 2020. The auditor to the Scheme reports on contributions payable under the schedule certified by the Actuary on 1 October 2018 in the Auditor's Statement about Contributions.

Contributions payable under the schedule in respect of the Scheme year	£'000s
Employer:	
Normal contributions	20,867
Deficit Funding	18,600
Longevity Swap	7,308
PPF Levy reimbursement	958
Expenses	1,697
Additional benefits	66
Employee:	
Normal contributions	10
Contributions payable under the Schedule (as reported on by the auditor)	49,506

Reconciliation of contributions payable under the schedule to contributions reported in the accounts in respect of the Scheme year:

Contributions payable under the Schedule (as above)	49,506
Contributions payable in addition to those due under the Schedule:	
Member additional voluntary contributions	6
Contributions as reported in note 4	49,512

Signed on behalf of the Trustee on 29 September 2020

Trustee Director

Trustee Director

4. Financial Statements

4.1 Fund Account

for the year ended 31 March 2020

	Note	**2020 £'000s**	2019 £'000s
Contributions and benefits			
Contributions receivable			
Employer	4	**49,496**	44,737
Employee	4	**16**	16
Transfers in	5	**614**	309
Other income	6	**510**	-
		50,636	45,062
Benefits paid or payable	7	**(63,043)**	(60,296)
Payments to and on account of leavers	8	**(31,333)**	(58,371)
Other payments	9	**(403)**	(392)
Administrative expenses	10	**(2,167)**	(2,434)
		(96,946)	(121,493)
Net withdrawals from dealings with members		**(46,310)**	(76,431)
Returns on investments			
Investment income	11	**33,065**	28,520
Change in market value of investments	20	**(33,649)**	74,543
Investment management expenses	12	**(3,942)**	(2,965)
Net returns on investments		**(4,526)**	100,098
Net (decrease) / increase in the fund during the year		**(50,836)**	23,667
Net assets of the Scheme at beginning of year		**1,861,574**	1,837,907
Net assets of the Scheme at end of year		**1,810,738**	1,861,574

The notes on pages 25 to 45 form part of these Financial Statements.

Financial Statements

4.2 Statement of Net Assets (available for benefits)

as at 31 March 2020

	Note	2020 £'000s	2019 £'000s
Investment assets	20		
Bonds		**1,998,361**	1,518,773
Pooled investment vehicles	14	**891,920**	1,004,552
Derivatives	16	**228,027**	158,321
AVC investments	18	**171**	228
Cash deposits		**10,570**	7,203
Other investment balances	19	**94,780**	18,640
		3,223,829	2,707,717
Investment liabilities			
Bonds	15	**(78,668)**	-
Derivatives	16	**(291,244)**	(171,364)
Longevity swap	17	**(83,690)**	(69,894)
Other investment balances	19	**(964,144)**	(607,722)
Total investments		**1,806,083**	1,858,737
Current assets	21	**9,317**	6,290
Current liabilities	22	**(4,662)**	(3,453)
Total net assets		**1,810,738**	1,861,574

The accounts summarise the transactions of the Scheme and deal with the net assets at the disposal of the Trustee. They do not take account of obligations to pay pensions and benefits which fall due after the end of the Scheme year. The actuarial position of the Scheme, which does take account of such obligations, is dealt with in the Report on Actuarial Liabilities on page 47 of the annual report and these financial statements should be read in conjunction with that report.

The notes on pages 25 to 45 form part of these financial statements.

These financial statements were approved by the Trustee on 17 September 2020 and signed on its behalf by:

Trustee Director 29 SEPTEMBER 2020 *Trustee Director* 29 SEPTEMBER 2020

4.3 Notes to the Financial Statements

1. Basis of preparation

The Financial Statements have been prepared on the going concern basis and in accordance with Financial Reporting Standard 102 – the Financial Reporting Standard applicable in the UK and Republic of Ireland issued by the Financial Reporting Council and with the guidance set out in the Statement of Recommended Practice (SORP) (revised June 2018) published by the Pension Research Accountants Group (PRAG).

2. Identification of the financial statements

The Scheme is established as a trust under English law. The address for enquiries to the Scheme is included in the Trustee's report.

3. Accounting policies

(a) *Investments*

i. Investments are included at fair value at the date of the Statement of Net Assets.

ii. Quoted investments are stated at the bid price or the last traded price, depending on the convention of the stock exchange on which they are quoted, at the date of the Statement of Net Assets.

iii. Bonds are stated at their clean prices. Accrued income is accounted for within investment income receivable. Bonds sold short are classified within investment liabilities at the year end at their clean prices, any related accrued income is classified as income payable within other investment balances.

iv. Holdings in pooled investment vehicles which are not traded on active markets are stated at bid price for funds with bid/offer spreads, or single price values where there are no bid/offer spreads as advised by the investment manager at the year end date and accepted by the Trustee.

Shares in other pooled arrangements have been valued at the latest available net asset value ('NAV'), determined in accordance with fair value principles, provided by the pooled investment manager.

v. Derivatives are stated at fair value.

- Exchange traded derivatives are stated at market values determined using market quoted prices.
- Swaps are valued taking the current value of future cash flows arising from the swap determined using discounted cash flow models and market data at the reporting date.
- Over the Counter (OTC) derivatives are stated at market value using pricing models and relevant market data as at the year end date.
- Forward foreign currency contracts are valued by determining the gain or loss that would arise from closing out the contract at the reporting date by entering into an equal and opposite contract at that date.
- All gains and losses arising on derivative contracts are reported within 'Change in Market Value'.
- Receipts and payments arising from derivative instruments are reported as sale proceeds, purchase of investments or as income received where appropriate.

vi. Repurchase and Reverse Repurchase arrangements

Under repurchase (repo) arrangements, the Scheme continues to recognise and value the securities that are delivered out as collateral and includes them in the Financial Statements. The cash received is recognised as an asset and the obligation

Notes to the Financial Statements

3. Accounting Policies (continued)

to pay it back is recognised as a liability.

Under reverse repurchase (reverse repo) arrangements, the Scheme does not recognise the collateral securities received as assets in its Financial Statements. The Scheme does recognise the cash delivered to the counterparty as a receivable in the Financial Statements.

vii. Longevity swaps are valued on a fair value basis based on the expected future cash flows arising under the swap discounted using market interest rates and taking into account the risk premium inherent in the contract. Payments and receipts relating to the longevity swap are accounted for as investment purchases or sales.

viii. AVC funds are included at the market value advised by the fund managers at the year end.

(b) *Change in market value*

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

(c) *Investment income*

i. Distributions from pooled investment vehicles are accounted for in the period in which they fall due. Where investment income arising from the underlying investments is rolled up and reinvested within the pooled investment vehicle this is reflected in the unit price and reported within 'Change in Market Value'.

ii. Interest on bonds and on cash deposits is accounted for on an accruals basis.

(d) *Foreign currencies*

The functional and presentational currency of the Scheme is Sterling. Balances denominated in foreign currencies are translated into Sterling at the rate ruling at the year end date. Asset and liability balances are translated at the bid and offer rates respectively. Transactions denominated in foreign currencies are translated at the rate ruling at the date of the transaction. Differences arising on investment balance translation are accounted for in the change in market value of investments during the year.

(e) *Contributions*

i. Employee contributions and employer normal contributions are accounted for in line with the pay period to which they relate.

ii. Deficit funding and other employer contributions are accounted for on the due dates on which they are payable in accordance with the Recovery Plan and Schedule of Contributions under which they are being paid.

(f) *Benefits*

Benefits to members are accounted for in the period in which they fall due for payment. Where there is a choice, benefits are accounted for in the period in which the member notifies the Trustee of his decision or, if there is no member choice, they are accounted for on the date of retirement or leaving.

(g) *Transfer values*

Individual transfer values to and from other pension schemes are accounted for when the liability is discharged, usually when they are paid or received.

Notes to the Financial Statements

3. Accounting Policies (continued)

Bulk transfers are accounted for in accordance with the terms of the transfer agreement.

(h) *Expenses*

Expenses are accounted for on an accruals basis.

(i) Tax status

The Scheme is a registered pension scheme for tax purposes under the Finance Act 2004. The Scheme is therefore exempt from UK income and capital gains tax.

4. Contributions receivable

	2020 £'000s	2019 £'000s
Employer:		
Normal	**20,867**	20,754
Deficit funding	**18,600**	18,600
Expenses	**1,697**	1,675
Additional defined benefits (Added years)	**66**	71
Additional (Longevity Swap)	**7,308**	2,760
Additional (PPF Levy reimbursement)	**958**	877
	49,496	44,737
Employee:		
Normal	**10**	7
Additional Voluntary Contributions	**6**	9
	16	16
Total	**49,512**	44,753

Salary sacrifice arrangements are in place. Under such arrangements employees sacrifice salary in exchange for their employer making contributions to the Scheme on their behalf. Such contributions are classified as employer contributions in the financial statements.

Deficit contributions of £18,600,000 were paid under the Schedule of Contributions certified by the Scheme Actuary on 1 October 2018. This was the second of seven annual payments of £18,600,000 due under this Schedule of Contributions.

5. Transfers in

	2020 £'000s	2019 £'000s
Dependants' redundancy pension	**614**	309

Dependants' redundancy pension represents transfers in respect of adult dependants' death benefits falling due under the terms of the employer's redundancy schemes.

6. Other income

	2020 £'000s	2019 £'000s
Claims on term insurance policies	**510**	-

Notes to the Financial Statements

7. Benefits payable

	2020 £'000s	2019 £'000s
Pensions	**49,799**	47,424
Commutations and lump sum retirement benefits	**12,580**	12,611
Death in service benefits	**503**	-
Lump sum death benefits	**146**	245
Purchase of annuity	**4**	-
Annual / Lifetime allowance tax paid on behalf of members	**11**	16
Total	**63,043**	60,296

Disclosure of taxation paid where lifetime or annual allowances are exceeded is a requirement introduced by the 2018 revision to the SORP and the prior year has therefore been restated to show this.

8. Payments to and on account of leavers

	2020 £'000s	2019 £'000s
Individual transfers out to other schemes	**30,509**	22,697
Bulk transfers out to other schemes	**824**	35,674
	31,333	58,371

The bulk transfers to other schemes were in respect of the transfer of former civil servants to the Civil Service Pension Scheme as described on page 7.

9. Other payments

	2020 £'000s	2019 £'000s
Premiums on term insurance policies	**403**	392

10. Administrative expenses

	2020 £'000s	2019 £'000s
Actuarial fees	**242**	403
Audit fee	**36**	32
Administrative salaries and expenses	**453**	433
Independent Trustee fee and expenses	**117**	144
Pensioner Trustee fee and expenses	**12**	14
Employer nominated trustee fee and expenses	**12**	-
Legal and other professional fees	**302**	496
PPF Levy	**993**	912
Total	**2,167**	2,434

All other administrative expenses are borne by the Principal Employer.

Notes to the Financial Statements

11. Investment income

	2020 **£'000s**	2019 £'000s
Income from bonds	**20,006**	19,453
Net interest payable on repurchase agreements	**(6,421)**	(5,299)
Net interest receivable on derivatives	**4,705**	3,088
Income from Pooled Investment Vehicles	**14,672**	11,186
Interest on Cash deposits	**103**	92
Total	**33,065**	28,520

12. Investment management expenses

	2020 **£'000s**	2019 £'000s
Administration management and custody	**3,404**	2,374
Investment adviser fees	**538**	591
Total	**3,942**	2,965

13. Taxation

The Scheme is a registered pension scheme under Chapter 2 of Part 4 of the finance Act 2004 and is therefore exempt from income tax and capital gains tax. The tax charge in the Fund Account (if any) represents irrecoverable withholding taxes arising on investment income.

14. Pooled Investment Vehicles

	2020 **£'000s**	2019 £'000s
Overseas Equity	**21,523**	166,871
Fixed Interest	**205,893**	212,968
Property (**see note below**)	**206,668**	136,286
Global Tactical Asset Allocation	**101,159**	116,171
Emerging Market Debt	**32,404**	18,741
Multi-Asset Credit	**70,356**	79,794
Absolute Return Bonds	**93,766**	104,736
Secured Finance	**124,161**	134,076
Private Debt	**23,281**	8,246
Cash Investments	**12,709**	26,663
	891,920	1,004,552

In line with VPS 3 and VPGA 10 of the RICS Red Book Global the investment managers for the Scheme's property funds have advised that due to the COVID-19 pandemic there is 'material valuation uncertainty' for the property assets within those portfolios, and that a higher degree of caution should be attached to the valuation than would normally be the case.

Notes to the Financial Statements

14. Pooled Investment Vehicles (continued)

Included within property values above at 31 March 2020 is £14,743,000 (2019: £14,729,000) in respect of the Scheme's holdings in the CBRE Osiris fund. The fund manager has announced its intention to wind-up this fund in an orderly manner. The fund's assets will be realised and the net proceeds distributed to investors in line with their unit holdings. Redemption requests will no longer be accepted by the fund manager.

15. Bonds

The value for bonds included under investment liabilities at the year end represents a short sale of a government bond as part of the Scheme's liability hedging programme. Such transactions allow the Scheme to access price efficient RPI inflation exposure.

16. Derivative Contracts

Objectives and policies

The Trustee has authorised the use of derivatives by their investment managers as part of its investment strategy for the pension Scheme.

The principal reason for the use of derivatives is to reduce exposure to liability risks, there is also some scope for their use in order to facilitate efficient portfolio management by enhancing investment returns as opportunities arise.

Interest rate and inflation swaps and fixed interest futures have been utilised in order to reduce risk arising from changes in the value of the Scheme's liabilities (liability risk) in response to movements in interest rates and inflation rates respectively.

Asset swaps have been utilised to gain capital efficient exposure to a combination of swaps and government bonds, which reduce exposure to liability risks.

Equity futures and equity total return swaps have been utilised in order to provide capital efficient, synthetic exposure to world equity markets.

Forward foreign exchange contracts have been utilised in order to partially hedge the exchange rate exposure arising from the use of equity total return swaps.

The Scheme had derivative contracts outstanding at the period end as shown below. Due to the large numbers of interest rate swaps and inflation swaps, values have been aggregated and disclosed according to the length of the term.

Notes to the Financial Statements

16. Derivative Contracts (continued)

	2020 Assets £'000	**Liabilities £'000**	2019 Assets £'000	Liabilities £'000
Inflation swaps	**51,425**	**(72,650)**	19,197	(25,731)
Interest rate swaps	**176,261**	**(151,874)**	132,553	(97,850)
Asset swaps	**-**	**(45,557)**	-	(42,730)
Equity total return swaps	**-**	**(15,484)**	6,146	-
Equity futures	**-**	**-**	221	(2,548)
Fixed interest futures	**153**	**(2,888)**	-	(1,022)
Forward foreign exchange contracts	**188**	**(2,791)**	204	(1,483)
	228,027	**(291,244)**	158,321	(171,364)

(a) Inflation Swaps

	No. of contracts	**Notional £'000s**	**Assets £'000s**	**Liabilities £'000s**
Pay fixed, receive index linked				
Expiring				
within 10 years	7	95,042	-	(5,427)
between 10 and 20 years	13	117,860	-	(17,260)
between 20 and 30 years	7	44,161	-	(25,962)
between 30 and 40 years	3	13,929	-	(12,048)
between 40 and 50 years	4	10,879	-	(11,953)
	34		-	(72,650)
Pay index linked, receive fixed				
Expiring				
within 10 years	8	146,343	9,696	-
between 10 and 20 years	9	71,511	18,780	-
between 20 and 30 years	6	40,421	14,370	-
between 30 and 40 years	2	4,726	6,440	-
between 40 and 50 years	1	3,604	2,139	-
	26		51,425	-
	60		**51,425**	**(72,650)**

Notes to the Financial Statements

16. Derivative contracts (continued)

(b) Interest Rate Swaps

	No. of contracts	Notional Receivable £'000s	Notional Payable £'000s	Asset £'000s	Liability £'000s
Pay fixed, receive floating GBP					
Expiring					
within 10 years	8	106,144	(127,165)	-	(19,335)
between 10 and 20 years	5	41,833	(85,754)	-	(36,777)
between 20 and 30 years	14	124,795	(172,084)	-	(52,727)
between 30 and 40 years	3	7,716	(24,855)	-	(13,591)
between 40 and 50 years	5	10,112	(45,107)	-	(29,419)
after 50 years	2	3,764	(739)	2,495	-
	37			2,495	(151,849)
Pay floating, receive fixed GBP					
Expiring					
within 10 years	9	143,071	(113,529)	21,623	-
between 10 and 20 years	8	114,177	(87,988)	32,844	-
between 20 and 30 years	9	98,148	(73,250)	37,037	-
between 30 and 40 years	8	70,680	(42,904)	37,685	-
between 40 and 50 years	10	91,939	(70,328)	40,235	-
	44			169,424	-
Basis swaps - Pay floating, receive floating					
Expiring					
between 20 and 30 years	8	86,625	(88,857)	1,852	-
between 30 and 40 years	8	91,504	(92,464)	1,481	(25)
between 40 and 50 years	4	26,698	(27,141)	1,009	-
	20			4,342	(25)
	101			**176,261**	**(151,874)**

(c) Asset Swaps

Maturity	Notional Receivable £'000s	Notional Payable £'000s	Asset £'000s	Liability £'000s
November 2042	2,785	(2,095)	-	(2,524)
November 2042	8,547	(6,594)	-	(8,332)
November 2047	7,610	(5,400)	-	(8,240)
March 2050	6,989	(5,417)	-	(8,430)
November 2055	6,856	(3,678)	-	(8,402)
March 2062	5,325	(4,638)	-	(9,629)
			-	**(45,557)**

Notes to the Financial Statements

16. Derivative contracts (continued)

(d) Equity Total Return Swaps

	No. of contracts	Asset £'000s	Liability £'000s
Swaps expiring by July 2020	2	**-**	**(15,484)**

(e) Fixed Interest Futures

	No. of contracts	Asset £'000s	Liability £'000s
Futures contracts expiring June 2020	7	**153**	**(2,888)**

(f) Forward foreign exchange contracts

	Settlement Date	GBP Amount £'000s	Foreign Currency Amount '000s	Asset £'000s	Liability £'000s
Buy GBP Sell Hong Kong dollar	20-Apr-20	561	(5,564)	-	(18)
Buy GBP Sell Australian dollar	20-Apr-20	1,027	(2,047)	18	-
Buy GBP Sell Swiss franc	20-Apr-20	1,580	(1,890)	4	-
Buy GBP Sell Canadian dollar	20-Apr-20	1,573	(2,768)	5	-
Buy GBP Sell Japanese yen	20-Apr-20	3,892	(514,649)	46	-
Buy GBP Sell Euro	20-Apr-20	5,389	(6,108)	-	(18)
Buy GBP Sell US dollar	20-Apr-20	30,345	(38,701)	-	(855)
Buy GBP Sell US dollar	22-Apr-20	17,951	(23,248)	-	(791)
Buy US dollar Sell GBP	22-Apr-20	(4,701)	5,725	58	(143)
Buy GBP Sell US dollar	27-May-20	15,729	(20,348)	-	(665)
Buy US dollar Sell GBP	27-May-20	(3,003)	3,726	57	(58)
Buy GBP Sell US dollar	17-Jun-20	14,876	(18,592)		(99)
Buy US dollar Sell GBP	17-Jun-20	(3,664)	4,371	-	(144)
				188	**(2,791)**

(h) Collateral

In respect of the OTC swaps counterparties had deposited collateral of £26,440,754 (2019: £42,711,737) in favour of the Scheme. Such collateral is not reported within the Scheme's net assets. At the year end the Scheme had deposited collateral of £78,183,408 (2019: £39,020,579) in favour of counterparties. Such collateral is reported within the Scheme's net assets. Collateral is in the form of cash and government bonds.

Notes to the Financial Statements

17. Longevity swap

In June 2009 the Scheme entered into an agreement with Credit Suisse. Under the terms of this contract the Trustee is committed to pay a series of fixed payments over a 50 year term to Credit Suisse and in return Credit Suisse will make variable payments to the Trustee to cover the Scheme's obligation to pensioners and their dependants. The value of the contract at year end is shown below:

	2020	**2019**
	£'000s	**£'000s**
Longevity swap contract expiring June 2059	**(83,690)**	(69,894)

During the year to 31 March 2020, the Scheme's gross commitment to make fixed payments was £29,521,115 and Credit Suisse's gross variable payments due to the Trustee was £28,654,144.

The net payment of £866,971 is shown as payments in respect of this investment (see note 20).

Under the terms of this contract the Trustee has placed collateral to the value of £83,700,000 at 31 March 2020 (2019: £69,900,000). The collateral is reported in the Scheme's Net Assets within Bonds.

The value of the longevity swap is affected by changes in underlying assumptions such as discount rate, inflation and the mortality scaling factors.

18. AVC Investments

The Trustee holds investments separately from the main fund in the form of investment policies securing additional benefits on a money purchase basis for those members electing to pay additional voluntary contributions. The aggregate amounts of these AVC investments are as follows:

	2020	2019
	£'000	£'000
Utmost Life and Pensions	**171**	-
Equitable Life	**-**	228
	171	228

The AVC funds previously held with Equitable Life were transferred to Utmost Life and Pensions on 1 January 2020.

Notes to the Financial Statements

19. Other Investment Balances

	2020		2019	
	Assets £'000	**Liabilities £'000**	Assets £'000	Liabilities £'000
Repurchase and reverse repurchase agreements	**77,493**	**(955,798)**	-	(606,400)
Interest on repurchase and reverse repurchase agreements	**78**	**(2,851)**	-	(842)
Investment Income receivable / (payable)	**8,087**	**(505)**	7,510	-
Recoverable Tax	**41**	**-**	211	-
Balances on futures contracts	**3,282**	**(153)**	10,919	-
Unsettled sales / (purchases)	**5,799**	**(4,837)**	-	(480)
	94,780	**(964,144)**	18,640	(607,722)

Repurchase and reverse repurchase agreements

During the year the Scheme has used repurchase and reverse repurchase agreements to increase fixed interest exposure as part of the liability hedging programme. Fixed interest securities have been sold subject to contractual agreements for the repurchase of equivalent securities. Security for these agreements is provided by the cash received on sale and by the exchange of collateral in the form of fixed interest securities.

Collateral has been deposited by counterparties to cover the net exposure between the fixed interest investments sold subject to repurchase agreements of £968,677,393 (2019: £625,632,876) and the value of the liability at maturity date of £955,798,000 (2019: £606,400,000).

Collateral has been deposited by the Scheme to cover the net exposure between the fixed interest investments purchased under reverse repurchase agreements of £79,033,795 (2019: Nil) and the value of the asset at maturity date of £77,493,000 (2019: Nil).

Notes to the Financial Statements

20. Investment reconciliation

Reconciliation of investments held at the beginning and end of the year:

	Value at 1 April 2019 £'000s	**Purchases at cost and derivative payments £'000s**	**Sales proceeds and derivative receipts £'000s**	**Change in market value £'000s**	**Value at 31 March 2020 £'000s**
Bonds	1,518,773	911,423	(540,524)	30,021	1,919,693
Pooled Investment Vehicles	1,004,552	513,633	(579,877)	(46,388)	891,920
Derivatives	(13,043)	1,022,981	(1,070,512)	(2,643)	(63,217)
Longevity swap	(69,894)	867	-	(14,663)	(83,690)
AVC investments	228	7	(88)	24	171
	2,440,616	**2,448,911**	**(2,191,001)**	**(33,649)**	2,664,877
Cash deposits	7,203				10,570
Other investment balances	(589,082)				(869,364)
Net investment assets	**1,858,737**				**1,806,083**

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

21. Current Assets

	2020 £'000	2019 £'000
Employer normal contributions due	**2,131**	2,245
VAT recoverable	**183**	232
Prepayments and sundry debtors	**508**	16
Cash at bank	**6,495**	3,797
	9,317	6,290

22. Current Liabilities

	2020 £'000	2019 £'000
Benefits payable	**(787)**	(1,020)
Investment management expenses	**(3,057)**	(1,571)
Administrative expenses	**(265)**	(306)
Payable on longevity swap	**(74)**	(49)
PAYE payable	**(479)**	(507)
	(4,662)	(3,453)

23. GMP Equalisation

As explained on page 7 in the Report of the Trustee, on 26 October 2018, the High Court handed down a judgment involving the Lloyds Banking Group's defined benefit pension schemes. The judgment concluded that the schemes should be amended to equalise pension benefits for men and women in relation to guaranteed minimum pension benefits. The Trustee is aware that the issue will affect the Scheme and continues to participate in a working party with the employer and the other principal Babcock group pension schemes in order to consider the next steps. Under the ruling schemes are required to backdate benefit adjustments in relation to GMP equalisation and provide interest on the backdated amounts. Based on an initial assessment of the likely backdated amounts and related interest the Trustee does not expect these to be material to the financial statements and therefore has not included a liability in respect of these matters in these financial statements. They will be accounted for in the year they are determined.

24. Transaction costs

Included within investment purchases and sales are direct transaction costs of £218,000 (2019: £899,000) comprising fees and commissions. These costs are attributable to the key asset classes as follows:

	Fees £'000	**Commission £'000**	**Stamp Duty £'000**	**2020 Total £'000**	2019 Total £'000
Derivatives	**-**	**9**	**-**	**9**	39
Overseas Equity PIV sales	**31**	**-**	**-**	**31**	-
Property PIV sales and purchases	**178**	**-**	**-**	**178**	860
	209	**9**	**-**	**218**	899
2019	860	39	-	899	899

In addition to the transaction costs noted above, indirect costs are incurred through the bid-offer spread on investments within pooled investment vehicles and charges made within those vehicles.

Notes to the Financial Statements

25. Investment Fair Value Hierarchy

The fair value of financial instruments has been disclosed using the following fair value hierarchy:

Level (1) The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date;

Level (2) Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly;

Level (3) Inputs are unobservable (i.e. for which market data is unavailable) for the asset or liability.

For those investments that fall into level (2) and (3) above, their fair value is measurable reliably if either (a) there is insignificant variability in the range of fair value estimates, or (b) a reasonable estimate of the fair value can be calculated by probability-weighting the possible outcomes.

The Scheme's investment assets and liabilities have been categorised using the above hierarchy categories as follows:

	Level (1)	**Level (2)**	**Level (3)**	**Total**
	£'000	£'000	£'000	£'000
At 31 March 2020				
Bonds	1,757,936	161,757	-	1,919,693
Pooled Investment Vehicles	-	422,639	469,281	891,920
Derivatives	(2,735)	(2,603)	(57,879)	(63,217)
Longevity swap	-	-	(83,690)	(83,690)
AVC investments	-	160	11	171
Cash	10,570	-	-	10,570
Other investment balances (see note 19 and below)	2,144	(879,246)	7,738	(869,364)
	1,767,915	(297,293)	335,461	1,806,083

	Level (1)	**Level (2)**	**Level 3**	**Total**
	£'000	£'000	£'000	£'000
At 31 March 2019				
Bonds	1,355,485	163,288	-	1,518,773
Pooled Investment Vehicles	-	569,640	434,912	1,004,552
Derivatives	(3,349)	(1,279)	(8,415)	(13,043)
Longevity swap	-	-	(69,894)	(69,894)
AVC investments	-	-	228	228
Cash	7,203	-	-	7,203
Other investment balances (see note 19 and below)	14,451	(605,223)	1,690	(589,082)
	1,373,790	126,426	358,521	1,858,737

The significant negative Level 2 balances included in 'Other investment balances' primarily comprise repurchase agreements in respect of government bonds. Although the bonds themselves are included in Level 1 the repurchase agreements are considered to be more appropriately classified as Level 2 as they are contractual agreements and not priced on any exchange.

Notes to the Financial Statements

25. Investment Fair Value Hierarchy (continued)

It is also noted that, following the year end, subscriptions and redemptions to the H2O Allegro and Adagio funds held by the Scheme, and classified within Level (2) above with a combined value of £47,552,000 at 31 March 2020, were suspended on 28 August 2020 for a temporary period, anticipated to be around four weeks, to allow restructuring of the funds in order to separate ‘private’ securities held within the funds from the other assets. The fund manager believes that the suspension ensures fair and equitable treatment of all investors in the funds. The Trustee believes that the Level (2) classification as at the year end is appropriate and will continue to monitor and consider developments in respect of future assessments.

26. Investment risks

FRS 102 requires the disclosure of information in relation to certain investment risks to which the Scheme is exposed at the end of the reporting period. These risks are set out by FRS102 as follows:

Credit risk: this is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

Market risk: this is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises currency risk, interest rate risk and other price risk, each of which is detailed as follows:

- Currency risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in foreign exchange rates.

- Interest rate risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market interest rates.

- Other price risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The Scheme has exposure to these risks because of the investments it makes in following the investment strategy set out below. The Trustee determines its investment strategy after taking advice from a professional investment adviser. The Trustee has delegated the implementation of the investment strategy to the Investment Committee (“IC”). The IC appoints investment managers, who are responsible for the day-to-day management of the asset portfolio of the Scheme.

The Trustee and the IC manage investment risks, including credit risk and market risk, within agreed risk limits which are set taking into account the Scheme’s investment objectives and investment strategy. The investment objectives, investment strategy and risk limits are implemented through the investment management agreements in place with the Scheme’s investment managers and monitored by the Trustee via its representatives on the IC. The IC undertakes regular reviews of the investment portfolios including the compliance with the risk limits. In addition, a process is in place to reduce risk as the funding level improves and the IC monitors the funding level on a regular basis in order to capture opportunities to remove investment risk from the portfolio.

Further information on the Trustee’s approach to credit and market risks is set out below. This does not include AVC investments as these are not considered significant in relation to the overall investments of the Scheme.

Notes to the Financial Statements

26. Investment risks (continued)

Investment strategy

The investment objectives, investment strategy and risk limits of the Scheme are outlined in the Statement of Investment Principles ("SIP") and the day-to-day implementation of the SIP is set out in the Investment Policy Implementation Document ("IPID").

The objective is to invest the Scheme's assets in the best interests of the members and beneficiaries by ensuring that benefit obligations can be met and by achieving a high level of security of benefits. It is recognised that it is desirable to take on a controlled level of investment risk in order to improve the Scheme's funding level. The Trustee has agreed to move towards a target of full funding on a gilts flat basis through a long term de-risking strategy. De-risking will be implemented as the funding level on the long term target improves over time.

The investment strategy takes account of the maturity profile of the Scheme, the funding level on the de-risking basis and the expected strength of covenant of the principal employer. Assets are allocated between three portfolios as detailed below, each with a different objective. Reallocation of assets between the portfolios takes place as the de-risking funding level changes over time.

- The Growth Portfolio is designed to generate a long term return and comprises such growth seeking investments as UK and overseas equities, multi-strategy funds, multi-asset credit, emerging market debt, and investment property.
- The Low Risk Portfolio is designed to reduce risk and generate a long term return and comprises investment grade corporate bonds, absolute return bonds, asset backed securities, high lease to value property, secured finance, private debt and other investments designed to deliver positive returns over the long term with low volatility.
- The Matching Portfolio is a very low risk portfolio, the primary aim of which is to hedge the liabilities by matching movements in the de-risking funding level caused by interest rate and inflation changes. The portfolio comprises government bonds, repurchase agreements, swaps and cash.

In addition, the IC can use equity futures as a short term measure in order to implement de-risking or to re-risk in order to achieve the desired return.

Each of the investment risk types is considered below.

(i) Credit Risk

The Scheme is subject to credit risk as it directly invests in bonds, OTC derivatives and holds cash balances. The Scheme also invests in pooled investment vehicles (PIVs) and is therefore directly exposed to credit risk in relation to the instruments it holds in PIVs. The Scheme is indirectly exposed to credit risks arising on the financial instruments held by the PIVs.

Notes to the Financial Statements

26. Investment risks (continued)

Analysis of direct credit risk *

	Investment grade	Non-investment grade	Unrated	Total
	£'000	£'000	£'000	£'000
At 31 March 2020				
Bonds	1,998,361	-	-	1,998,361
OTC Derivatives	227,874	-	-	227,874
Cash	10,570	-	-	10,570
Other investment balances	86,382	-	8,398	94,780
Pooled Investment Vehicles	-	-	891,920	891,920
	2,323,187	-	900,318	3,223,505

	Investment grade	Non-investment grade	Unrated	Total
	£'000	£'000	£'000	£'000
At 31 March 2019				
Bonds	1,518,773	-	-	1,518,773
OTC Derivatives	158,100	-	-	158,100
Cash	7,203	-	-	7,203
Other investment balances	16,356	-	2,284	18,640
Pooled Investment Vehicles	-	-	1,004,552	1,004,552
	1,700,432	-	1,006,836	2,707,268

*Only asset balances are shown as liability balances are not considered to be exposed to credit risk from the Scheme's perspective.

The Trustee considers financial instruments or counterparties to be of investment grade if they are rated at BBB- or higher by Standard & Poor's or Fitch, or rated at Baa3 or higher by Moody's.

Government bonds and Corporate bonds: Credit risk arising on bonds held directly is mitigated by investing in government bonds where the credit risk is minimal. Credit risk arising on corporate bonds held directly is mitigated by investing in corporate bonds which are rated at least investment grade.

Cash is held within financial institutions which are at least investment grade credit rated.

Credit risk on repurchase agreements is mitigated through collateral arrangements as disclosed in note 19.

Credit risk on derivatives depends on whether the derivative is exchange traded or over the counter (OTC). OTC derivative contracts are not guaranteed by any regulated exchange and therefore the Scheme is subject to risk of failure of the counterparty. The credit risk is reduced by the use of collateral arrangements as disclosed in note 16. Credit risk also arises on forward foreign currency contracts. There are no collateral arrangements for these contracts but all counterparties are required to be at least investment grade.

The Scheme's holdings in pooled investment vehicles are not rated by credit rating agencies. The IC, acting on behalf of the Trustee, manages and monitors the credit risk arising from its pooled investment arrangements by considering the nature of the arrangement, the legal structure and regulatory environment. Direct credit risk arising from pooled investment vehicles is mitigated by the regulatory environments in which the pooled managers operate and diversification of investments amongst a number of pooled arrangements.

Notes to the Financial Statements

26. Investment risks (continued)

Pooled investment arrangements used by the Scheme comprise Open Ended Investment Companies, Closed Ended Investment Companies, unit trusts, Qualifying Investor Funds, Qualifying Investor Alternative Investment Funds (QIAIFs), Undertakings for Collective Investment in Transferable Securities (UCITS), Unregulated Collective Investment Schemes (UCIS), sub-funds of an umbrella fund and Limited Partnerships.

The indirect credit risk arising in relation to the underlying investments held in all pooled investment vehicles, except equity funds, (see note 14) is mitigated through careful selection and ongoing monitoring of pooled funds by the IC. The Scheme invests in Funds which may hold non-investment grade credit rated instruments with a view to adding value.

(ii) Currency risk

The Scheme is directly exposed to currency risk because some of the pooled investment vehicles in which it invests are denominated or priced in a foreign currency. Indirect currency risk arises from

the Scheme's investment in Sterling priced pooled investment vehicles which hold underlying investments denominated in foreign currency.

The Scheme's investment in overseas equity pooled investment vehicles exposes the Scheme to direct and indirect currency risk. To limit currency risk 50% of the Scheme's direct developed market currency exposure is hedged using Equity Total Return Swaps and Forward Foreign Exchange contracts. The IC considers any foreign currency hedging that is conducted within the pooled investment vehicle as well as any exposure arising from new investments and revisits its overseas currency hedging policy on a regular basis.

The Scheme's investments in Absolute Return Bond PIVs, Emerging Market debt PIVs, Global Tactical Asset Allocation PIVs and some of the Fixed Interest PIVs are subject to indirect currency risk. The managers use currency exposure as part of the funds' investment strategy and therefore the Scheme has left these exposures unhedged.

The Scheme's total gross direct exposure by major currency at the year end was as follows:

	2020	2019
	£'000	£'000
US Dollar	**54,560**	137,038
Other	**106**	1,008

(iii) Interest rate risk

The Scheme is directly exposed to interest rate risk because some of the investments are held in bonds, swaps, cash and fixed interest futures, either as segregated investments or through pooled investment vehicles whose underlying investments are exposed to interest rate risks. The longevity swap exposes the Scheme to interest rate risk as it is valued by discounting the projected payments by an interest rate. There is also indirect exposure through pooled vehicles. The Trustee has considered interest rate risks in the context of the investment strategy and believe such exposures will add value for the Scheme. At the year end investments held that are subject to interest rate risk comprised:

Notes to the Financial Statements

26. Investment risks (continued)

	2020 £'000	2019 £'000
Direct		
Bonds	**1,919,693**	1,518,773
Interest rate swaps	**24,387**	34,703
Fixed interest futures	**(2,735)**	(1,022)
Asset Swaps	**(45,557)**	(42,730)
Longevity Swap	**(83,690)**	(69,894)
Cash Deposits	**10,570**	7,203
Indirect		
Fixed Interest (PIVs)	**205,893**	212,968
Absolute Return Bonds (PIVs)	**93,766**	104,736
Multi-Asset Credit (PIVs)	**70,356**	79,794
Secured Finance (PIVs)	**124,161**	134,076
Emerging Market Debt (PIVs)	**32,404**	18,741
Private Debt (PIVs)	**23,281**	8,246
Cash investment (PIVs)	**12,709**	26,663

The Scheme's exposure to direct interest rate risk arises primarily through its segregated investments in the Matching Portfolio. Investments are held in the Matching Portfolio because their sensitivity to interest rates helps to mitigate funding level volatility risk that arises from changes in the liabilities. Under this strategy, if interest rates fall, the value of the Matching investment will rise to help match the increase in Scheme liabilities arising from a fall in the discount rate.

These exposures are not hedged as they are consistent with the objective of the Scheme's Low Risk Portfolio; however, the Scheme's corporate bond investments are taken into account when designing the Scheme's interest rate liability hedge.

Further, the Trustee invests in Fixed Interest, Absolute return bonds, Emerging Market Debt, Multi-Asset Credit, Secured Finance, Private Debt and cash pooled investment funds which expose the Scheme to indirect interest rate risk. These investments are part of the investment managers' strategy to add value and as such the exposure has been left unhedged.

(iv) Other price risk

Other price risk arises principally from the Scheme's investments in the growth seeking portfolio. The Scheme manages this exposure to other price risk by constructing a diverse portfolio of investments across various markets.

At the year end the Scheme's exposure to investments subject to other price risk was:

Notes to the Financial Statements

26. Investment risks (continued)

	2020 £'000	2019 £'000
Direct		
Equity futures	**-**	(2,327)
Equity Total Return Swaps	**(15,484)**	6,146
Indirect		
Equity (PIVs)	**21,523**	166,871
Property (PIVs)	**206,668**	136,286
Global Tactical Asset Allocation (PIVs)	**101,159**	116,171
Emerging Market Debt (PIVs)	**32,404**	18,741

27. Concentration of investments

Investments, excluding UK government securities, accounting for more than 5% of the net assets of the Scheme were:

	2020		2019	
	£'000	**%**	£'000	%
At 31 March				
Insight LDI Active 26 Fund	**137,355**	**8**	140,605	8
M&G Illiquid Credit Opportunities Fund VI	**124,161**	**7**	134,075	7
Aviva Lime Property Fund Unit Trust	**151,568**	**8**	84,153	5

28. Capital commitments

As a consequence of the property investments entered into with Longbow, Rockspring and Aviva, and the private debt agreement with Cambridge Associates, the Scheme is committed to complying with funding requests, known as draw downs, up to an agreed maximum funding limit. The total amount drawn down, cumulative commitment and cumulative undrawn commitment at the year end are shown below.

	2020 £'000	2019 £'000
Cumulative commitment	**148,800**	110,800
Drawn Down	**(95,180)**	(67,610)
Cumulative undrawn commitment	**53,620**	43,190

29. Self-investment

The Scheme does not hold any direct investments in its sponsoring company or its affiliates.

Notes to the Financial Statements

30. Related party transactions

Related party transactions and balances outstanding at year end are analysed below:

	2020 £000		2019 £000	
	Assets/ (Liabilities)	**Expenses**	Assets/ (Liabilities)	Expenses
Trustee fees and expenses	**(17)**	**141**	(24)	158
Babcock Marine (Rosyth) Limited	**(90)**	**359**	(106)	353
Rosyth Royal Dockyard Pension Scheme	**1**	**(1)**	2	(2)
Babcock International Group Pension Scheme	**(5)**	**5**	(24)	24
Babcock Naval Services Pension Scheme	**(1)**	**(1)**	-	-

The Trustee fees and expenses were in respect of certain Trustee Directors who were not in direct employment of the Babcock Group.

The Scheme was administered by Babcock Marine (Rosyth) Limited, a Babcock group company. The costs of administration have been borne by the Scheme.

From time to time the Scheme may charge/be charged for costs incurred on behalf of/by other Babcock group pension schemes.

Contributions received in respect of and benefits paid to Trustee Directors who are members of the Scheme have been made in accordance with the Trust Deed and Rules.

5. Actuarial Statements

5.1 Actuary's certification of the Schedule of Contributions

Actuary's certification of the Schedule of Contributions

Name of scheme: Devonport Royal Dockyard Pension Scheme

Adequacy of rates of contributions

1. I certify that, in my opinion, the rates of contributions shown in this Schedule of Contributions are such that the statutory funding objective could have been expected on 31 March 2017 to be met by the end of the period specified in the recovery plan dated 16 July 2018.

Adherence to statement of funding principles

2. I hereby certify that, in my opinion, this Schedule of Contributions is consistent with the Statement of Funding Principles dated 16 July 2018.

The certification of the adequacy of the rates of contributions for the purpose of securing that the statutory funding objective can expect to be met is not a certification of their adequacy for the purpose of securing the Scheme's liabilities by the purchase of annuities, if the Scheme were to be wound up.

Signature: Date: 1/10/2018

Name: Simon Head

Qualification: Fellow of the Institute and Faculty of Actuaries

Address: Verulam Point
Station Way
St Albans
AL1 5HE

Name of employer: Aon Hewitt Limited

5.2 Report on Actuarial Liabilities

Under Section 222 of the Pensions Act 2004, every scheme is subject to the Statutory Funding Objective, which is to have sufficient and appropriate assets to cover its technical provisions. The technical provisions represent the present value of the benefits members are entitled to based on pensionable service to the valuation date. This is assessed using the assumptions agreed between the Trustee and the Employer and set out in the Statement of Funding Principles, which is available to Scheme members on request.

The most recent actuarial valuation of the Scheme was carried out as at 31 March 2017. The Trustee also receives an annual update of the approximate financial position of the Scheme from the Scheme Actuary. The most recent update was as at 31 March 2019 and showed that on that date:

The value of the technical provisions was: £2,037 million

The value of the assets at that date was: £1,931 million

The deficit at that date was: £106 million

The value of the assets as a percentage of the technical provisions at that date was: 95%

The method and significant assumptions used to determine the technical provisions are as follows (all assumptions adopted are set out in the appendix to the Statement of Funding Principles):

Method

The actuarial method to be used in the calculation of the technical provisions is the Projected Unit Method.

Significant actuarial assumptions

Discount interest rate: term dependent rates set by reference to the UK fixed interest forward gilt yield curve at the calculation date, plus 1.0% per annum up to 31 March 2037, and plus 0.5% per annum thereafter.

Future Retail Price inflation: term dependent rates derived from the UK gilt implied RPI yield curve at the calculation date.

Future Consumer Price inflation: term dependent rates derived from the assumption for future retail price inflation less an adjustment equal to 1.1% per annum.

Pension increases: term dependent rates derived from the assumption for future consumer price inflation allowing for the caps and floors on pension increases according to the provisions in the Scheme's rules.

Pay increases: for Industrial members, pay increases (inclusive of promotional increases) of 0.5% per annum above the term dependent rates for future consumer price inflation. For Non-industrial members, pay increases of 1.0% per annum above the term dependent rates for future consumer price inflation, together with an allowance for promotional increases.

Mortality: for the period in retirement, standard tables S2PMA_H with a scaling factor of 82% for male members and S2PFA_H with a scaling factor of 96% for female members. An allowance is made for future improvements in line with the CMI_2016 S=7.5 Core Projections assuming a long-term annual rate of improvement in mortality rates of 1.5% for men and women.