Notice of meeting and agenda

Pensions Committee

10.00am, Tuesday 17 June 2014

Mandela Room, City Chambers, High Street, Edinburgh

This is a public meeting and members of the public are welcome to attend

Contact

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Committee Services Manager

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Tel: 0131 529 4239

EDINBVRGH THE CITY OF EDINBURGH COUNCIL

1. Order of business

1.1 Including any notices of motion and any other items of business submitted as urgent for consideration at the meeting.

2. Declaration of interests

2.1 Members of the Committee and members of the Consultative Panel should declare any financial and non-financial interests they have in the items of business for consideration, identifying the relevant agenda item and the nature of their interest.

3. Deputations

3.1 None

4. Minute

4.1 Previous Minute 24 March 2014 – Submitted for approval as a correct record (circulated)

5. Reports

5.1 Referrals and recommendations from Audit Sub-Committee – verbal update from Convener of the Sub-Committee.

5.2 Agenda Planning – report by the Director of Corporate Governance (circulated)

5.3 Lothian Pension Fund – Internal Audit Monitoring 14/15 - report by the Director of Corporate Governance (circulated)

5.4 Lothian Pension Fund Annual Report Unaudited - report by the Director of Corporate Governance (to follow)

5.5 Statement of Investment Principles- report by the Director of Corporate Governance (circulated)

5.6 Investment Strategy Panel Activity - report by the Director of Corporate Governance (circulated)

5.7 Investment and Funding Update – Lothian Pension Fund - report by the Director of Corporate Governance (circulated)

5.8 Investment and Funding Update – Lothian Buses Pension Fund - report by the Director of Corporate Governance (circulated)

5.9 Investment and Funding Update – Scottish Homes Pension Fund - report by the Director of Corporate Governance (circulated)

5.10 Reform of the Local Government Pension Scheme in Scotland and Regulatory Update - report by the Director of Corporate Governance (circulated)

5.11 Risk Management - report by the Director of Corporate Governance (circulated)

5.12 Appointments - Pensions Audit Sub-Committee – report by the Director of Corporate Governance (circulated)

6. Motions

6.1 If any

Carol Campbell

Head of Legal, Risk and Compliance

Committee Members

Councillor Rankin (Convener), Councillor Child, Councillor Bill Cook, Councillor Orr and Councillor Rose, John Anzani and Darren May.

Information about the Pensions Committee

The Pensions Committee consists of 5 Councillors and 2 external members and is appointed by the City of Edinburgh Council. The Pensions Committee usually meets every eight weeks.

The Pensions Committee usually meets in the City Chambers on the High Street in Edinburgh. The meeting is open to all members of the public.

Further information

If you have any questions about the agenda or meeting arrangements, please contact Gavin King, Committee Services, City of Edinburgh Council, City Chambers, High Street, Edinburgh EH1 1YJ, Tel 0131 529 4239, e-mail gavin.king@edinburgh.gov.uk.

A copy of the agenda and papers for this meeting will be available for inspection prior to the meeting at the main reception office, City Chambers, High Street, Edinburgh.

The agenda, minutes and public reports for this meeting and all the main Council committees can be viewed online by going to www.edinburgh.gov.uk/cpol.

Minutes

Pensions Committee

2.30 pm, Monday, 24 March 2014

Present

Councillor Rankin (Convener), John Anzani, Councillor Child, Darren May, and Councillor Rose.

Consultative Panel Members Present:

Eric Adair, Helen Carter, Sharon Dalli, Owen Murdoch and John Rodgers

1. Minutes

Decision

To approve the minute of the Pensions Committee of 18 December 2013 as a correct record.

2. Agenda Planning

An indication was provided of potential reports for future Pensions Committee and Pensions Audit Sub-Committee meetings in 2014.

Decision

To note the report.

(Reference – report by the Director of Corporate Governance, submitted.)

3. External Audit – Annual Audit Plan 2013-14

Audit Scotland presented its planned programme of work to support the statutory audit 2013/14.

A representative from Audit Scotland was present for this item.

Decision

1) To note the Annual Audit Plan 2013-14, as submitted by Audit Scotland

2) To note the formal reliance placed on the work of Internal Audit

3) To note that suitable provision had been made in the approved budget 2013/14 for the audit fee.

4) To note that progress against the Annual Audit Plan 2013-14 would be reported to future meetings of the Pensions Audit Sub-Committee and the Pensions Committee.

(Reference – report by the Director of Corporate Governance, submitted.)

4. Lothian Pension Fund – Internal Audit Monitoring 2014/15

The proposed draft annual internal audit plan for 1 April 2014 to 31 March 2015 was outlined. A summary was also provided of the audit activity between 1 October 2013 and 31 March 2014.

Decision

To continue consideration of the item to the next meeting of the Pensions Committee.

(Reference – report by the Director of Corporate Governance, submitted.)

5. Investment Controls and Compliance

The operational procedures of the investment team had been reviewed to ensure compliance with any laws and regulations and if not applicable then compliant with industry best practice.

Decision

1) To note the ongoing review and update of compliance procedures.

2) To note the headline recommendations of the investment operations review and actions being taken to address the risks.

3) To approve the proposal to proceed with FCA authorisation and to note that progress would be provided to Committee.

(Reference – report by the Director of Corporate Governance, submitted.)

6. Lothian Pension Fund Service Plan 2014 - 2017

Approval was sought for the Service Plan 2014-17 and the budget for 2014- 15. The Fund's three objectives remained unchanged:

- to provide excellent customer care;
- to support and develop staff; and
- to continue to be a top performing pension fund.

Decision

1) To approve the Service Plan 2014-17 and the budget for 2014-15.

2) To note the indicative budgets for years 2015-16 and 2016-17.

(Reference – report by the Director of Corporate Governance, submitted.)

7. Customer and Partner Engagement

An update was provided on the pension fund's engagement with customers and partners.

Decision

To note that the Fund continued to meet its overall satisfaction target, the retention of the Customer Service Excellence award and the Fund's continued efforts to improve customer service.

(Reference – report by the Director of Corporate Governance, submitted.)

8. Training Activity of Committee and Consultative Panel

A record of the training for the members of the Committee and the members of the Consultative Panel were outlined. Induction training had been carried out for the three new Consultative Panel members.

Decision

To note the improvement of the training record in the context of the minimum amount of training for Committee and Consultative Panel members.

(Reference – report by the Director of Corporate Governance, submitted.)

9. Update on Employers Participating in Lothian Pension Fund

Details were provided of a review of the employer covenant and employers who were looking to join or leave the Fund.

Decision

1) To note the changes to the employers participating in the Fund.

2) To note the work being carried out to review the covenant of employers.

(Reference – report by the Director of Corporate Governance, submitted.)

Declaration of Interest

Councillor Rose declared a non-financial interest in the above item as an adviser to the Canongate Youth project.

10. Service Plan Progress

An update was provided on the Service Plan's performance indicators and the key actions necessary to enable the Fund to meet its objectives.

Decision

To note the progress of the Fund against its 2013-2016 Service Plan.

(Reference – report by the Director of Corporate Governance, submitted.)

11. Risk Management

The Quarterly Risk Overview at 25 February 2014 was provided which highlighted the material risks facing the pension funds and identified any new risks or concerns.

Decision

To note the quarterly Risk Overview.

(Reference – report by the Director of Corporate Governance, submitted.)

Pensions Committee

10.00 a.m., Tuesday, 17th June 2014

Agenda Planning

Item number	5.2
Report number	
Executive/routine	
Wards	All

Executive summary

This document provides Committee with an indication of the agenda for future meetings of the Pensions Committee and Audit Sub Committee. It also provides a more general overview of the current cycle of papers for Committee.

There will, of-course, be specific matters and papers which need to be brought to the attention of the Pension Committee and the Audit Sub-Committee in addition to those set out herein.

Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	

Report

Agenda Planning

Recommendations

1.1 That Committee notes the agenda planning document.

Background

2.1 In order for the Pensions Committee and Consultative Panel to gain an overview of the content of the Committee Cycle it was agreed that an agenda planning document be submitted each quarter.

Main report

3.1 Based on the Committee cycle, the proposed agendas for the 2014 and March 2015 meetings are set out below.

September 2014

Pensions Committee	Pensions Audit Sub Committee
• Referrals / recommendations from Pensions Audit-Sub Committee • LPF Annual Report (& Accounts) Audited • ISA 260 Audit Report • Update on Employer Admissions in LPF • Annual Performance Report and Benchmarking • Discretions • Service Plan Update • Risk management summary	• LPF Annual Report (& Accounts) Audited • ISA 260 Audit Report • Pensions Data Quality • Fraud Prevention • Delegated authorities - Write offs • Risk management summary

December 2014

Pensions Committee	Pensions Audit Sub Committee
• Referrals / recommendations from Pensions Audit-Sub Committee • Annual Report by External Auditor • Consultative Panel Membership • Actuarial Valuations (if complete) • Funding Strategy Statement (if complete) • EU Tax Claims • Class actions • Environmental Social and Governance Activity Update • Service Plan Update • Risk management summary	• Annual Report by External Auditor • EU Tax Claims • Investment Income Review- Cross Border Withholding Tax • Class actions • Investment Controls (custody, currency, taxation, Stock Lending) • Investment Controls (progress in implementing recommendations from external assessment of controls) • Risk management summary

March 2015

The following papers are currently scheduled for the Pensions Committee meeting:

- Audit plans and reports (internal and external)
- 2014-17 Service Plan update
- 2015-18 Service Plan and Budget
- Training Activity (Committee and Panel)
- Update on Employer Admissions in Lothian Pension Fund
- Risk management summary

It is proposed that the Pensions Audit Sub-Committee does not meet in March 2015. Audit plans will be developed in consultation with the Convener of the Audit Sub-Committee before consideration by the Pensions Committee.

Measures of success

4.1 The Committee and Consultative Panel will have greater clarity regarding the content of the Committee Cycle.

Financial impact

5.1 None.

Risk, policy, compliance and governance impact

6.1 There is no direct impact as a result of this report. The forward planning of the Committees' agendas should facilitate improved risk management and governance for the pension funds.

Equalities impact

7.1 None.

Sustainability impact

8.1 None.

Consultation and engagement

9.1 The Consultative Panel for the Funds, comprising member and employer representatives, is integral to governance.

Background reading / external references

None.

Alastair Maclean

Director of Corporate Governance

Susan Handyside, Customer Service and Compliance Officer

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Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	
Appendices	Appendix 1 - Agenda planning appendix.

Frequency	Pensions Committee	Audit Sub Committee	Month
Annually	Audit plans and reports (internal and external)	N/A - Draft audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee.	March
	Service Plan and Budget	N/A	March
	Training Activity	N/A	March
	LPF Annual Report (& Accounts) **Unaudited**	LPF Annual Report (& Accounts) **Unaudited**	June
	Statement of Investment Principles	N/A	June
	Investment Strategy Panel Activity	N/A	June
	Annual Investment and funding – LPF/LBPF/SHPF	N/A	June
	LPF Annual Report & Accounts **Audited**	LPF Annual Report & Accounts **Audited**	September
	ISA 260 Audit Report	ISA 260 Audit Report	September
	N/A	Pensions Data Quality	September
	N/A	Delegated authorities: Write offs -	September
	N/A	Fraud Prevention	September
	Annual Performance Benchmarking	N/A	September
	Consultative Panel Membership	N/A	December
	Annual Report by External Auditor	Annual Report by External Auditor	December
	EU Tax Claims & Income Recovery	EU Tax Claims & Income Recovery	December
	Class Actions	Class Actions	December
	N/A	Investment Income Review-Cross-Border withholding tax	December
	Environmental Social and Governance Activity	N/A	December
	N/A	Investment Controls & Compliance	December

Frequency	Pensions Committee	Audit Sub Committee	Month
Semi Annually	Update on Employer Admissions in LPF	N/A	March & September
3 Times per year	Service Plan Update	N/A	March, September & December
	Referrals / recommendations from Pensions Audit-Sub	N/A	June, September & December
Quarterly	Risk management summary	Risk management summary	
	Policies/Strategies e.g. Training, Communications	N/A	(March Committee preferable for these reports)
Every 3 years	Actuarial Valuation: LPF/LBPF/SHPF Funding Strategy Statement		December or March
As required	Delegated authorities (provider appointments)	N/A	
	N/A	Audit reports	
	N/A	Internal Audit Reports	
	Regulatory Update	N/A	
	Investment Strategy Reviews (at least every 3 years)	N/A	
	N/A	Risk management (in depth review)	

Pension Committee

10.00 a.m., Tuesday, 17th June 2014

Lothian Pension Fund - Internal Audit Monitoring 14/15

Item number	5.3
Report number	
Executive/routine	
Wards	All

Executive summary

As part of the improvement and alignment of internal audit with the Council's overall governance programme, the internal audit year has been aligned with the financial year of the Council from 2014. As a consequence of this adjustment, there was a one-off, six month reporting period to 31 March 2014.

The purpose of this report is provide a summary of the audit activity during the six month period covering 1 October 2013 to 31 March 2014 and to outline the proposed annual internal audit plan for 1 April 2014 to 31 March 2015.

This plan is based on the allocation of internal audit resource across the Council's services, which was considered and approved by the Council's Governance and Best Value Committee on 2 April.

Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	

Report

Lothian Pension Fund - Internal Audit Monitoring 14/15

Recommendations

1.1 Note the summary of audit activity covering the six month period to 31 March 2014.

1.2 Note the planned internal audit activity for the year 2014/15.

Background

2.1 One internal audit final report was issued in the Pensions area in the six month between October 2013 and March 2014 in addition one guidance note was also issued.

2.2 The internal audit plan needs to be risk based, focused on governance, risk and controls in order to allow the Chief Internal Auditor to provide an opinion on Lothian Pension Fund's internal control environment, based on the work undertaken during the year.

2.3 The areas proposed for inclusion in the audit plan are based on discussions with Lothian Pension Fund management team members to examine current risk register items and to prioritise areas for examination. It is important to note that the Council is embarking on a programme to refresh the Risk Management System and we expect this to increasingly drive the improvement of the risk based approach to audit planning as the programme moves forward.

Main report

Internal Audit Activity

3.1 Introduction

During the period October 2013 and March 2014, Internal Audit issued one final report and one internal controls advisory paper:

- Review of controls around the new payroll system – Part 2

- Payroll controls (guidance note)

3.2 Summary of recommendations

Audit Area	Critical	High	Medium	Low	Advisory	Comment
New Payroll System – P2	-	-	2	1	-	Follow-up work to be undertaken as part of planned 2nd quarter work on immediate payments (live data) – July 2014

3.3 Findings & Recommendations (Medium risk)

Two medium findings were reported, these are included below along with the internal audit recommendations.

Finding1:

Within Heywood's Service Level Agreement there is a 48 hour activation commitment. In essence, this means that systems could go down for up to 2 days under the service standards within the contract and Heywood would still be within their contractual obligations. Heywood's disaster recovery site and its data only need to support this 48 hour commitment. This length of down time may adversely affect Lothian Pension Funds commitments and service standards, especially at critical periods of the month.

Recommendation:

Lothian Pension Fund need to carefully risk assess both the likelihood and the impact of a 48 hour down time and what issues that would have on the service and make contingency plans accordingly

Finding 2:

There are good controls in place with access rights to the Payroll system, to ensure segregation of duties. However, there is over-reliance on the integrity of the Systems and Payroll Manager to control access rights to the system both on a temporary and permanent basis. It was agreed that this posed a risk to the payroll system and a risk to the officer's integrity. It was also noted during a meeting with the System and Payroll Manager that he changed his own access rights to ensure that data entry onto the payroll system was no longer permissible.

There is currently no evidence retained to support requests for temporary changes in access rights

Recommendation:

A process should be put in place to ensure that officers who have full access rights to the payroll system are audited on a regular basis. The officer carrying out this audit should be independent of the payroll input process, be of sufficient seniority and have a good working knowledge of the Altair payroll system.

Note:

An element of the remit for ‘New Payroll System Audit – Part 2’ was deferred until July ’14. The assessment of reconciliation controls between the payroll and pensions systems was considered to be more effective once the new system was fully implemented.

3.4 Management have reported that actions have been put in place to address the risks. Comments and actions were as follows:

Finding1:

A 48 hour down time is very unlikely. Previous incidents have generally been shorter than one day and Heywood have prioritised returning service based on payroll deadlines. However management agree that a 48 hour outage is possible and would have a severe service impact. In order to mitigate this, the standard process includes two contingency measures.

The first contingency measure is to extract a BACSs and cheque file 2 days before the targeted close down period. This is saved in a secure folder outwith the Altair system. This file could be used to pay 99% of pensioners. New joiners keyed in the period after the data has been extracted would be paid by a Bankline payment. This will ensure that all pensioners are paid on time.

The second contingency measure is to build additional time into the close down timetable. Two days contingency time has been built into the timetable. If an outage occurred at the critical time it should be possible to complete the process after the service returns.

Finding 2:

Recommendations accepted and have been implemented with immediate effect. The pensions administration system provides reporting facility on any amendment to a member record to the fullest level of detail, i.e. what, by whom and when.

Internal Audit 2014/15 Plan

3.5 This plan is based on the allocation of internal audit resource across all the Council’s services, which was considered and agreed by the Council’s Governance and Best Value Committee on 2 April.

3.6 Internal audit planning optimises the use of audit time and matches the internal audit team’s skill sets to individual internal audit reviews. Given the specialist nature of pensions, we have utilised the Internal Audit co-source agreement with PwC and will deploy experienced auditors, with direct pension’s experience, to deliver the planned work. Wherever possible the PwC auditors will work alongside permanent staff to ensure key skills and knowledge are transferred, for the benefit of the long term internal audit capability of the Council.

3.7 The reporting of internal audit findings now categorises findings as Critical Risk, High Risk, Medium Risk, Low Risk and Advisory to ensure findings are risk based.

3.8 The Audit Plan for the year to 31 March 2015 will focus on the following themes below:

Qtr	Audit Remit	Planned Days
Q1	No audit this quarter.	N/A
Q2	Audit the immediate payment (live) system from Payments Units. Also assess reconciliation controls between payroll and pension systems. Perform pension payroll follow up work from 2013/14 audit. This is linked to Risk Refs IP009 Technological Risks & IP024 Risk of Incorrect Pension Payments. In particular cost/risk implications. The audit will examine the governance and controls around the payments systems processes and will focus on providing assurance over the accuracy of the reconciliation between the payroll and pensions systems.	30 days
Q3	Review the Scheme of Delegation. Ensure that core internal controls around both payments and investment comply with the Scheme of Delegation. This is linked to Risk Ref IP032 Reputational Risk, the Risk of Acting out-with Proper Delegated Authority. The governance and controls over how operational and signing delegations are performing and that appropriate policy, training and guidance is being deployed.	20 days
Q4	Audit of Pensions Administration including a review of data quality and impact on payments (electronic transfers). Assess employer's quality control systems through liaising with their auditors. Obtain assurance over the accuracy of pay information received. This is linked to a number of risks including Risk Ref IP003 Financial Risk, Collapse of an employer, IP004 Key Staff and IP006 Theft of Pension Fund assets. This will examine Employer's data governance and controls in place to ensure the quality and accuracy of data transferred to LPF. It will look at how LPF work with Employers to improve data quality and what is in place to ensure Employers understand the impact of poor data quality and inaccuracy.	25 days

3.9 Planned days are indicative at this stage as the nature, timing and extent of the audit work is not confirmed in detail until the planning meeting with LPF management prior to the start of the audit fieldwork. In addition, circumstances can change over the audit year resulting in minor adjustment to the specific audit remit to reflect changes in risk.

3.10 In agreement with LPF management, areas considered for 2014/15, but deferred until annual audit year 2015/16 are set out below:-

3.10.1 Review high level control improvements in preparation for accreditation with the Financial Conduct Authority (FCA). Assess how the section has progressed with the issues identified through the Investment Operating Review undertaken by Mercer.

3.10.2 Review assurance mapping to assist with identifying areas of risk including ICT.

Measures of success

4.1 Alignment of the Internal Audit Plan to the key risks faced by Lothian Pension Fund to ensure that governance is improved, managers take responsibility for corrective action and confidence in the management of risk is increased

Financial impact

5.1 There are no direct financial implications.

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Risk, policy, compliance and governance impact

6.1 There are no adverse impacts

Equalities impact

7.1 There are no adverse equalities impacts arising from this report.

Sustainability impact

8.1 There are no adverse sustainability impacts arising from this report.

Consultation and engagement

9.1 Internal audit management team consulted with LPF senior management in preparing the annual audit plan.

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Background reading / external references

Internal audit reports issued in the six months to 31 March 2014

Alastair Maclean

Director of Corporate Governance

Richard Brown, Chief Internal Auditor

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Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	
Appendices	None

Pensions Committee

10.00 a.m., Tuesday, 17th June 2014

Lothian Pension Funds Annual Report 2014 Unaudited

Item number	5.4
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to approve the unaudited Annual Report for the year ended 31 March 2014 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund.

A copy of the unaudited Lothian Pension Funds' Annual Report for the year to 31 March 2014 is attached as Appendix 1. The Accounts show that the Lothian Pension Fund valuation increased from £4,094.6m to £4,377.5m and Lothian Buses Pension Fund increased from £311.9m to £337.1m. The Scottish Homes Pension Fund decreased from £140.1m to £136.3m.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Report

Lothian Pension Funds Annual Report 2014 Unaudited

Recommendations

1.1 Pensions Committee is recommended to approve the unaudited Annual Report for the year ended 31 March 2014 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund.

Background

Statutory provisions and accounting guidance

2.1 The Scottish Government has issued statutory accounting guidance which requires that Local Government Pension Scheme (LGPS) financial statements be published within an Annual Report. The statutory guidance provides that for 2010/11 onwards the LGPS Annual Report should be published separately from the Authority's own financial statements and that LGPS Annual Report contents should comply with the requirements of Scottish Statutory Instrument 2010/234 and there should be a separate audit report.

2.2 The Local Government (Scotland) Act 1973 stipulates that unaudited financial statements must be presented to the Council and the Controller of Audit within three months of the financial year end, that is 30 June. It is within the Pensions Committee's remit to approve the unaudited Annual Report for the pension funds. As per Audit Scotland guidance, the Annual Report will be submitted to Council on 26 June 2014 for the purposes of noting.

Main report

Unaudited Lothian Pension Funds Annual Report

3.1 A copy of the unaudited Annual Report for the year to 31 March 2014 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund is attached as Appendix 1. Relevant assurance statements will follow.

3.2 In considering the unaudited Pension Funds' Annual Report, Committee should note the following:

3.2.1 Section 95 of the Local Government (Scotland) Act 1973 states that "every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the authority has responsibility for the administration of those affairs". The Head of Finance serves as the Section 95 Officer for all of the City of Edinburgh Council's accounting arrangements, including those of the Pension Funds administered by the Council. For the Pension Funds, however, this Section 95 responsibility has been delegated to the Pensions and Accounting Manager.

3.2.2 The Accounts show that the Lothian Pension Fund valuation increased from £4,094.6m m to £4,377.5m and Lothian Buses Pension Fund increased from £311.9m to £337.1m. The Scottish Homes Pension Fund decreased from £140.1m to £136.3m.

3.2.3 The Annual Report includes an Annual Governance Statement which sets out details of how the Funds are governed and the internal controls that are in place to manage risk. This mirrors the requirement to have a similar statement within the Financial Statements of the Council.

3.2.4 The report also includes a Governance Compliance Statement; this is a requirement of the LGPS Regulations. The purpose of this Statement is to record the extent to which the constitutional governance arrangements complies with best practice guidance issued by the Scottish Public Pensions Agency.

3.2.5 Related to the Annual Governance Statement is the Statement of Responsibilities for the Statement of Accounts. This sets out the respective responsibilities of the Administering Authority and the Pensions & Accounting Manager.

3.2.6 The unaudited Report includes a section into which the Independent Auditor's Report will be slotted when the audit is completed. Each of the three funds has a separate Actuarial Statement provided by the Actuary which provides information on the triennial valuation as at 31 March 2011 and the movement in the funding level since that date.

3.2.7 Under International Accounting Standard 26 (Retirement Benefit Plans), there is a requirement to disclose the actuarial present value of promised retirement benefits. The basis of the valuation is the same as that used for FRS17 / International Accounting Standard (IAS)19 required in the accounts of some individual employers, but covers the liabilities of the whole Fund. The valuation basis is not used for funding purposes and setting contribution levels. The

Actuary has provided a value for the liabilities of each of the three Funds and a suitable note has been added to the accounts of each fund (Lothian Pension Fund £5,483m from the previous year's £4,946m, Lothian Buses Pension Fund £358m from £321m and Scottish Homes £138m from £136m). The increase in the value of the liabilities is largely due to the reduction in bond yields (discount rate) from 4.5% to 4.3% as at 31 March 2014.

3.2.8 In accordance with Audit Scotland's Annual Report on the audit of the 2012/13 accounts, significant effort has been made to improve the transparency of investment management fees. An officer from Lothian Pension Fund has participated in a CIPFA working group to look at the issue but at the time of compiling the accounts, guidance had not yet been issued. Nevertheless, the accounts for 2012/13 have been restated to include investment management fees charged within comingled investment vehicles.

3.3 Following the approval of the unaudited Annual Report by Pensions Committee, the next steps will be:

3.4 City of Edinburgh Council will be asked to note the unaudited accounts on 26 June 2014.

3.5 In order to meet the statutory timetable, the Pensions Audit Sub-Committee of 22 September 2014 and thereafter the Pensions Committee, at its meeting on 23 September 2014, will consider the International Standard on Auditing (ISA) 260 Audit Report (covering all significant issues arising from the audit of the accounts) and the Audited Annual Report 2014.

3.6 Finally, the external auditor will issue his annual report, which summarises all significant matters arising from the audit and overall conclusions about the management of key risks. It will be considered by the Pensions Audit Sub-Committee and Pensions Committee at meetings on 16 and 17 December 2014 respectively.

Measures of success

4.1 The prime objective of the Council, as administering authority of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, is to ensure an unqualified audit opinion of the Annual Report 2014. This will be determined in due course.

Financial impact

5.1 There are no direct financial implications as a result of this report.

Risk, policy, compliance and governance impact

6.1 The Local Government (Scotland) Act 1973 stipulates that unaudited financial statements must be presented to the Pensions Committee and the Controller of Audit within three months of the financial year end, that is 30 June.

Equalities impact

7.1 There are no adverse equalities impacts arising from this report.

Sustainability impact

8.1 There are no adverse sustainability impacts arising from this report.

Consultation and engagement

9.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds. This report is also being considered by the Pensions Audit Sub-Committee at its meeting on 16 June 2014 and its recommendation(s) will be reported orally.

Background reading / external references

Alastair Maclean

Director of Corporate Governance

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Links

Coalition pledges	
Council outcomes	
Single Outcome Agreement	CO26

Appendices	1. Unaudited Annual Report 2014 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund; Appendices 2-4 will follow 2. Lothian Pensions Funds - Annual Statement by Head of Internal Audit; 3. City of Edinburgh Council – Statement on the system of internal financial control by Head of Finance; 4. Lothian Pensions Funds - Statement on the system of internal financial control by Pensions & Accounting Manager

Lothian PENSION FUND

2013/14

UNAUDITED ANNUAL REPORT AND ACCOUNTS

LOTHIAN PENSION FUND
LOTHIAN BUSES PENSION FUND
SCOTTISH HOMES PENSION FUND

INVESTORS IN PEOPLE | Gold

CUSTOMER SERVICE EXCELLENCE CSE

Contents

Report from the Convener of the Pensions Committee

I am pleased to introduce the 2013/14 Annual Report for Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund.

This has been another challenging year for local government and for those who deliver services on its behalf. As the 'trustees' of the Local Government Pension Scheme (LGPS) in the Lothian area, I and my colleagues on the Pensions Committee are very conscious of our responsibilities to our 76,000 members and 101 employers.

For a number of years the Consultative Panel has been an integral part of the pension funds' governance. The twelve people on the Panel, representing the members and employers in the Funds, attend meetings of the Pensions Committee and contribute to decision making. However, this was the first full year that two of its members have been part of the Pensions Committee formally recognising the involvement of stakeholders in the Funds' governance. Allison Cosgrove then John Anzani (before/after December 2013 respectively) and Darren May have had full voting rights on the Committee.

This is also the first full year we have had a Pensions Audit Sub-Committee and an independent professional observer, Sarah Smart, in place. Pension issues can be technical and complex and these changes have helped to scrutinise advice in more detail and further strengthen the governance of the Funds. I was particularly pleased that the Lothian Pension Fund won the Engaged Investor Award for its Governance during the year. This is testimony to our commitment to ensuring open and transparent decision making.

The reform of pensions across the public sector moves ahead and the new Scottish Local Government Pension Scheme comes into force in April 2015. It will bring changes to members' benefits as well as changes to governance. We will continue to work closely with our members and employers to support them through the changes.

We welcome the intention to review the structure of the Local Government Pension Scheme in Scotland. Conflicts do arise from the fact that the administrating authorities and pension funds are the same legal entity, performing different functions that are the subject of potentially different priorities. We are generally comfortable that our open and transparent governance structure is a strong defence against potential conflicts. However, structural change could make this clearer and more workable. Consistency of data between the funds in Scotland, particularly those relating to investment costs, will also be important for the review and I am pleased to see increased transparency of investment costs in the Funds' accounts.

I would also like to thank all those involved in the management of the Funds over the last year.

Councillor Alasdair Rankin
Pensions Committee Convener
The City of Edinburgh Council
June 2014

Report by the Convener of the Pensions Audit Sub-Committee

The new Sub-Committee was created in 2012 following a review of Council and Funds governance. Its role is to assess the control of the Funds to provide assurance of effective and efficient operations and to make appropriate recommendations to the Pensions Committee.

Over the 2013/14 year, the Pensions Audit Sub-Committee met three times. It consists of three members of the Pensions Committee. Two members of the Consultative Panel (Eric Adair and Eric Maclennan) and the independent professional observer also attend. The Sub-Committee considered the 2012/13 accounts, findings from internal and external audits, fraud prevention, recovery of income tax on investment income and the service from the Funds' investment custodian.

Previously the accounts were scrutinised by the City of Edinburgh Council's Audit Committee. I believe the Pensions Sub-Committee, ensures a sharper focus in assessing operations, controls and risks in greater detail. It also draws on appropriate specialist knowledge, understanding and expertise to scrutinise the operation of the Funds.

I am confident the new Audit Sub-Committee provides added benefit to the Funds and ultimately to members and employers.

Councillor Cameron Rose
Audit Sub Committee Convener
The City of Edinburgh Council
June 2014

Report by the Independent Professional Observer

I was delighted to be appointed to Lothian Pension Fund as an Independent Professional Observer in March 2013. The purpose of my role is to assist the Pensions Committee to exercise their governance responsibilities as effectively and as efficiently as possible.

I have been involved with the world of institutional investment since 1999 and have been a pension trustee of various schemes since 2004. I now hold a portfolio of pension trustee and non-executive positions, all of which provides me with a depth and breadth of experience with which to assist the Pensions Committee.

The Pensions Committee is made up of individuals who have a high level of intelligence and are extremely competent in their own fields. However they are not pensions experts. My job is to help them apply their intelligence and competence to the area of pensions and investment. I do this by attending meetings, helping with training for Committee and Panel members and challenging independent advice to the Funds as appropriate. My role is not to take over the role of governance, but to help the Committee and Consultative Panel members to be better equipped to exercise their governance responsibilities.

Since joining Lothian Pension Fund, members of the Committee have all been very welcoming and have shown enormous enthusiasm for engaging with the issues that they are presented with for consideration. I have been impressed with the level of debate that occurs in Committee meetings and the way in which Committee members challenge recommendations made by the Officers to ensure they fully understand all the consequences of decisions to be made.

Sarah Smart
Independent Professional Observer
June 2014

Review of the year

Funding & Investment

During 2013/14 investment markets provided relatively strong returns despite periods of volatility. The Funds all delivered positive returns over the one year period: 6.8%, 8.9% and 2.1% for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund respectively.

Lothian Pension Fund's Fund Account shows income from members and employers increased marginally from £178m in 2012/13 to £182m in 2013/4. Pensions paid out continued to increase from £113m to £120m as programmes of workforce downsizing continued for some of our larger employers. In total, net additions from dealing with members reduced from £22m to £13m. Investment income of £124m is expected to provide ample cover for future increases in pension payments over the coming years.

Reducing income and increasing expenditure is evident in the Lothian Buses Pension Fund - this is inevitable as the employer has not permitted new employees to join since 2008.

Net dealings with members for Scottish Homes Pension Fund continues to be negative as there are no active members in the Fund and employer contributions are relatively small. The net reduction from dealing with members is broadly unchanged over the year: £6.9m in 2012/13 and £6.7m in 2013/14.

A number of changes have been made to the investments of the Lothian Pension Fund, moving decisively away from portfolios that are constructed based on the size of companies. Assessing a company's ability to preserve capital and for growth is more important for the Funds. Investments held in regional portfolios have also been reduced in favour of global portfolios, as the country in which an investment is listed has become less important in the ever-increasing global economy. Over the long term, the changes are expected to enhance the Fund's risk-adjusted returns. Similar changes have also been made to the investments of Lothian Buses Pension Fund.

The Lothian Pension Fund and the Lothian Buses Pension Fund have also continued to identify and invest in attractive assets within the Alternative category, which includes assets with attractive yields and inflation protection, such as infrastructure and timber. Investments made over the year include co-investments in UK Private Finance Initiative (PFI) projects, such as schools and hospitals, which offer stable income over the term of the concession periods and some protection against inflation.

Unlike most Local Government Pension Schemes, we employ a number of skilled staff that manage some of the investments in-house. During the year, we subjected our investment controls to external scrutiny and this provided comfort that our operations are well structured and effective. It has also provided direction for further improvement in our controls and we will be seeking authorisation from the Financial Conduct Authority over the coming year. This is an important step for the Funds in making them responsive and prepared for the challenges ahead in public sector pensions.

Despite the positive investment markets, there are still significant challenges ahead. The investment and funding outlook for the pension funds remain exceptionally challenging as western economies struggle to show meaningful growth and government bond yields remain stubbornly low. This, together with the abolition of contracting out from the State Earnings Related Pension Scheme, could mean significant increases in costs for employers and higher National Insurance contributions for members. In order to provide budgetary certainty for employers over the next few years, a contribution stability mechanism has been put in place for certain employers in Lothian Pension Fund. The financial position of all three Funds, and the employer contributions for the coming years, will be assessed at the 2014 actuarial valuation.

Customer Service

We continue to use a variety of engagement techniques to develop our understanding of members and employers, for example face to face meetings, surveys and customer journey mapping techniques. Their needs, experiences of our service and their perception of the Funds help us to continually improve and become more efficient and effective. During the year, the Funds were, once again, successful in retaining the Customer Service Excellence award and achieved specific recognition for 'commitment to putting the customer at the heart of service delivery'.

In 2013/14, we increased the use of the online service by offering members the option to carry out retirement and voluntary redundancy quotes online. Over 12,000 members are registered to use the service. Further services will be offered online in the coming year and we expect an upgrade to improve usability of the system.

During the year, our new employer on-line system was rolled out to employers. It facilitates secure electronic data transfer from employers to the Funds, increasing efficiency and reducing the risk of manual errors. A quarter of our employers are now using this facility to provide details of monthly contributions for each member. This ensures any changes in membership are identified and acted upon quickly, facilitating an improved service to members. During 2014/15, monthly reporting will be rolled out to all employers.

We have worked alongside The Pensions Regulator's high profile campaign to warn members of the risk of pension liberation fraud. Our process and documentation relating to pension transfers have been reviewed to try to prevent such fraud and to seek to ensure that members are making fully informed decisions when transferring benefits out of the Funds.

Over the year we also integrated the pensioner payroll system with our pension administration system. The change has reduced risk, increased efficiency and facilitated data reconciliations.

Employers in the Lothian Pension Fund continue to face organisational changes and during the year a number of admitted bodies investigated options to exit the Fund. We continue to work with employers to facilitate changes and also to ensure commitments to the Fund are honoured.

Local Government Pension Scheme Reform

The new Scottish Local Government Pension Scheme will start in April 2015. It will introduce a career average scheme, fundamentally different to the final salary scheme currently in place. Officers have been involved in the development of the new scheme over the year and will continue to do so, as work progresses on the finer detail.

There will be significant communication challenges to explain the new career average pension scheme to both members and employers. It will be more complex to administer and there will also be greater scrutiny of the Funds by The Pensions Regulator.

We are participating in a working group to develop a Scotland-wide communication strategy and liaising with our software provider to ensure that the pension administration system will be updated in a timely manner. We will continue to work closely with our employers and members to support them through the forthcoming changes.

ALASTAIR MACLEAN
Director of Corporate Governance
The City of Edinburgh Council
June 2014

CLARE SCOTT
Investment and Pensions Service Manager
The City of Edinburgh Council
June 2014

How the Funds work

The City of Edinburgh Council acts as administering authority for the Local Government Pension Scheme in the Lothian area. Pension matters are delegated by the Council to a Committee whose members act as 'quasi trustees'.

Pensions Committee

Membership 1 April 2013 to 31 March 2014

Councillor Alasdair Rankin
(Convener from 22/8/13)

Councillor Maureen Child
(Convener until 21/8/13)

Councillor Jim Orr
(Pensions Audit Sub-Committee member)
(Resigned 4/3/14)

Councillor Bill Cook
(Pensions Audit Sub-Committee member)

Councillor Cameron Rose
(Convener of Pensions Audit Sub-Committee)

John Anzani (nominated by Consultative Panel)
(Appointed 21/11/13)

Darren May
(nominated by Consultative Panel)

Allison Cosgrove
(nominated by Consultative Panel) (Resigned from Committee 20/11/13)

The Pensions Committee held four meetings during the year. Membership of the Committee during the year is shown above. Changes to the Committee included the appointment of Councillor Rankin as Convener, the resignation of Councillor Orr and the appointment of John Anzani, who replaced Allison Cosgrove.

The Pensions Audit Sub-Committee met three times during the year.

Consultative Panel

The Consultative Panel made up of employer and member representatives act as a sounding board for the Pensions Committee. The Panel made up of six employer representatives and six member representatives. who are shown below.

Consultative Panel membership 1 April 2013 to 31 March 2014			
	Employer	Representing	
Employer representatives			
Alan Williamson	Edinburgh College	Colleges/universities	
Darren May*	Scottish Water	Other employers	
Helen Carter	Scottish Government	Scottish Homes	Appointed 16/12/13
Eric Adair	EDI	Other employers	
Guy Hughes	Lothian Buses	Lothian Buses	
Sharon Dalli	Police Scotland	Other employers	Appointed 19/09/13
Member representatives			
Charlie Boyd	The City of Edinburgh Council	Active members	
Allison Cosgrove	East Lothian Council	Unison	Resigned 31/12/2013
Eric MacLennan	The City of Edinburgh Council	Unison	
Owen Murdoch	Retired member	Unison	
John Rodgers	Lothian Buses	Unite	
John Anzani*	Midlothian Council	Active members	Appointed 24/09/2013

* denotes member of the Pensions Committee at 31 March 2014.

Pensions Committee and Consultative Panel training

The Committee and Panel members must attend training as outlined in the Fund's Trustee training policy. The policy includes a framework, based on the CIPFA framework, to assess knowledge and identify training to ensure effective decision making. The training covers key areas including pension legislation, investment, accounting and auditing standards and actuarial practices.

All Committee members undertook extensive training covering key elements of pension legislation and investments. This included induction training for new members and external events including the Reform of the Local Government Pension Scheme (Scotland) Seminar.

Committee members collectively attended 259 hours of training over the year. Panel members undertook 103 training hours.

Investment and Pensions Division

The Investment and Pensions Division sits within the City of Edinburgh Council and carries out the day-to-day running of all three pension funds. The Division functions include investment, pension administration and payroll, communications and accounting. The investment responsibilities include monitoring and selecting external investment managers and carrying out in-house investment management.

The senior officers are:

- Alastair Maclean, Director of Corporate Governance
- Clare Scott, Investment and Pensions Service Manager
- Struan Fairbairn, Legal and Risk Manager
- Bruce Miller, Investment Manager
- John Burns, Pensions and Accounting Manager
- Esmond Hamilton, Financial Controller

Investment Strategy Panel

The Pensions Committee sets the overall investment strategy with the implementation of that strategy, including investment monitoring, delegated to the Director of Corporate Governance who takes advice from the Investment Strategy Panel. The Investment Strategy Panel meets quarterly and comprises the Director of Corporate Governance, Investment and Pensions Service Manager, Pensions and Accounting Manager, Investment Manager and three independent advisers. The independent advisors are Gordon Bagot, Scott Jamieson and KPMG, represented by David O'Hara.

Investments

Investment markets

With the Bank of England's official interest rate pegged at 0.5%, the lowest rate in its 320 year history by some margin and quantitative easing (bond buying by the central bank) continuing, the new governor, Mark Carney, appears more concerned about the economy's growth potential than the risks of inflation. Carney is not alone amongst global monetary policymakers. However, 2013/14 was the year when outgoing chairman of the US central bank, Ben Bernanke, alerted the world that monetary policy had been so easy for so long that a change was overdue. The word "tapering" entered the financial market lexicon to describe a reduction in the pace of quantitative easing by central banks, effectively a tightening in monetary policy.

The price movements of equities, bonds and currencies around the world over 2013/14 largely demonstrated countries' relative vulnerability to tapering. Given the excellent stock market returns since 2009, investors are obviously nervous about a reversal of policies that have supported asset prices and which foreshadow interest rate increases. Developed world equities in the UK, Europe and the US wobbled occasionally, but marched higher over the year, rising between 8% and 14% in sterling terms. Asian and Emerging Market equities fell, in some cases quite sharply. Worst affected were the prices of assets in countries with large current account deficits where central banks increased interest rates to defend their currencies. This tightening of monetary policy portends slower economic growth and potential repayment problems for issuers of foreign currency denominated debt. Bond markets around the world too produced negative returns over the year, and in the UK, conventional gilts fell 8% and index-linked gilts almost 4%.

Investment strategies

The review of investment strategies for all three funds following the 2011 Actuarial Valuation concluded that there was scope to reduce investment risk over the next few years. Given valuations of fixed income markets, the Funds' current focus is on robust income generation and lower risk from other assets, including equities. The allocations to index-linked gilts provide a good match to liabilities and a measure of diversification for the Funds, but they provide a very low real return.

The Funds have made considerable progress in moving away from market capitalisation benchmarks, which are regarded as sub-optimal, and continue to focus on ways to ensure that the objectives and risk tolerances of individual portfolios are closely aligned with the overall objectives of the Funds as possible. Capital preservation and growth are more important than following an index.

Responsible investment

The Funds strive to be active shareholders to enhance the long-term value of our investments, including engagement on environmental, social and governance issues, in a manner which is consistent with fiduciary duties.

We are a signatory to the United Nations Principles for Responsible Investment and publish how we meet the Financial Reporting Council UK Stewardship Code requirements which promotes public disclosure of stewardship activities. We undertake voting and engagement activities through Hermes Equity Ownership Service for the majority of the investments of Lothian Pension Fund. Baillie Gifford, UBS and State Street take direct responsibility for stewardship issues in the investments they manage on our behalf.

Over the year, we voted on over 10,500 resolutions at more than 900 company meetings and opposed over 900 resolutions. We engaged with over 250 companies across the world on topics such as board structure, executive compensation and climate change. We also participate in class action lawsuits and are acting as co-lead plaintiff in a number of court actions.

Councillor Cameron Rose, a member of the Pensions Committee, is Vice Chair of the Local Authority Pension Fund Forum (LAPFF) which promotes local authority investment pension fund interests and seeks to maximise their influence as shareholders.

Financial performance

Funding Strategy Statement

The Funding Strategy Statement sets out how the Fund balances the potentially conflicting aims of affordability and stability of employers' pension contributions whilst taking a prudent long-term view of funding those liabilities. The Funding Strategy Statement was revised at the 2011 Actuarial Valuation and and can be viewed on our website at www.lpf.org.uk/publications.

Administrative Expenses

A summary of the Division's administrative expenditure for 2013/14, against the budget approved by Pensions Committee, is shown in the table below.

The budget focuses on controllable expenditures and therefore excludes all benefit payments and transfers of pensions from the Fund. Similarly, income does not include contributions receivable and pension transfers to the Fund.

The key variances against budget were:-

- Employees - £177k underspend. This arose from savings in unfilled posts and also the timing of recruitment.
- Third party payments -£157k underspend and Supplies and Services -£138k underspend. These resulted from the refund of overpaid global custodian fees and savings in computer system charges.
- Investment management fees –£381k underspend. This saving arose from greater use of in-house investment management expertise, this factor serving to offset additional charges payable from the fee linkage to enhanced Fund Manager investment performance.
- Securities lending revenue exceeded budget by £147k.

Administrative expenses (comparison with approved budget)

	Approved budget	Actual outturn	Actual variance
	£000	£000	£000
Employees	2,161	1,984	(177)
Transport	27	25	(2)
Supplies and services	843	705	(138)
Investment Managers fees	10,093	9,712	(381)
Other third party payments	612	455	(157)
Depreciation	74	75	1
Direct expenditure	13,810	12,956	(854)
Support costs and office accommodation	552	594	42
Income	(870)	(1,017)	(147)
Total cost to the Funds	13,492	12,533	(959)

The budget excluded certain investment management fees relating to pooled investment funds, including private equity, infrastructure and property. This reflected the previous accounting policy, whereby such costs were included within "changes in market value of investments" and "investment income".

For 2013/14, these costs are shown below together with a reconciliation of gross costs for 2013/14 is shown below in anticipation of CIPFA guidance on greater transparency of investment management fees:

	Actual outturn
	£000
Actual outturn on budgeted items above	12,533
Add back securities lending revenue included in income above	938
Investment property administration costs	781
Investment transaction costs	3,075
Investment management fees deducted from capital	13,946
Total cost to the Funds (inclusive of full investment management fees)	31,273
Per Fund Accounts	
Lothian Pension Fund	27,933
Lothian Buses Pension Fund	3,092
Scottish Homes Pension Fund	248
Total	31,273

Our service plan and performance

The Fund's vision, objectives, performance indicators and key actions are set out in the annual service plan. Progress of performance indicators and key actions are reported to the Pensions Committee regularly throughout the year and monitored monthly by the Fund's senior management team.

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The Fund has three objectives

- to provide excellent customer care
- to support and develop staff
- to continue to be a top performing fund.

Our key performance indicators are split into three main categories in line with our objectives - customers, staff and performance. Our performance indicator targets and final performance are set out below with comment and analysis thereafter. Investment performance for each pension fund is provided in the relevant section later in this report.

Service plan objective 1 - To provide excellent customer care

	Target	Actual
Overall satisfaction of employers, active members and pensioners with our services as measured by surveys	86%	85%
Proportion of active members receiving a benefit statement by 30/9/13	95%	96%
Maintain Customer Service Excellence Standard	Retain	Retained

Customer Service Excellence

Lothian Pension Fund is committed to providing an excellent service to customers. Using the Customer Service Excellence (CSE) framework ensures continuous improvement in our customer services. An annual external assessment monitors how we have improved and developed.

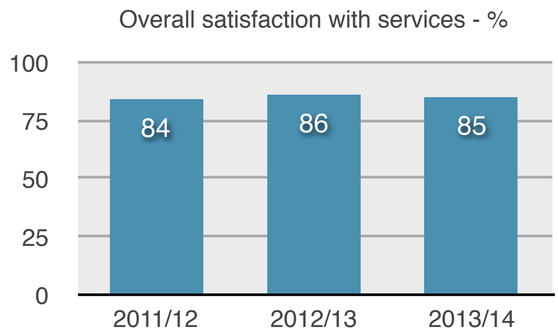
In February 2014, the Pension Fund again retained CSE for another year. The external assessor commented on the high quality and varied approaches the Fund uses for customer consultation ensuring differing customer views are gained. The assessment also noted the many changes the Fund had experienced and commented that 'the leadership have maintained a clear focus on delivering for customers during this difficult period'.

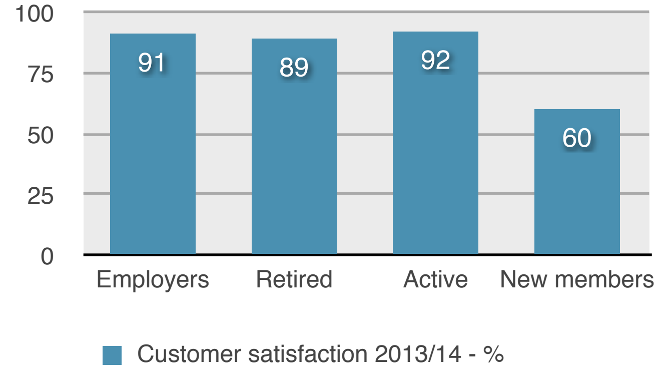
A key area for improvement has been identified as the exchange of information with employer partners and the impact this has. For example, new scheme members who have experienced delay in service from the Fund due to delays caused by some employers.

Surveys

Our overall customer satisfaction, measured by employers, retired, new and active scheme members, was 85%, marginally below the 86% target.

Satisfaction of employers, retired and active members is approximately 90%. However, new members satisfaction continues to be lower due largely to delays in receiving information about the pension scheme.





The Fund has implemented a number of improvements to ensure improved partnership working and data exchange including the new employer online system for data transfer. It is expected that these activities will improve the service for new scheme members.

Complaints

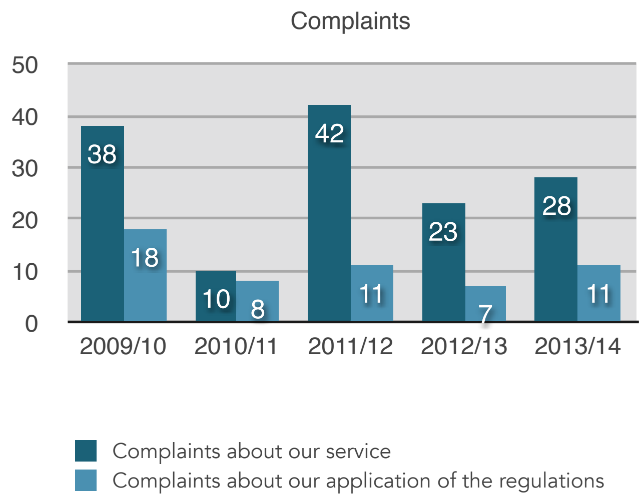
We monitor the complaints we receive on a monthly basis. We respond promptly to any complaints, investigate them and learn from them to improve the service.

We categorise our complaints in two ways:

Complaints about our service

Complaints about our application of the regulations

The graph shows the number of complaints in each of the categories. These represent less than 0.2% percentage of the procedures (over 19,000) we carried out in 2013/14.

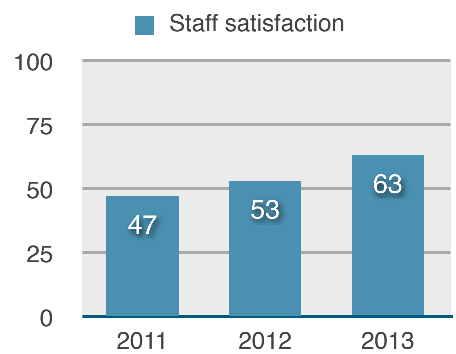


Service plan objective 2 – Support and develop staff

	Target	Actual
Level of sickness absence	4%	2.2%
Staff satisfaction with present job	60%	63%
Minimum number of days training per year for each member of staff	2 days	2 days

The Fund recognises that staff are at the heart of our business and key to delivering our objectives. Over the last year the management team have reviewed development opportunities for staff and ensured that all staff had a minimum of two days training during the year. We have also involved staff in key service improvement projects. In addition, regular one to one meetings, team meetings and staff updates keep everyone informed of developments and provide opportunities to share opinions and make service improvement suggestions.

Key indicators for staff in 2013/14 are overall staff satisfaction, sickness absence levels and training hours completed. All targets were achieved. The sickness absence rate was low at 2.24% and overall job satisfaction rose 10% to 63%.

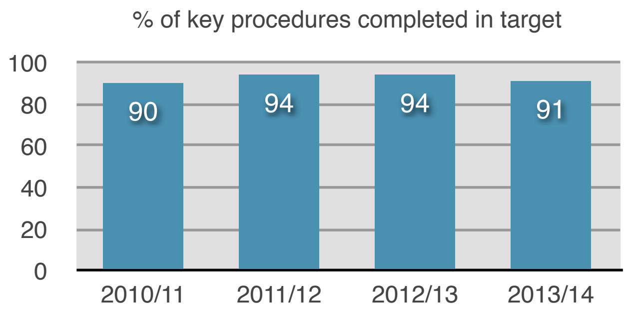


Service plan objective 3 – To continue to be a top performing Fund

To continue to be a top performing fund	Target	Actual
Percentage of critical pensions administration work completed within standards	90%	91%
Audit of annual report	Unqualified opinion	Yes
Data quality - compliance with best practice as defined by the Pensions Regulator	Fully compliant	Fully compliant
Employer contributions paid within 19 days of month end	98%	96%

Pensions Administration

The dedicated in-house team provides pension administration services for the Funds. The time it takes to complete our procedures is monitored. Key procedures include processing of retirement and dependent benefits, providing information for new members, transfers and retirement quotes. Performance for these key procedures over the year 2013/14 showed 91% of the work completed was within target.



Data quality

The administration of pensions relies on good data. Along with our new employer website, introduced to assist with the transfer of data, we have adopted other initiatives to improve member information. These include participation in specialist longevity and data analyses through "Club Vita", a service provided by the Funds' Actuary.

Pension record keeping standards are also measured against The Pension Regulator's best practice guidance and appropriate assurance attained.

The Pensions Regulator data standards	Target	Actual
Common data		
New data (post June 2010)	100%	100%
Old data (pre June 2010)	95%	96%
Conditional and Numerical Data		
Fund-scheme specific measurement including date of joining; pensionable remuneration; date of leaving and reasons for leaving etc.	98%	98%

The Pensions Administration Strategy

The Fund's Pensions Administration Strategy highlights the duties and performance standards for the Fund and participating employers.

As a Fund we rely on employers providing prompt information to ensure we can provide timely and accurate services to our members. We monitor employer performance regularly and update employers on their performance both individually and on a fund-wide basis at our employer events. During 2012/13, we met with our largest employers to discuss performance and have worked with them to improve, providing training and holding follow-up meetings to assess improvements where appropriate.

Employer performance for 2013/14 and 2012/13 for comparison is shown below.

		2012/13			2013/14		
Case type	Target (working days)	Number received	Number within target	% within target	Number received	Number within target	% within target
New member	20	2693	2386	89%	4069	2812	69%
Leaver	20	592	380	64%	1006	384	38%
Retirement	20	803	314	39%	778	374	48%
Death in service	10	37	7	19%	42	23	55%

In 2013/14, the proportion of retirement and death in service cases where we have received information from employers within target timescales increased from 2012/13. However information continues to be received later than target for a significant proportion of these cases.

In contrast the proportion of cases when we receive information on new members and leavers from employers within target timescales has worsened over the year. In both cases, this is due to efforts to rectify outstanding queries relating to member data. Of the 4,069 new members in 2013/14, 574 related to members who joined in the previous financial year (2012/13). 64% of these cases were received from employers late. Similarly, 457 of the 1,006 leavers processed in 2013/14 related to leavers in the prior financial year (2012/13) and 96% of these were late.

Efforts to ensure employers send details of membership changes promptly to the Fund are continuing, including further roll-out of monthly contribution submission to the Fund.

Employer contributions

The Pensions Act 1995 requires employers to pay pension contributions by the 19th of the month following the deduction from an employee's pay. This requirement is highlighted in the Pensions Administration Strategy and to all new employers on joining the Fund.

We monitor this requirement via our key performance indicators to ensure compliance with the Act. The target for 2013/14 was 98% of pension contributions to be paid in time. Actual performance was 96% and the dip in performance was largely due to a banking error that delayed a large payment by two days.

Of the 1,185 payments made to the Fund in 2013/14, 57 payments were later than the target of the 19th of the month. They are shown below:

Employer	Number of late payments
Barony Housing Association	1
Broomhouse Centre Representative Council	2
Centre for the Moving Image	1
Children First	1
Children's Hearing Scotland	2
Compass Group	1
Dawn Construction	2
Edinburgh College	6
Edinburgh World Heritage	1
Edinburgh Leisure	2
Enjoy East Lothian	1
Festival City Theatres Trust	2
First Step	1

Employer	Number of late payments
Granton Information Centre	2
Into Work	2
The Improvement Service	1
Keymoves	1
Police Scotland	2
Pilton Community Health Project	4
Royal Edinburgh Military Tattoo	2
Scotland's Learning Partnership	1
Scottish Fire & Rescue Service	1
Skanska	3
St Columba's Hospice	1
Stepping Out Project	2
Streetwork	4
Victim Support Scotland	1
West Lothian College	1
West Lothian Council	1
Waverley Care Trust	3
Young Scot Enterprise	2

Statement of accounting policies and general notes

1 Basis of preparation

The Statement of Accounts summarises the transactions of the Funds for the 2013/14 financial year and their position at year-end as at 31 March 2014. The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts summarise the transactions of the Funds and report on the net assets available to pay pension benefits. The accounts do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present values of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, are disclosed in the Notes to the Accounts.

2 Summary of significant accounting policies

Fund account - revenue recognition

a) Contribution income

Normal contributions, both from the members and from employers, are accounted for on an accruals basis at the rate recommended by the Scheme Actuary in the payroll period to which they relate.

Employers' pensions strain contributions are accounted for in the period in which the liability arises. Any amount due but unpaid will be classed as a current financial asset. Amounts not due until future years are classed as long-term financial assets.

b) Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the fund during the financial year and are calculated in accordance with the Local Government Pension Scheme Regulations.

Individual transfers in/out are accounted for when received/paid, which is normally when the member liability is accepted or discharged.

Transfers in from members wishing to use the proceeds of their additional voluntary contributions to purchase scheme benefits are accounted for on a receipts basis and are included in Transfers In.

Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

c) Investment income

i) Interest income

Interest income is recognised in the fund account as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transaction costs or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.

ii) Dividend income

Dividend income is recognised on the date the shares are quoted ex-dividend. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

iii) Distributions from pooled funds

Distributions from pooled funds are recognised at the date of issue. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

iv) Income from unquoted private equity and infrastructure investments

Income from the above sources is recognised when it is notified by the manager. Distributions are split into capital and income elements with the latter being included under investment income in the Fund Account.

v) Property related income

Property-related income consists primarily of rental income. Rental income from operating leases on properties owned by the fund is recognised on a straight-line basis over the term of the lease. Any lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

During the year the accounting policy was changed and rental income is now reported gross with the operational costs of the properties included in investment management expenses (see note 11 to the accounts of Lothian Pension Fund). There is no impact on the net increase in fund during the year (see note 24 to the accounts of Lothian Pension Fund).

Contingent rents based on the future amount of a factor that changes other than with the passage of time, such as turnover rents, are only recognised when contractually due.

vi) Movement in the net market value of investments

Changes in the net market value of investments (including investment properties) are recognised as income and comprise all realised and unrealised profits/losses during the year.

Fund account - expense items

d) Benefits payable

Pensions and lump sum benefits payable include all amounts known to be due as at the end of the financial year. Any amounts due but unpaid are disclosed in the net assets statement as current liabilities.

e) Taxation

The Local Government Pension Scheme is a registered public service scheme under section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a fund expense as it arises.

f) Administrative expenses

All administrative expenses are accounted for on an accruals basis. The Investment and Pensions Division of the Council is responsible for administering the three Pension Funds. The Division receives an allocation of the overheads of the Council, this is based on the amount of central services consumed. In turn, the Division allocates its costs to the three Pension Funds.

Costs directly attributable to a specific Fund are charged to the relevant Fund. Investment management costs that are common to all three Funds are allocated in proportion to the value of the Funds as at the end of the year. Other administration costs are allocated in proportion to the number of members in each of the Funds at the end of the year.

g) Investment management expenses

All investment management expenses are accounted for on an accruals basis.

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change. For some investment managers, an element of their fee is performance related. The amount of any performance related fees paid is disclosed in the note to the accounts on investment management expenses provided for each Fund.

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, the decision has been made to change the policy on accounting for investment management expenses. This means that investment management costs that are deducted from the value of an investment are now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Both categories of expense are disclosed separately in the notes to the accounts of each of the Funds under investment management expenses.

The changes have no impact on net results for the year for any of the Funds, details for the prior year adjustments made can be found in the notes to the accounts (see note 24 to the accounts of Lothian Pension Fund and notes 19 to the accounts of both Lothian Buses Pension Fund and Scottish Homes Pension Fund).

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are not treated as an expense. Such costs are accounted for as part of the acquisition costs or sale proceeds.

The cost of obtaining investment advice from external consultants is included in investment management charges.

The costs of the in-house fund management team are charged to the Funds. The basis of allocation is as described above.

h) Operating lease

Lease payments under an operating lease are recognised as an expense on a straight-line basis over the term of the lease. In accordance with SIC 15, lease incentives are recognised as a reduction in the lease expense over the term of the lease on a straight-line basis.

Net assets statement

i) Financial assets

Financial assets are included in the net assets statement on a fair value basis as at the reporting date. A financial asset is recognised in the net assets statement on the date the fund becomes party to the contractual acquisition of the asset. From this date any gains or losses arising from changes in the fair value of asset are recognised by the fund.

The values of investments as shown in the net assets statement have been determined as follows:

i) Market quoted investments

The value of an investment for which there is a readily available market price is determined by the bid market price ruling on the final day of the accounting period.

ii) Fixed interest securities

Fixed interest securities are recorded at net market value based on their current yields.

iii) Unquoted investments

The fair value of investments for which market quotations are not readily available is determined as follows:

- valuations of delisted securities are based on the last sale price prior to delisting, or where subject to liquidation, the amount the council expects to receive on wind-up, less estimated realisation costs.

- securities subject to takeover offer – the value of the consideration offered under the offer, less estimated realisation costs.

- directly held investments include investments in limited partnerships, shares in unlisted companies, trusts and bonds. Other unquoted securities typically include pooled investments in property, infrastructure, debt securities and private equity. The valuation of these pools or directly held securities is undertaken by the investment manager or responsible entity and advised as a unit or security price. The valuation standards followed in these valuations adhere to industry guidelines or to standards set by the constituent documents of the pool or the management agreement.

- investments in unquoted property and infrastructure pooled funds are valued at the net asset value or a single price advised by the fund manager.

- the values of the direct investments in unquoted private equity, infrastructure, timber and real estate are based on valuations provided by the general partners to the funds in which the Fund has invested. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of IFRS. The valuations are usually undertaken at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

iv) **Pooled investment vehicles**

Pooled investment vehicles are valued at closing bid price if both bid and offer prices are published; or if single priced, at the closing single price. In the case of pooled investment vehicles that are accumulation funds, change in market value also includes income which is reinvested in the fund, net of applicable withholding tax.

v) **Freehold and leasehold properties**

The properties were valued at open market value at 31 March 2014 by John Symes-Thompson FRICS and Genine Terry MRICS of independent external valuers CB Richard Ellis Ltd in accordance with the Royal Institute of Chartered Surveyors' - Professional Standards (2012) ("the Red Book"). The valuer's opinion of market value and existing use value was primarily derived using comparable recent market transactions on arm's-length terms.

j) Foreign currency transactions and balances

Dividends, interest and purchases and sales of investments in foreign currencies have been accounted for at the spot market rates at the date of transaction. End-of-year spot market exchange rates are used to value cash balances held in foreign currency bank accounts, market values of overseas investments and purchases and sales outstanding at the end of the reporting period.

k) Derivatives

Derivative contract assets are fair valued at bid prices and liabilities are fair valued at offer prices. Changes in the fair value of derivative contracts are included in change in market value.

The value of futures contracts is determined using exchange prices at the reporting date. Amounts due from or owed to the broker are the amounts outstanding in respect of the initial margin and variation margin.

The future value of forward currency contracts is based on market forward exchange rates at the year-end date and determined as the gain or loss that would arise if the outstanding contract were matched at the year-end with an equal and opposite contract.

l) Cash and cash equivalents

Cash comprises cash in hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to minimal risk of changes in value.

m) Financial liabilities

The Funds recognise financial liabilities at fair value as at the reporting date. A financial liability is recognised in the net assets statement on the date the fund becomes party to the liability. From this date any gains or losses arising from changes in the fair value of the liability are recognised.

n) Actuarial present value of promised retirement benefits

The actuarial present value of promised retirement benefits of each of the Funds is assessed on a annual basis by the Scheme Actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

As permitted under IAS 26, the Funds have opted to disclose the actuarial present value of promised retirement benefits by way of a note to the net assets statements.

o) Additional voluntary contributions

The Lothian Pension Fund and Lothian Buses Pension Fund provide an additional voluntary contributions (AVC) scheme for their members, the assets of which are invested separately from those of the Funds. The Funds have appointed Standard Life and Prudential as their AVC providers. AVCs are paid to the AVC providers by employers and are specifically for providing additional benefits for individual contributors. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year.

In accordance with regulation 5(2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 1998, AVCs are not included in the pension fund financial statements. Details of contributions paid and the total value of funds invested are disclosed by way of note.

3 Critical judgements in applying accounting policies

Unquoted private equity and infrastructure investments

It is important to recognise the highly subjective nature of determining the fair value of private equity and infrastructure investments. They are inherently based on forward-looking estimates and judgements involving many factors. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of IFRS.

For the Lothian Pension Fund, the value of unquoted private equity and infrastructure investments at 31 March 2014 was £527.2m (2013 £508.5m).

For the Lothian Buses Pension Fund, the value of unquoted private equity and infrastructure investments at 31 March 2014 was £11.3m (2013 £12.2m).

Actuarial present value of promised retirement benefits

Each Fund is required to disclose the estimated actuarial present value of promised retirement benefits as at the end of the financial year. These estimates are prepared by the Fund's Actuary. These values are calculated in line with International Accounting Standard 19 (IAS19) assumptions and comply with the requirements of IAS26. However, the results are subject to significant variances based on changes to the underlying assumptions.

The figures are only prepared for the purposes of IAS26 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

4 Assumptions made about the future and other major sources of estimation uncertainty

The Statement of Accounts contain estimated figures that are based on assumptions made by the Council; private equity and infrastructure managers; other providers of valuation information; and the Scheme Actuary about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the net assets statement at 31 March 2014 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

a) Actuarial present value of promised retirement benefits

Uncertainties

Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. The Fund Actuary advises on the assumptions to be applied and prepares the estimates.

Effect if actual results differ from assumptions - Lothian Pension Fund

The effects on the net pension liability of changes in individual assumptions can be illustrated as follows:

Change in assumptions - year ended 31 March 2014	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in discount rate	9	516
1 year increase in member life expectancy	3	168
0.5% increase in salary increase rate	4	214
0.5% increase in pensions increase rate	5	298

Effect if actual results differ from assumptions - Lothian Buses Pension Fund

The effects on the net pension liability of changes in individual assumptions can be illustrated as follows:

Change in assumptions - year ended 31 March 2014	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in discount rate	10	36
1 year increase in member life expectancy	3	11
0.5% increase in salary increase rate	4	14
0.5% increase in pensions increase rate	5	22

Effect if actual results differ from assumptions - Scottish Homes Pension Fund

The effects on the net pension liability of changes in individual assumptions can be illustrated as follows:

Change in assumptions - year ended 31 March 2014	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in discount rate	7	9
1 year increase in member life expectancy	3	4
0.5% increase in pensions increase rate	7	9

b) Unquoted private equity and infrastructure investments

Uncertainties

These investments are not publicly listed and as such there is a degree of estimation involved in the valuation.

Effect if actual results differ from assumptions

There is a risk that these investments may be under or overstated in the accounts at any point in time. The actual financial return of this type of investment is only known with certainty when they reach the end of their lifecycles and the final distributions are made to investors.

Lothian Pension Fund

Membership records

Status	Membership at 31/03/2012	Membership at 31/03/2013*	Membership at 31/03/2014
Active	28,337	28,869	30,622
Deferred	15,392	16,600	16,482
Pensioners	18,905	20,484	19,972
Dependants	3,720	4,064	3,770
Total	66,354	70,017	70,846

*Figures have been adjusted from 2012/3 annual report to include Councillor members

Funding

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the Fund in accordance with the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008. These contributions depend on pay and for the year ended 31 March 2014 the contribution rates were as follows:

Full time equivalent pensionable pay (rate of pay on 31/3/2014)	Rate
Less than £20,382	5.5%
Between £20,383 and £26,489	Between 5.6% and 6.0%
Between £26,490 and £33,254	Between 6.1% and 6.5%
Between £33,255 and £46,876	Between 6.6% and 7.5%
Between £46,877 and £52,810	Between 7.6% and 8.0%
Between £52,811 and £70,711	Between 8.1% and 9.0%
Between £70,712 and £106,974	Between 9.1% and 10.0%
Between £106,975 and £245,412	Between 10.1% and 11.2%

Employers' contributions are set at the triennial actuarial valuation. The contribution rates for the year ended 31 March 2014 were based on the actuarial valuation as at 31 March 2011. This valuation resulted in a common contribution rate (i.e. the average of the employers contributions) of 18.0% of pensionable earnings, this includes 1.2% in respect of the past service deficit. In practice, each employer pays contributions at a specific rate that relates to its funding experience. For 2014/15, the rates for the four Council's as major employers ranged from 16.6% to 17.2% for service currently being accrued plus a fixed amount towards the past service deficit.

In December 2013, Lothian Pension Fund introduced a Contribution Stability Mechanism for contribution rates for some employers until March 2021. In developing this proposal, the Fund commissioned, from its Actuary, detailed financial modelling of liability and asset cashflows under a range of scenarios. Membership factors and salary growth assumptions were taken into account. Forecasts were made over the long-term horizon relevant to the Local Government Pension Scheme. Currently, total contributions received by the Lothian Pension Fund remain sufficient to pay pension benefits. The Fund, however, is expected to move to a cashflow negative position in the near future and when / if it does investment income will be used to pay pensions, rather than reinvesting. The Fund continues to regularly monitor its cashflows.

More information on funding can be found in the Actuarial Statement for 2013/14 at the end of this section.

Work has commenced on the triennial actuarial valuation at 31 March 2014. At the last valuation in 2011, the funding level calculated by the Fund's actuary was 96%.

Investment strategy

The Pensions Committee approved the Investment Strategy 2012-17 for Lothian Pension Fund in October 2012. The general thrust of the strategy is to reduce the Fund's investment risk in the long term by focusing on capital preservation, durable investment income generation and a reduction in the absolute volatility of the Fund.

The investment strategy is set at the broad asset class level of Equities, Index-Linked gilts and Alternatives, which are the key determinants of investment risk and return. The Equities category includes listed and unlisted equities; Index-Linked Assets includes index-linked gilts, bonds and gold; Alternatives include property, infrastructure, timber and fixed income assets, such as corporate bonds.

The long term strategy for 2012-17 is set out in the table below along with the current interim strategy allocation and the asset allocation limits under normal financial conditions.

	Interim benchmark at 31 March 2014 %	Strategy for 2012-2017 %	Asset allocation limits minimum - maximum %
Equities	70	65	50 - 75
Index-linked gilts	5	7	0 - 20
Alternatives	24	28	20 - 35
Cash	1	0	0 - 10
Total	100	100	n/a

The objectives of the Fund were redefined in December 2012 and are:

- over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
- over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

The Fund is gradually implementing the strategy and will continue to do so over the next few years. Progress is dependent on finding attractive assets in the Alternatives category to provide the desired return and diversification.

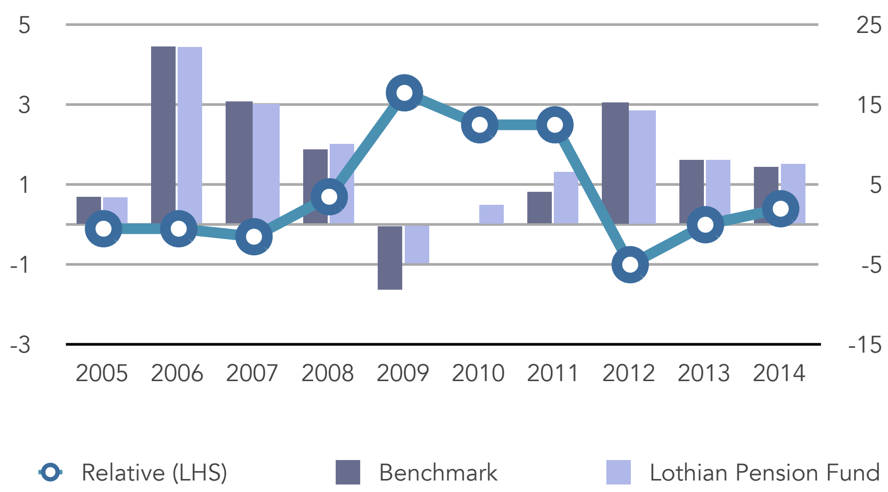
Investment performance

Annualised returns to 31 March 2014 (% per year)

	1 year	3 years	10 years
Lothian Pension Fund	6.8	7.6	8.3
Benchmark	5.2	7.2	7.4
Retail Price Index (RPI)	2.5	3.1	3.3
Consumer Price Index (CPI)	1.7	2.6	2.8
National Average Earnings	1.5	0.9	2.7

The absolute performance of Lothian Pension Fund over the 12-month period was +6.8% and the 3 year performance was +7.6% per annum. Over 10 years, the Fund returned +8.3% per annum, well ahead of measures of inflation, and national average earnings.

Annualised 3 yearly returns ending 31 March (% per year)



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Fund	3.4	22.2	15.1	10.1	(4.8)	2.5	6.6	14.3	8.1	7.6
Benchmark	3.5	22.3	15.4	9.4	(8.1)	0.0	4.1	15.3	8.1	7.2
Relative	(0.1)	(0.1)	(0.3)	0.7	3.3	2.5	2.5	(1.0)	0.0	0.4

Lothian Pension Fund

Fund Account for year ended 31 March 2014

2012/13 Restated* £000		Note	2013/14 £000
	Income		
137,821	Contributions from employers	*2*	140,721
40,194	Contributions from members	*3*	41,363
4,484	Transfers from other schemes	*4*	4,280
182,499			186,364
	Less: expenditure		
113,181	Pension payments including increases	*5*	120,434
33,176	Lump sum retirement payments	*6*	34,942
5,362	Lump sum death benefits	*7*	5,331
191	Refunds to members leaving service		235
147	Premiums to State Scheme		186
6,152	Transfers to other schemes	*8*	10,392
1,925	Administrative expenses	*9*	1,943
160,134			173,463
22,365	**Net additions from dealing with members**		12,901
	Returns on investments		
85,887	Investment income	*10*	124,526
431,875	Change in market value of investments	*12a, 13b*	171,440
(26,091)	Investment management expenses	*11*	(25,990)
491,671	**Net returns on investments**		269,976
514,036	**Net increase in the Fund during the year**		282,877
3,580,623	**Net assets of the Fund at 1 April 2013**		4,094,659
4,094,659	**Net assets of the Fund at 31 March 2014**	*13a*	4,377,536

*The results for the year ended 31 March 2013 have been restated to reflect a change in the accounting policy on investment management expenses. This change has the effect of increasing the reported investment income by £1.203m; increasing the change in market value of investment by £15.316m and increasing investment management expenses by £16.519m. There is no change in the net returns on investment. See note 24 for details.

Lothian Pension Fund

Assets Statement as at 31 March 2014

31 March 2013 £000		Note	31 March 2014 £000
	Investments		
4,086,938	Assets		4,349,645
(25,042)	Liabilities		(6,335)
4,061,896		*12, 14*	4,343,310
	Fixed assets		
157	Computer systems		397
157			397
	Current assets		
4,355	The City of Edinburgh Council	*20*	4,950
34,616	Cash balances	*14, 20*	31,734
10,299	Debtors	*17*	14,155
49,270			50,839
	Current liabilities		
(16,664)	Creditors	*18*	(17,010)
(16,664)			(17,010)
32,606	**Net current assets**		33,829
4,094,659	**Net assets of the Fund at 31 March 2014**	*13a*	4,377,536

JOHN BURNS FCMA CGMA
Pensions and Accounting Manager
June 2014

Note to the net assets statement
The financial statements summarise the transactions of the Fund during the year and its net assets at the year end. They do not take account of the obligations to pay pensions and benefits which fall due after the end of the year. The actuarial position of the Fund, which does take account of such obligations, is discussed in the Actuarial Valuation section of this report and these financial statements should be read in conjunction with that information. In addition, as required by IAS26, the Actuarial Present Value of Promised Retirement Benefits is disclosed in the notes to these financial statements.

Notes to the Accounts

1 **Events after the balance sheet date**

There have been no events since 31 March 2014, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

2 **Contributions from employers**

The total contributions receivable analysed between the administering authority, other scheduled bodies and admitted bodies were as follows:-

	2012/13 £000	2013/14 £000
By category		
Percentage of pay	103,781	107,927
Fixed deficit contribution	24,711	24,756
Strain costs	8,929	7,870
Cessation contribution	400	168
	137,821	140,721
By employer type		
Administering Authority	56,359	56,472
Other Scheduled Bodies	65,143	67,659
Community Admission Bodies	16,090	16,292
Transferee Admission Bodies	229	298
	137,821	140,721

From 1 April 2012, following the actuarial valuation of 31 March 2011, all employers are required to make a fixed contribution towards the past service deficit that relates to their employees. In previous years only some of the larger employers were required to make a fixed contribution. The deficit recovery period varies depending on the individual circumstances of each employer ranging up to 20 years.

Where an employer makes certain decisions which result in additional benefits being paid out to a member, or benefits being paid early, this results in a "strain" on the Fund. The resulting pension strain costs are calculated and recharged in full to that employer.

Any employer that ceases to have at least one actively contributing member is required to pay a cessation contribution.

3 **Contributions from members**

By employer type	2012/13 £000	2013/14 £000
Administering Authority	15,694	16,172
Other Scheduled Bodies	19,047	19,433
Community Admission Bodies	5,394	5,686
Transferee Admission Bodies	59	72
	40,194	41,363

4 **Transfers in from other pension schemes**

	2012/13 £000	2013/14 £000
Group transfers	-	-
Individual transfers	4,484	4,280
	4,484	4,280

5 Pensions payable

By employer type	2012/13 £000	2013/14 £000
Administering Authority	58,752	62,517
Other Scheduled Bodies	45,050	47,937
Community Admission Bodies	9,288	9,883
Transferee Admission Bodies	91	97
	113,181	120,434

6 Lump sum retirement benefits payable

By employer type	2012/13 £000	2013/14 £000
Administering Authority	16,740	15,131
Other Scheduled Bodies	12,733	17,289
Community Admission Bodies	3,573	2,477
Transferee Admission Bodies	130	45
	33,176	34,942

7 Lump sum death benefits payable

By employer type	2012/13 £000	2013/14 £000
Administering Authority	2,836	2,453
Other Scheduled Bodies	2,310	2,340
Community Admission Bodies	216	489
Transferee Admission Bodies	-	49
	5,362	5,331

8 Transfers out to other schemes

	2012/13 £000	2013/14 £000
Group transfers	-	5,287
Individual transfers	6,152	5,105
	6,152	10,392

9 Administrative expenses

	2012/13 £000	2013/14 £000
Employee costs	1,020	1,042
The City of Edinburgh Council - pension payroll costs	222	111
The City of Edinburgh Council - other support costs	276	262
System costs	183	197
Actuarial fees	23	75
External audit fees	41	43
Legal fees	87	64
Printing and postage	32	38
Depreciation	38	63
Office costs	-	40
Sundry costs less sundry income	3	8
	1,925	1,943

The Investment and Pensions Division of the Council is responsible for administering the three pension Funds. The Division receives an allocation of the overheads of the Council. In turn the Division allocates administration and investment costs to the three pension funds. Costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are allocated on a defined basis. Other costs are allocated on the basis of the number of members in each pension fund.

10 Investment income

	2012/13 £000	2013/14 £000
Income from fixed interest securities	11,146	10,911
Dividends from equities	49,976	84,814
Unquoted private equity and infrastructure	5,074	9,472
Income from pooled investment vehicles	579	960
Gross rents from properties	18,605	19,022
Interest on cash deposits	1,354	617
Stock lending and sundries	1,119	1,345
	87,853	127,141
Irrecoverable withholding tax	(1,966)	(2,615)
	85,887	124,526

11 Investment management expenses

	2012/13 £000	2013/14 £000
External management fees - invoiced	7,878	7,542
External management fees - deducted from capital	13,376	13,318
Transaction costs	2,030	2,805
Property operational costs	1,203	781
Employee costs	664	772
Custody fees	364	206
Engagement and voting fees	67	68
Performance measurement fees	45	56
Investment consultancy fees	66	40
System costs	132	141
Legal fees	134	109
The City of Edinburgh Council - other support costs	100	104
Office costs	-	16
Sundry costs	32	32
	26,091	25,990

The Investment and Pensions Division of the Council is responsible for administering the three pension Funds. The Division receives an allocation of the overheads of the Council. In turn the Division allocates administration and investment costs to the three pension funds. Costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are allocated based on the value of the Funds as at the year end.

Following a change in accounting policy, the expenses for 2012/13 have been restated to account for costs that were deducted from capital and therefore impacted the change in market value of investments reported in the Fund Account. The related costs are included above as external management fees deducted from capital. Investment transaction costs that were previously added to the cost of purchases or deducted from the proceeds are now accounted for as expenses and shown above as transaction costs. In addition, operational costs on property that were previously netted against rental income are now reported separately.

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales (see note 12a - Reconciliation of movements in investments and derivatives).

The external investment management fees above include £3.056m in respect of performance-related fees (2012/13 £3.504m).

12 Net investment assets

	31 March 2013 £000	31 March 2014 £000
Fixed interest securities	326,829	318,215
Equities	2,718,320	2,866,444
Pooled investment vehicles	582,535	598,687
Properties	251,480	270,753
Derivatives		
Futures	1,067	304
Forward foreign exchange	3,262	9,977
	4,329	10,281
Cash deposits		
Margin balances	1,769	894
Deposits	187,608	257,749
	189,377	258,643
Other investment assets		
Due from broker	3,029	12,553
Dividends and other income due	11,039	14,067
	14,068	26,620
Total investment assets	4,086,938	4,349,643
Investment liabilities		
Derivatives		
Futures	(622)	(91)
Forward foreign exchange	(20,844)	(268)
	(21,466)	(359)
Other financial liabilities - due to broker	(3,576)	(5,974)
Total investment liabilities	(25,042)	(6,333)
Net investment assets	4,061,896	4,343,310

12a Reconciliation of movement in investments and derivatives

	Market value at 1 April 2013 £000	Purchases at cost and derivative payments £000	Sale proceeds and derivative receipts £000	Change in market value £000	Market value at 31 March 2014 £000
Fixed interest	326,829	142,683	(136,047)	(15,250)	318,215
Equities	2,718,320	1,826,082	(1,796,521)	118,563	2,866,444
Pooled investment vehicles	582,535	65,326	(68,717)	19,543	598,687
Property	251,480	9,160	(15,822)	25,935	270,753
Derivatives - futures	445	1,007,496	(1,007,306)	(422)	213
Derivatives - fwd foreign exchange	(17,582)	30,266	(33,753)	30,778	9,709
	3,862,027	3,081,013	(3,058,166)	179,147	4,064,021
Other financial assets / liabilities					
Margin balances	1,769			-	894
Cash deposits	187,608			(7,713)	257,749
Broker balances	(547)			6	6,579
Dividends due etc	11,039			-	14,067
	199,869			(7,707)	279,289
Net financial assets	4,061,896			171,440	4,343,310

	Market value at 1 April 2012 £000	Purchases at cost and derivative payments £000	Sale proceeds and derivative receipts £000	Change in market value £000	Market value at 31 March 2013 £000
Fixed interest	300,883	110,307	(110,489)	26,128	326,829
Equities	1,647,371	1,221,629	(446,344)	295,664	2,718,320
Pooled investment vehicles	1,217,874	85,678	(850,443)	129,426	582,535
Property	246,915	27,216	(20,215)	(2,436)	251,480
Derivatives - futures	518	3,484	(1,463)	(2,094)	445
Derivatives - fwd foreign exchange	19,131	88,677	(109,010)	(16,380)	(17,582)
	3,432,692	1,536,991	(1,537,964)	430,308	3,862,027
Other financial assets / liabilities					
Margin balances	1,687			-	1,769
Cash deposits	105,153			1,587	187,608
Broker balances	(2,822)			(20)	(547)
Dividends due etc	9,201			-	11,039
	113,219			1,567	199,869
Net financial assets	3,545,911			431,875	4,061,896

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.

Following a change in accounting policy, transaction costs are no longer included in the cost of purchases and sale proceeds. As a result, the figures for 2012/13 have been restated, information on transaction costs can now be found in note 11 on investment management expenses. Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

12b Analysis of investments (at market value)

	Area	31 March 2013 £000	31 March 2014 £000
Fixed interest securities			
Public sector fixed interest quoted	UK	2,758	2,560
Public sector index linked gilts quoted	UK	148,478	144,621
Corporate quoted	UK	62,942	65,908
Public sector quoted	Overseas	7,076	9,542
Commercial quoted	Overseas	105,575	95,584
		326,829	318,215
Equities			
Quoted	UK	783,615	583,053
Quoted	Overseas	1,934,705	2,283,391
		2,718,320	2,866,444
Pooled investment vehicles			
Managed funds - other	UK	17,977	16,187
Managed funds - property	UK	56,053	55,319
Private equity and infrastructure funds	UK	85,688	137,191
Private equity and infrastructure funds	Overseas	422,817	389,990
		582,535	598,687
Properties			
Direct property	UK	251,480	270,753

Derivatives - futures

Contract type	Contract expires	Economic exposure £000	Market value at 31 March 2013 £000	Economic exposure £000	Market value at 31 March 2014 £000
Assets					
UK Fixed Income	< 1 year	31,120	911	14,458	111
Overseas Fixed Income	< 1 year	26,232	156	(28,605)	193
			1,067		304
Liabilities					
UK fixed income	< 1 year	-	-	-	-
Overseas fixed income	< 1 year	(99,274)	(622)	23,247	(91)
			(622)		(91)
Net asset			445		213

The economic exposure represents the notional value of securities purchased under the futures contract and therefore the value subject to market movements. All futures contracts are exchange traded. The Fund uses futures for the purposes of efficient portfolio management and/or risk reduction. During the year, the Fund's bond manager transacted futures to manage interest rate exposure.

Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2014

Contract settlement within	Currency bought	Currency sold	Local currency bought £000	Local currency sold £000	Asset value £000	Liability value £000
Up to one month	AUD	CAD	230	(227)	5	-
Up to one month	AUD	GBP	16,828	(9,132)	216	-
Up to one month	CAD	GBP	248	(134)	1	-
Up to one month	CHF	JPY	37	(4,192)	1	-
Up to one month	EUR	GBP	1,213	(996)	7	-
Up to one month	EUR	SEK	130	(1,151)	1	-
Up to one month	GBP	AUD	91,745	(158,735)	3,561	-
Up to one month	GBP	EUR	276,936	(328,858)	5,048	-
Up to one month	GBP	USD	42,589	(69,328)	1,002	-
Up to one month	USD	EUR	8,071	(5,974)	-	(97)
Up to one month	USD	GBP	5,835	(3,543)	-	(43)
Up to one month	USD	JPY	424	(43,287)	2	-
Up to one month	USD	MXN	11,557	(152,484)	-	(70)
One to six months	USD	AUD	2,300	(2,615)	-	(58)
One to six months	USD	CHF	18,845	(16,410)	133	-
					9,977	(268)
Net forward currency contracts at 31 March 2014						9,709

Prior year comparative

Open forward currency contracts at 31 March 2013	3,262	(20,844)
Net forward currency contracts at 31 March 2013		(17,582)

The above table summarises the contracts held by maturity date, all contracts are traded on an over the counter basis.

In order to maintain appropriate diversification of investments in the portfolio and take advantage of wider opportunities, the Lothian Pension Fund invests over half of the fund in overseas markets. A currency hedging programme, using forward foreign exchange contracts, has been put in place to reduce the extent to which the Fund is exposed to currency movements. In addition, the Fund's bond manager uses forward foreign exchange contracts to add value to the Fund.

12c Investment managers and mandates

Manager	Mandate	Market value at 31 March 2013 £000	Percent of total 31 March 2013 %	Market value at 31 March 2014 £000	Percent of total 31 March 2014 %
In-house	UK all cap equities	525,587	13.0	100,415	2.3
In-house	UK mid cap equities	80,201	2.0	100,553	2.3
Total UK equities		605,788	15.0	200,968	4.6
In-house	European ex UK equities	256,315	6.4	98,404	2.3
In-house	US equities	296,993	7.3	98,265	2.3
Baillie Gifford	Pacific equities	318,547	7.8	152,847	3.5
Invesco	Pacific equities	137,155	3.4	140,806	3.2
Mondrian	Emerging markets	111,524	2.7	92,455	2.1
UBS	Emerging markets	107,612	2.6	91,186	2.1
Total regional overseas equities		1,228,146	30.2	673,963	15.5
In-house	Global high div equities	202,357	5.0	642,862	14.8
In-house	Global low vol equities	-	-	744,406	17.1
Cantillon	Global equities	220,072	5.4	238,423	5.5
Lazard	Global equities	261,099	6.4	-	-
Harris	Global equities	153,319	3.8	175,955	4.1
Nordea	Global equities	-	-	163,920	3.8
Total global equities		836,847	20.6	1,965,566	45.3
AG Bisset	Currency hedge	(19,098)	(0.5)	-	-
In-house	Currency hedge	-	-	8,771	0.2
Total currency overlay		(19,098)	(0.5)	8,771	0.2
Total listed equities		2,651,683	65.3	2,849,268	65.6
In-house	Private equity unq'ted	200,947	4.9	190,787	4.4
In-house	Private equity quoted	47,327	1.2	51,480	1.2
Total private equity		248,274	6.1	242,267	5.6
Total equities		2,899,957	71.4	3,091,535	71.2

Investment managers and mandates (cont'd)

Manager	Mandate	Market value at 31 March 2013 £000	Percent of total 31 March 2013 %	Market value at 31 March 2014 £000	Percent of total 31 March 2014 %
In-house	Index linked gilts	145,181	3.6	152,699	3.5
In-house	Gold	21,039	0.5	15,412	0.4
Total inflation linked bonds and gold		166,220	4.1	168,111	3.9
In-house	Property	72,418	1.8	59,218	1.4
Standard Life	Property	289,511	7.1	322,037	7.4
Total property		361,929	8.9	381,255	8.8
In-house	Infrastructure unq'ted	200,486	4.9	251,116	5.8
In-house	Infrastructure quoted	27,219	0.7	25,531	0.6
In-house	Timber	50,621	1.2	51,666	1.2
Total other real assets		278,326	6.8	328,313	7.6
In-house	Secured loans	21,825	0.5	17,520	0.4
Rogge	Corporate bonds	189,578	4.7	184,569	4.2
Total other bonds		211,403	5.2	202,089	4.6
In-house	Cash	143,935	3.6	171,892	3.9
In-house	Transition	126	-	115	-
Total cash and sundries		144,061	3.6	172,007	3.9
Net financial assets		4,061,896	100.0	4,343,310	100.0

12d Investments representing more than 5% of the net assets of the Fund or 5% of any investment class

	Market value at 31 March 2013 £000	Percent of class 31 March 2013 %	Market value at 31 March 2014 £000	Percent of class 31 March 2014 %
Fixed interest				
UK Gov 1.125% Index Linked 22/11/37	-	-	19,450	6.1
Pooled funds				
Stafford Elm Inc	38,482	6.6	35,169	5.9
Macquarie European Infrastructure Fund	33,134	5.7	33,204	5.5
RREEF Pan European Infrastructure Fund	31,477	5.4	30,638	5.1
Carlyle Europe Real Estate III LP	30,437	5.2	21,024	3.5
Property				
London, 119-125 Wardour St	16,500	6.6	20,800	7.7
Martlesham Heath, Retail Park	19,050	7.6	20,500	7.6
Sheffield, Bochum Parkway	15,175	6.0	18,250	6.7
London, 100 St John Street	14,000	5.6	16,450	6.1
Exeter, David Lloyd Leisure	14,150	5.6	14,850	5.5
Exeter, Bishops Court	14,250	5.7	14,675	5.4

Over the last two years no single investment represented more than 5% of the net assets of the Fund.

12e Securities lending

During the year Lothian Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2014, £120.9m (2013 £112.3m) of securities were released to third parties. Collateral valued at 107.4% (2013 107.2%) of the market value of the securities on loan was held at that date.

12f Property holdings

	2012/13 £000	2013/14 £000
Opening balance	246,915	251,480
Additions	27,216	9,160
Disposals	(20,215)	(15,822)
Net change in market value	(2,436)	25,935
Closing balance	251,480	270,753

As at 31 March 2014, there were no restrictions on the realisability of the property or the remittance of income or sale proceeds. The Fund is not under any contractual obligations to purchase, construct or develop any of these properties. However, the Fund does have the responsibility of repairs and maintenance on any properties that are unlet.

13 Financial Instruments

13a Classification of financial instruments

Accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the fair value amounts of financial assets and liabilities by category and net assets statement heading. No financial assets were reclassified during the accounting period.

All financial instruments are marked to market (at fair value) in the Fund's accounting records hence there is no difference between the carrying value and fair value.

	31 March 2013			31 March 2014		
Financial assets	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000
Investment assets						
Fixed interest	326,829			318,215		
Equities	2,718,320			2,866,444		
Pooled investments	582,535			598,687		
Property leases	11,544			10,706		
Derivative contracts	4,329			10,281		
Margin balances		1,769			894	
Cash		187,608			257,749	
Other balances		14,068			26,620	
	3,643,557	203,445	-	3,804,333	285,263	-
Other assets						
City of Edinburgh Council		4,355			4,950	
Cash		34,616			31,734	
Debtors		10,299			14,155	
	-	49,270	-	-	50,839	-
Assets total	3,643,557	252,715	-	3,804,333	336,102	-

	31 March 2013 Designated as fair value through fund account £000	31 March 2013 Loans and receivables £000	31 March 2013 Financial liabilities at amortised cost £000	31 March 2014 Designated as fair value through fund account £000	31 March 2014 Loans and receivables £000	31 March 2014 Financial liabilities at amortised cost £000
Financial liabilities						
Investment liabilities						
Derivative contracts	(21,466)			(359)		
Other investment balances	(3,576)			(5,974)		
	(25,042)	-	-	(6,333)	-	-
Other liabilities						
Creditors			(16,664)			(17,010)
Liabilities total	(25,042)	-	(16,664)	(6,333)	-	(17,010)
Net assets total	3,618,515	252,715	(16,664)	3,798,000	336,102	(17,010)
Total net financial instruments			3,854,566			4,117,092
Amounts not classified as financial instruments			240,093			260,444
Total net assets			4,094,659			4,377,536

13b Net gains and losses on financial instruments

	2012/13 £000	2013/14 £000
Designated as fair value through fund account	432,648	153,378
Loans and receivables	1,567	(7,707)
Financial liabilities at amortised cost	-	-
Total	434,215	145,671
Gains and losses on directly held freehold property	(2,340)	25,769
Change in market value of investments per fund account	431,875	171,440

The valuation of financial instruments has been classified into three levels, according to the quality and reliability of information used to determine fair values.

Level 1

Financial instruments at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise quoted equities and unit trusts.

Quoted investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

Level 2

Financial instruments at Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3
Financial instruments at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include unquoted equity investments, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

The values of the investments in unquoted private equity, infrastructure, timber and European real estate are based on valuations provided by the general partners to the funds in which the Fund has invested.

These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of International Financial Reporting Standards (IFRS). The valuations are usually undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

The following table provides an analysis of the financial assets and liabilities of the Fund grouped into Levels 1 to 3, based on the level at which the fair value is observable.

	31 March 2014			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Designated as fair value through fund account	2,922,624	318,215	563,494	3,804,333
Loans and receivables	336,102			336,102
Total financial assets	3,258,726	318,215	563,494	4,140,435
Financial liabilities				
Designated as fair value through fund account	(6,333)			(6,333)
Financial liabilities at amortised cost	(17,010)			(17,010)
Total financial liabilities	(23,343)	-	-	(23,343)
Net financial assets	3,235,383	318,215	563,494	4,117,092

	31 March 2013			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Designated as fair value through fund account	2,768,341	327,913	547,303	3,643,557
Loans and Receivables	252,715			252,715
Total financial assets	3,021,056	327,913	547,303	3,896,272
Financial liabilities				
Designated as fair value through fund account	(25,042)			(25,042)
Financial Liabilities at amortised cost	(16,664)			(16,664)
Total financial liabilities	(41,706)	-	-	(41,706)
Net financial assets	2,979,350	327,913	547,303	3,854,566

14 Nature and extent of risk arising from financial instruments

Risk and risk management

The Fund's primary aim is to ensure that all members and their dependants receive their benefits when they become payable. The investment strategy aims to maximise the returns from investments within reasonable risk parameters and hence minimise the long-term cost to employers. The Fund achieves this by investing in a diverse range of assets to reduce risk to an acceptable level.

In addition, the Fund ensures that sufficient cash is available to meet all liabilities when they are due to be paid.

Responsibility for the Fund's overall investment strategy rests with the Pensions Committee. The Investment Strategy Panel and the internal investment team monitor investment risks on a regular basis. Investment risk management tools are used to identify and analyse risks faced by the Fund's investments.

Consideration of the Fund's investment risk is part of the overall risk management of the pensions operations. Risks are reviewed regularly to reflect changes in activity and market conditions.

Types of investment risk

There are various ways of considering investment risks for pension funds. For the purposes of this note, market risk is the potential for an investor to experience losses from falls in the prices of investments. All financial instruments, including cash deposits, present a risk of loss of capital and risks vary depending on different asset classes.

Market risk also changes over time as economic conditions and investor sentiment change. The Fund considers overall fluctuations in prices arising from a variety of sources: market risk, foreign exchange risk, interest rate risk, credit risk, etc. The different risks may, to some extent, offset each other.

The overall market risk of the Fund depends on the actual mix of assets and encompasses all the different elements of risk.

The Fund manages these risks in a number of ways:

- assessing and establishing acceptable levels of market risk when setting overall investment strategy. Importantly, risk is considered relative to the liabilities of the Fund

- diversification of investments in terms of type of asset, investment styles, investment managers, geographical and industry sectors as well as individual securities

- taking stewardship responsibilities seriously and pursuing constructive engagement with the companies in which we invest

- monitoring market risk and market conditions to ensure risk remains within tolerable levels

- using equity futures contracts from time to time to manage market risk. Exchange traded options are not used by the Fund.

Sensitivity analysis

Asset prices have a tendency to fluctuate. The degree of such fluctuation is known as "volatility" and it differs by asset class. The table sets out the long-term volatility assumptions used in the Fund's asset-liability modelling undertaken by the Fund's investment adviser KPMG:

Asset type	Potential price movement (+ or -)
Equities - Developed Markets	20.0%
Equities - Emerging Markets	30.0%
Private Equity	30.0%
Timber and Gold	30.0%
Secured Loans	10.0%
Corporate Bonds	11.0%
Fixed Interest Gilts	10.5%
Index-Linked Gilts	8.5%
Infrastructure	8.0%
Property	13.0%
Cash	1.5%

Volatility is the standard deviation of annual returns. Broadly speaking, in two years out of three, the asset's change in value (which could be a gain or a loss) is expected to be lower than the volatility figure, but in one year out of three, the change in value is expected to be higher than the volatility figure.

Asset classes do not always move in line with each other. The extent to which assets move together is known as their "correlation". A lower correlation means that there is less risk of assets losing value at the same time.

The overall Fund benefits from "diversification " because it invests in different asset classes, which don't all move in line with each other. Consequently, the aggregate risk at the Fund level is less than the total risk from all the individual assets in which the Fund invests. The following table shows the risks at the asset class level and the overall Fund level, with and without allowance for correlation.

Asset type	Value at 31 March 2014 £m	% of fund %	Change + / - %	Value on increase £m	Value on decrease £m
Equities - Developed Markets	2,656	61.2	20.0	3,187	2,125
Equities - Emerging Markets	183	4.2	30.0	238	128
Private Equity	242	5.6	30.0	315	169
Timber and Gold	67	1.5	30.0	87	47
Secured Loans	18	0.4	10.0	20	16
Corporate Bonds	182	4.2	11.0	202	162
Fixed Interest Gilts	3	0.1	10.5	3	3
Index-Linked Gilts	153	3.5	8.5	166	140
Infrastructure	277	6.4	8.0	299	255
Property	381	8.8	13.0	431	331
Cash and forward foreign exchange	181	4.1	1.5	184	178
Total [1]	4,343	100.0	18.2	5,132	3,554
Total [2]			15.6	5,021	3,665
Total [3]			15.0	4,994	3,692

[1] No allowance for correlations between assets
[2] Including allowance for correlations between assets
[3] Including allowance for correlation between assets and liabilities.

The value on increase/decrease columns illustrates the monetary effect of the percentage change in the volatility column. The actual annual change in value is expected to be lower than this in two years out of three, but higher in one year out of three.

It can be seen that the risk to the overall Fund assets *[2]* is lower than the total of the risks to the individual assets.

However, because the purpose of a pension scheme is to make payments to scheme beneficiaries, the true risk of a pension scheme is not measured in absolute terms, but relative to its liabilities *[3]*. The risk is lower than the absolute asset risk, due to the impact of correlation with the discount rate used to value the liabilities.

This risk analysis incorporates volatility from market, interest rate, foreign exchange, credit, and all other sources of risk, and, importantly, makes allowance for how these risks may offset each other.

Credit risk

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit risk in their pricing and consequently the risk of loss is implicitly provided for in the value of the Fund's assets and liabilities (as outlined in Market Risk above).
In essence, the Fund's entire investment portfolio is exposed to some sort of credit risk. However, through the selection of counterparties, brokers and financial institutions the Fund reduces the credit risk that may occur through the failure to settle a transaction in a timely manner.

Cash deposits, derivatives and securities lending are the major areas of credit exposure where credit risk is not reflected in market prices.

Cash deposits
At 31 March 2014, cash deposits represented £289.5m, 6.6% of total net assets. This was held with the following institutions:

	Moody's Credit Rating 31 March 2014	Balances at 31 March 2013 £000	Balances at 31 March 2014 £000
Held for investment purposes			
Northern Trust Global Investment Limited - liquidity funds	*Aaa*	75,949	45,480
Northern Trust Company - cash deposits	*A1*	17,758	80,765
The City of Edinburgh Council - treasury management	*See below*	93,901	131,504
Total investment cash		187,608	257,749
Held for other purposes			
The City of Edinburgh Council - treasury management	*See below*	34,616	31,734
Total cash		222,224	289,483

The majority of Sterling cash deposits of the Fund are managed along with those of the administering authority (the City of Edinburgh Council) and other related organisations which are pooled for investment purposes as a treasury cash fund. Management of the cash fund is on a low risk basis, with security of the investments the key consideration. The Council has in place counterparty criteria.

The Fund's cash holding at the year end under its treasury management arrangements was held with the following institutions:

Money market funds	Moody's Credit Rating 31 March 2014	Balances at 31 March 2013 £000	Balances at 31 March 2014 £000
Deutsche Bank AG, London	*Aaa*	13,961	21,502
Goldman Sachs	*Aaa*	13,290	12,037
Bank call accounts			
Bank of Scotland	*A2*	12,714	14,852
Royal Bank of Scotland	*Baa1*	7,088	5,600
Santander UK	*A2*	21	15,363
Barclays Bank	*A2*	12,531	14,983
Svenska Handelsbanken	*Aaa3*	18,117	23,089
Clydesdale Bank	*Baa2*	12,502	-
HSBC Bank	*Aa3*	-	22,274
Bank certificates of deposit			
Standard Chartered	*A1*	4,900	-
Floating rate note			
Rabobank	*Aa2*	4,910	-
Building society fixed term deposits			
Nationwide Building Society	*A2*	4,893	7,431
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	*n/a*	23,590	18,679
UK Government Treasury Bills	*Aa1*	-	7,428
		128,517	163,238

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2014 would have been 'Aa1'). Of the £18.7m on deposit with local authorities, £11.6m is with a local authority which has a 'Aa2' credit rating from Moody's.

No breaches of the Council's counterparty criteria occurred during the reporting period and the Fund does not expect any losses from non-performance by any of its counterparties in relation to deposits.

Securities lending

The Fund participates in a securities lending programme as described above. The Fund is potentially exposed to credit risk in the event of the borrower of securities defaults. This risk is mitigated by the contractual commitment that borrowers provide collateral in excess of 100% of the value of the securities borrowed. In addition, Northern Trust has signed an agreement requiring it to make good any losses arising from the lending programme.

Derivatives

The Fund transacts foreign currency derivatives over-the-counter and hence is exposed to credit risk in the event of a counterparty defaulting on the net payment or receipt that remains outstanding. This risk is minimised by the use of counterparties that are recognised financial intermediaries with acceptable credit ratings and by netting agreements. At 31 March 2014, the Fund was due £10.0m and owed £0.3m on over-the-counter foreign currency derivatives.

The Fund also transacts in futures which are traded on exchanges. The risk of default is minimal due the collateralisation of the contracts and the exchange having in place controls to cover defaulting counterparties. At 31 March 2014, the Fund was due £304k (£213k net of liabilities) from futures.

Liquidity risk

Liquidity risk reflects the risk that the Fund will not be able to meet its financial obligations as they fall due. The Fund therefore ensures that there is adequate cash and liquid resources to meet its commitments. Cash flow projections are prepared on a regular basis to understand and manage the timing of the Fund's cash flows.

The majority (estimated to be approximately 78%) of the Fund's investments could be converted to cash within three months in a normal trading environment.

Refinancing risk

Refinancing risk is the risk that the Fund will be bound to replenish a significant proportion of its pension fund financial instruments at a time of unfavourable interest rates. The Fund is not bound by any obligation to replenish its investments and hence is not exposed to refinancing risk.

15 Actuarial statement

The Scheme Actuary has provided a statement describing the funding arrangements of the Fund. This can be found at the end of this section.

16 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £5,483m (2013 £4,946m). This figure is used for statutory accounting purposes by Lothian Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end.

The figure is only prepared for the purposes of IAS26 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

Financial assumptions	31 March 2013 % p.a.	31 March 2014 % p.a.
Inflation / pensions increase rate	2.8	2.8
Salary increase rate*	5.1	5.1
Discount rate	4.5	4.3

*Salary increases were estimated at 1% p.a. nominal until 31 March 2015 reverting to the long term rate thereafter.

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements from 2008 in line with Medium Cohort and a 1% p.a. underpin. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	Males	Females
Current pensioners	20.4	22.8
Future pensioners (assumed to be currently 45 as at 31 March 2011)	22.6	25.4

This assumption is the same as that adopted as at 31 March 2012.

Commutation assumption

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

17 Debtors

	31 March 2013 £000	31 March 2014 £000
Contributions due - employers	7,676	8,773
Contributions due - members	1,976	1,900
Benefits paid in advance or recoverable	155	16
Pensions paid on behalf of employers	16	2,869
Sundry debtors	361	325
VAT	13	-
Prepayments	102	272
	10,299	14,155

Analysis of debtors

	31 March 2013 £000	31 March 2014 £000
Administering Authority	277	1,993
Other Scheduled Bodies	7,512	9,624
Community Admission Bodies	2,131	2,003
Transferee Admission Bodies	24	99
Other Local Authorities	7	9
Central Government Bodies	13	-
Other entities and individuals	335	427
	10,299	14,155

18 Creditors

	31 March 2013 £000	31 March 2014 £000
Benefits payable	3,919	4,662
VAT and State Scheme premiums	52	1,331
Contributions in advance	10,027	8,275
Miscellaneous creditors and accrued expenses	2,666	2,698
Office - operating lease	-	44
	16,664	17,010

Analysis of creditors

	31 March 2013 £000	31 March 2014 £000
Other Scheduled Bodies	9,952	8,237
Community Admission Bodies	75	38
Central Government Bodies	52	1,331
Other entities and individuals	6,585	7,404
	16,664	17,010

19 Additional Voluntary Contributions

Active members of the Lothian Pension Fund and the Lothian Buses Pension Fund have the option to pay additional voluntary contributions (AVCs). These AVCs are invested separately from the main funds, securing additional benefits on a money purchase basis for those members that have elected to contribute. The investment of the AVCs is managed by Standard Life and Prudential.

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

Contributions during year	2012/13 £000	2013/14 £000
Standard Life	395	450
Prudential	1,120	1,271
	1,515	1,721

Value at year end	31 March 2013 £000	31 March 2014 £000
Standard Life	5,968	6,253
Prudential	1,572	2,237
	7,540	8,490

20 Related party transactions

The City of Edinburgh Council

The Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund are administered by the City of Edinburgh Council. Consequently there is a strong relationship between the Council and the Pension Funds.

The Investment and Pensions Division of the Council is responsible for administering the three Pension Funds. The Division receives an allocation of the overheads of the Council, based on the amount of central services consumed. This included the pension payroll service provided by the Council for part of 2013/14. In turn, the Division allocates its costs to the three Pension Funds. Costs directly attributable to a specific Fund are charged to the relevant Fund; costs that are common to all three Funds are allocated on a defined basis.

The Council is also the single largest employer of members of the Fund and contributed £56.5m to the Fund during the year (2013 £56.4m).

Transactions between the Council and the Fund are managed via a holding account. Each month the Fund is paid a cash sum leaving a working balance in the account to cover the month's pension payroll costs and other expected costs.

Year end balance on holding account	31 March 2013 £000	31 March 2014 £000
	4,355	4,950

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2014, the fund had an average investment balance of £115.2m (2013 £93.5m). Interest earned was £603.7k (2013 £621.9k).

Year end balance on treasury management account	31 March 2013 £000	31 March 2014 £000
Held for investment purposes	93,901	131,504
Held for other purposes	34,616	31,734
	128,517	163,238

Office accommodation- 144 Morrison Street, Edinburgh

Investment and Pensions Division of the Council has entered into an internal agreement with the Council for the provision of office accommodation at 144 Morrison Street in Edinburgh. The terms of the agreement are equivalent to those that would have been obtained had the accommodation been let on a commercial basis. In the accounts of the Fund the arrangement has been treated as a operational lease. The agreement was effective from November 2013. The Investment and Pensions Division is committed to making the following future payments.

	31 March 2013 £000	31 March 2014 £000
Within one year	-	-
Between one and five years	-	157
After five years	-	1,222
	-	1,379
Recognised as an expense during the year	-	33

The above expense has been allocated across the three Funds, Lothian Pension Fund's share is £30.7k.

Governance

As at 31 March 2014, all members of the Pensions Committee, with the exception of Councillor Bill Cook, were active members of the Lothian Pension Fund.

Each member of the Pensions Committee is required to declare any financial and non-financial interests they have in the items of business for consideration at each meeting, identifying the relevant agenda item and the nature of their interest.

Key management personnel

During the period from 1 April 2013 to the date of issuing of these accounts, several employees of the City of Edinburgh Council held key positions in the financial management of the Lothian Pension Fund. These employees and their financial relationship with the Fund (expressed as cash-equivalent transfer values or CETV) are set out below:

Name	Position held	Accrued CETV as at 31 March 2013 £000	Accrued CETV as at 31 March 2014 £000
Alastair Maclean*	Director of Corporate Governance	67	115
Clare Scott	Investment and Pensions Service Manager	89	126
Struan Fairbairn	Legal and Risk Development Manager	1	9
John Burns	Pensions and Accounting Manager	349	386
Esmond Hamilton	Financial Controller	101	119
Bruce Miller	Investment Manager	90	112

* Also disclosed in the financial statements of the City of Edinburgh Council.

21 Contingent liabilities and contractual commitments

The Fund has commitments relating to outstanding call payments due on unquoted funds held in the private equity, timber, property and infrastructure parts of the portfolio. The amounts 'called' by these funds are irregular in both size and timing, taking place over a period of years from the date of each original commitment. The outstanding commitments at the year end are as follows:

	31 March 2013 £000	31 March 2014 £000
Outstanding investment commitments	164,316	109,692

As disclosed in note 20 on related party transactions the Investment and Pensions Division has a commitment to make future payments equivalent to rent in respect office accommodation at 144 Morrison Street. Details of the future payments are provided in that note.

The Fund has entered into an agreement with BT for the provision IT infrastructure at the new office accommodation of the Investment and Pensions Division of the Council. At 31 March 2014 there was an outstanding contractual commitment of £31k.

22 Contingent assets

There were no contingent assets at the year end.

23 Impairment losses

During the year the Fund recognised an increase in impairment losses in respect of specific benefit over payments for which reimbursement has been requested of £22.4k. This increased the impairment to £39.9k at the year end.

24 Prior year adjustment

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, the decision has been made to change the Fund's policy on accounting for investment management expenses. This means that investment management costs that are deducted from the value of an investment are now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. The final change is to recognise the operating costs of investments in property as an expense rather than netting those cost against rental income.

As a result of the above changes the results for the year ended 31 March 2013 have been restated. The change has the effect of increasing the reported investment income by £1.203m; increasing the change in market value of investments by £15.316m and increasing investment management expenses by £16.519m. The changes are reported in the Fund Account but there is no change to the net increase in the Fund for the year ended 31 March 2013 of £514.036m. The adjustments can be summarised as follows:

	2012/13 Fund Account as restated £000	Changes made £000
Fund Account 2012/13		
Investment income	85,887	1,203
Change in market value of investments	431,875	15,316
Investment management expenses	(26,091)	(16,519)

List of active employers at 31 March 2014

Almond Housing Association Ltd	CAB	Link In	CAB
Audit Scotland	CAB	Scottish Fire and Rescue Service	SB
BAM Construction Ltd	TAB	Police Scotland	SB
Barony Housing Association Ltd	CAB	Lothian Valuation Joint Board	SB
Baxter Storey	TAB	Melville Housing Association	CAB
Broomhouse Centre Representative Council	CAB	Mental Welfare Commission for Scotland	CAB
Canongate Youth Project	CAB	Midlothian Council	SB
Capital City Partnership	CAB	Mitie PFI	TAB
Centre for Moving Image (The)	CAB	Morrison Facilities Services Ltd	TAB
Children's Hearing Scotland	CAB	Museums Galleries Scotland	CAB
Children's Hospice Association Scotland	CAB	Newbattle Abbey College	CAB
Citadel Youth Centre	CAB	North Edinburgh Dementia Care	CAB
City of Edinburgh Council (The)	SB	NSL Ltd	TAB
Compass Chartwell	TAB	Open Door Accommodation Project	CAB
Convention of Scottish Local Authorities	CAB	Penumbra	CAB
Dawn Group Ltd	TAB	Pilton Community Health Project	CAB
Dean Orphanage and Cauvin's Trust	CAB	Pilton Equalities Project	CAB
Donaldson's Trust	CAB	Pilton Youth and Children's Project	CAB
East Lothian Council	SB	Queen Margaret University	CAB
EDI Group Ltd	CAB	Queensferry Churches Care in the Com Project	CAB
Edinburgh Business School	CAB	Royal Edinburgh Military Tattoo	CAB
Edinburgh Cyrenians Trust	CAB	Royal Society of Edinburgh	CAB
Edinburgh Development Group	CAB	Scotland's Learning Partnership	CAB
Edinburgh International Festival Society	CAB	Scottish Adoption Agency	CAB
Edinburgh Leisure	CAB	Scottish Futures Trust	CAB
Edinburgh Napier University	CAB	Scottish Legal Complaints Commission	CAB
Edinburgh Woman's Rape & Sexual Abuse Centre	CAB	Scottish Mining Museum	CAB
Edinburgh World Heritage Trust	CAB	Scottish Police Services Authority	SB
Edinburgh College	SB	Scottish Water	SB
ELCAP	CAB	SESTRAN	SB
Enjoy East Lothian	CAB	Skanska UK	TAB
Family Advice and Information Resource	CAB	Scottish Rural Council (SRUC)	SB
Family and Community West Lothian Dev	CAB	Scottish Schools Education Research Centre (SSERC)	CAB
Festival City Theatres Trust	CAB		
First Step	CAB	St Andrew's Children's Society Limited	CAB
Forth and Oban Ltd	TAB	St Columba's Hospice	CAB
Forth Estuary Transport Authority	SB	Stepping Out Project	CAB
Four Square (Scotland)	CAB	Storey Baxter	TAB
Freespace Housing Association	CAB	Streetwork UK Ltd	CAB
Granton Information Centre	CAB	University of Edinburgh (Edin College of Art)	CAB
Handicabs (Lothian) Ltd	CAB	Victim Support Scotland	CAB
Hanover (Scotland) Housing Association	CAB	Visit Scotland	SB
Health in Mind	CAB	Waverley Care	CAB
Heriot-Watt University	SB	Weslo Housing Management	CAB
Homeless Action Scotland	CAB	West Granton Community Trust	CAB
Homes for Life Housing Partnership	CAB	West Lothian College	SB
HWU Students Association	CAB	West Lothian Council	SB
Improvement Service (The)	CAB	West Lothian Leisure	CAB
Into Work	CAB	Wester Hailes Land and Property	CAB
ISS UK Ltd	TAB	Young Scot Enterprise	CAB
Keymoves	CAB	Youthlink Scotland	CAB

Scheduled Bodies **SB** | Community Admitted Bodies CAB | Transferee Admitted Bodies **TAB**

Lothian Pension Fund Actuarial Statement for 2013/14

This statement has been prepared in accordance with Regulation 31A(1)(d) of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2013/14.

Description of Funding Policy

The funding policy is set out in the administering authority's Funding Strategy Statement (FSS), dated March 2012. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the overall Fund;
- to minimise the degree of short-term change in employer contribution rates;
- maximise the returns from investments within reasonable and considered risk parameters, and hence minimise the cost to the employer;
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment;
- to help employers manage their pension liabilities;
- where practical and cost effective, to make allowance for the different characteristics of different employers and groups of employers.
  The FSS sets out how the administering authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2011. This valuation revealed that the Fund's assets, which at 31 March 2011 were valued at £3,477 million, were sufficient to meet 96% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2011 valuation was £142 million.

Individual employers' contributions for the period 1 April 2012 to 31 March 2015 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in my valuation report dated 15 February 2012.

Method

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

Assumptions

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

The key financial assumptions adopted for the 2011 valuation were as follows:

Financial assumptions	31 March 2011	
	% p.a. Nominal	% p.a. Real
Discount rate	5.8%	2.9%
Pay increases *	5.1%	2.2%
Price inflation/Pension increases	2.8%	-

* plus an allowance for promotional pay increases. Short term pay growth was assumed to be 1% p.a. for 2011/12 and 2012/13, reverting to 5.1% p.a. thereafter.

The key demographic assumption was the allowance made for longevity. As a member of Club Vita, the baseline longevity assumptions adopted at this valuation were a bespoke set of VitaCurves that were specifically tailored to fit the membership profile of the Fund. Longevity improvements were in line with standard year of birth mortality tables; with medium cohort projections and a 1% p.a. underpin effective from 2008. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	20.4 years	22.8 years
Future Pensioners	22.6 years	25.4 years

Copies of the 2011 valuation report and Funding Strategy Statement are available on request from the City of Edinburgh Council, Administering Authority to the Fund.

Experience over the period since April 2011

Experience has been poorer than expected since the 2011 valuation (excluding the effect of any membership movements). Real bond yields have fallen considerably, leading to an increase in liabilities. This has been partially offset by stronger than expected asset returns meaning that the funding level is likely to have fallen since the 2011 valuation.

The next actuarial valuation will be carried out as at 31 March 2014. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP

19 May 2014
Hymans Robertson LLP
20 Waterloo Street Glasgow G2 6DB

Lothian Buses Pension Fund

Membership records

Status	Membership at 31/03/2012	Membership at 31/03/2013	Membership at 31/03/2014
Active	1,407	1,335	1,268
Deferred	1,179	1,163	1,146
Pensioners	1,122	1,163	1,191
Dependants	303	310	320
Total	4,011	3,971	3,925

Funding

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the Fund in accordance with the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008. These contributions are payable at a certain rate for a band of earnings. For the year ended 31 March 2014 the contribution rates were as follows:

Full time equivalent pensionable pay (rate of pay on 31/3/2014)	Rate
Less than £20,382	5.5%
Between £20,383 and £26,489	Between 5.6% and 6.0%
Between £26,490 and £33,254	Between 6.1% and 6.5%
Between £33,255 and £46,876	Between 6.6% and 7.5%
Between £46,877 and £52,810	Between 7.6% and 8.0%
Between £52,811 and £70,711	Between 8.1% and 9.0%
Between £70,712 and £106,974	Between 9.1% and 10.0%
Between £106,975 and £245,412	Between 10.1% and 11.2%

Employers' contributions are set at the triennial actuarial valuation. The contribution rates for the year ended 31 March 2014 were based on the actuarial valuation at 31 March 2011. For the nine months to 31 December 2013 the rate was 19.9% of pensionable pay and 20.5% for the three months to 31 March 2014 for service currently being accrued.

At the last valuation in 2011, the funding level on an ongoing basis was calculated by the Fund's actuary to be 112%. At 31 March 2013, the actuary provided an updated estimate of 103%. As the Fund is closed to new members and the liabilities are expected to mature further over time, the funding basis will be reviewed during the 2014 actuarial valuation.

On the more prudent 'gilts basis', the funding levels were 87% and 80% at 31 March 2011 and 31 March 2013 respectively. More information on funding can be found in the Actuarial Statement for 2013/14.

Work has commenced on the triennial actuarial valuation at 31 March 2014.

Investment strategy

The Pensions Committee approved the Investment Strategy 2012-17 for Lothian Buses Pension Fund in October 2012. The general thrust of the strategy is to reduce the Fund's investment risk in the long term by focusing on capital preservation, durable investment income generation and a reduction in the absolute volatility of the Fund.

The investment strategy is set at the broad asset class level of Equities, Index-Linked gilts and Alternatives, which are the key determinants of investment risk and return. The Equities category includes listed and unlisted equities; Index-Linked Assets includes index-linked gilts; Alternatives include property, infrastructure, timber and fixed income assets, such as corporate bonds.The long term strategy for 2012-17 is set out in the table below along with the current interim strategy allocation and the asset allocation limits under normal financial conditions.

	Interim benchmark at 31 March 2014 %	Strategy for 2012 - 2017 %	Asset allocation limits minimum – maximum %
Equities	62.5	55.0	45 – 65
Index linked gilts	10.0	15.0	10 - 30
Alternatives	27.5	30.0	10 – 35
Cash	-	-	0 - 10
Total	100.0	100.0	

Investment performance

The objectives of the Fund were redefined in December 2012 and are:

- over long-term economic cycles (typically 5 years or more) the achievement of the same return as that generated by the strategic allocation
- over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

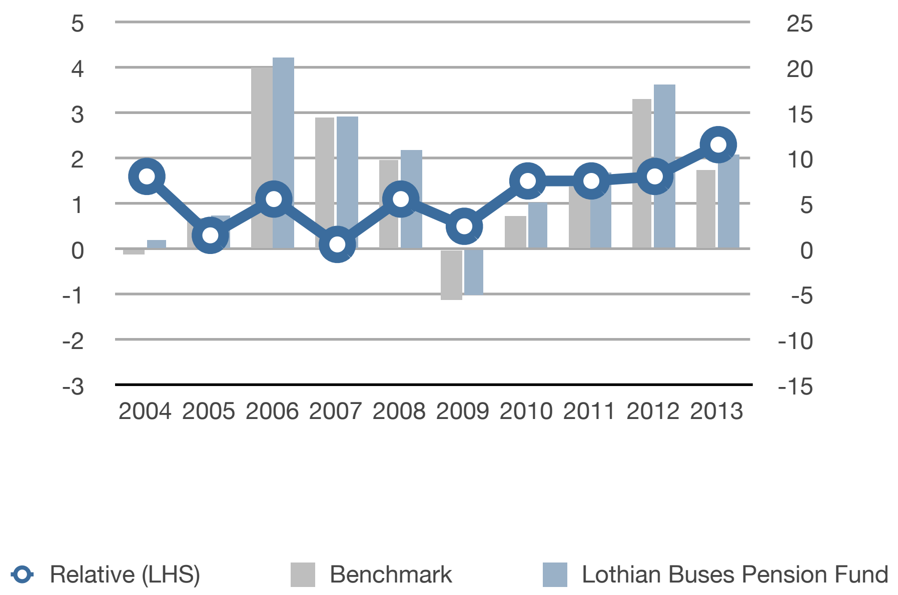
The Fund is gradually implementing the strategy and will continue to do so over the next few years. It is dependent on finding attractive assets in the Alternatives category to provide the desired diversification and an adequate return.

Annualised returns to 31 March 2014 (% per year)

	1 Year	3 Years	10 Years
Lothian Buses Pension Fund	8.9	10.0	9.9
Benchmark	5.1	7.7	8.4
Retail Price Index (RPI)	2.5	3.1	3.3
Consumer Price Index (CPI)	1.7	2.6	2.8
National Average Earnings	1.5	0.9	2.7

The absolute performance of Lothian Buses Pension Fund over the 12 month period was +8.9% and 3 year performance was +10.0% per annum. Over 10 years, the Fund returned +9.9% per annum, well ahead of measures of inflation and national average earnings.

Annualised 3 yearly returns ending 31 March (% per year)



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Fund	3.7	21.1	14.6	10.9	(5.1)	5.1	8.4	18.1	10.4	10.0
Benchmark	3.4	20	14.5	9.8	(5.6)	3.6	6.9	16.5	8.7	7.7
Relative	0.3	1.1	0.1	1.1	0.5	1.5	1.5	1.6	2.3	2.3

Lothian Buses Pension Fund

Fund Account for year ended 31 March 2014

2012/13 Restated* £000		Note	2013/14 £000
	Income		
7,147	Contributions from employer	2	7,126
2,261	Contributions from members		2,222
-	Transfers from other schemes		-
9,408			9,348
	Less: expenditure		
7,015	Pension payments including increases		7,358
2,136	Lump sum retirement payments		1,819
237	Lump sum death benefits		213
114	Transfers to other schemes	3	218
110	Administrative expenses	4	110
9,612			9,718
(204)	**Net (withdrawals) / additions from dealing with members**		(370)
	Returns on investments		
5,913	Investment income	5	6,156
36,459	Change in market value of investments	7a, 8b	22,411
(1,706)	Investment management expenses	6	(2,982)
40,666	**Net returns on investments**		25,585
40,462	**Net increase in the Fund during the year**		25,215
271,448	Net assets of the Fund at 1 April 2013		311,910
311,910	**Net assets of the Fund at 31 March 2014**	8a, 8c	337,125

*The results for the year ended 31 March 2013 have been restated to reflect a change in the accounting policy on investment management expenses. This change has the effect of increasing the reported change in market value of investment by £659k and increasing investment management expenses by £659k. There is no change in the net returns on investment. See note 19 for details.

Lothian Buses Pension Fund Net Assets Statement as at 31 March 2014

31 March 2013 £000		Note	31 March 2014 £000
	Investments		
309,255	Assets		337,279
(490)	Liabilities		(1,934)
308,765		*7, 9*	335,345
	Current assets		
459	The City of Edinburgh Council	*15*	422
1,913	Cash balances	*9, 15*	1,523
894	Debtors	*12*	912
3,266			2,857
	Current liabilities		
(121)	Creditors	*13*	(1,077)
3,145	**Net current assets**		1,780
311,910	**Net assets of the Fund at 31 March 2014**	*8a, 8c*	337,125

JOHN BURNS FCMA CGMA
Pensions and Accounting Manager
June 2014

Notes to the net asset statement

The financial statements summarise the transactions of the Fund during the year and its net assets at the year end. They do not take account of the obligations to pay pensions and benefits which fall due after the end of the year. The actuarial position of the Fund, which does take account of such obligations, is discussed in the Actuarial Valuation section of this report and these financial statements should be read in conjunction with that information. In addition, as required by IAS26, the Actuarial Present Value of Promised Retirement Benefits is disclosed in the notes to these financial statements.

Notes to the Accounts

1 Events after the balance sheet date

There have been no events since 31 March 2014, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

2 Contributions from employer

	2012/13 £000	2013/14 £000
Lothian Buses Plc		
Normal (ongoing contributions)	7,147	7,126
Deficit funding	-	-
Pension strain	-	-
Total	7,147	7,126

The Lothian Buses Pension Fund is a single employer pension fund for employees of Lothian Buses Plc. The Lothian Buses Fund was set up in 1986 under the Local Government Superannuation (Funds) (Scotland) regulations 1986 (SSI 115/1986).

From 2012/13 onwards, no deficit funding was required (as stated in the actuarial valuation of 31 March 2011). For the nine months to 31 December 2013 the rate was 19.9% of pensionable pay and 20.5% for the three months to 31 March 2014 for service currently being accrued.

Where the employer makes certain decisions which result in additional benefits being paid out to a member, or benefits being paid early, this results in a "strain" on the Fund. The resulting pension strain costs are calculated and recharged in full to the employer. There were no strain costs during 2013/14.

3 Transfers out to other pension schemes

	2012/13 £000	2013/14 £000
Group transfers	-	-
Individual transfers	114	-
	114	-

4 Administrative expenses

	2012/13 £000	2013/14 £000
Employee costs	58	59
The City of Edinburgh Council - pension payroll costs	13	7
The City of Edinburgh Council - other support costs	16	15
System costs	10	11
Actuarial fees	7	9
External Audit fees	2	2
Legal fees	-	-
Printing and postage	2	2
Depreciation	2	3
Office costs	-	2
Sundry costs less sundry income	-	
	110	110

The Investment and Pensions Division of the Council is responsible for administering the three pension Funds. The Division receives an allocation of the overheads of the Council. In turn the Division allocates administration and investment costs to the three pension funds. Costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are allocated on a defined basis. Other costs were allocated based on the number of members of each Fund.

5	**Investment income**	2012/13 £000	2013/14 £000
	Fixed income	-	7
	Dividends from equities	4,054	4,610
	Income from pooled investment vehicles	1,802	1,451
	Interest on cash deposits	31	46
	Securities lending and sundries	96	140
		5,983	6,254
	Irrecoverable withholding tax	(70)	-98
		5,913	6,156

6	**Investment management expenses**	2012/13 £000	2013/14 £000
	External management fees - invoiced	892	2,021
	External management fees - deducted from capital	576	568
	Transaction costs	89	268
	Employee costs	51	59
	Custody fees	51	21
	Engagement and voting fees	5	5
	Performance measurement fees	3	11
	Investment consultancy fees	15	3
	System costs	10	11
	Legal fees	4	3
	The City of Edinburgh Council - other support costs	8	8
	Office costs	-	1
	Sundry costs	2	3
		1,706	2,982

Following a change in accounting policy, the expenses for 2012/13 have been restated to account for costs that were deducted from capital and therefore impacted the change in market value of investments reported in the Fund Account. The related costs are included above as external management fees deducted from capital. Investment transaction costs that were previously added to the cost of purchases or deducted from the proceeds are now accounted for as expenses and shown above as transaction costs.

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales (see note 7a - Reconciliation of movements in investments).

The external investment management fees for 2013/14 above include £1.428m in respect of performance-related fees (2012/13 £0.460m).

7 Net investment assets

	31 March 2013 £000	31 March 2014 £000
Investment assets		
Fixed interest	-	6,511
Equities	214,633	221,274
Pooled investment vehicles	80,844	87,978
Deposits	11,850	19,521
Other investment assets		
Due from broker	1,104	1,084
Dividends and other income due	824	911
	1,928	1,995
Total investment assets	309,255	337,279
Investment liabilities		
Other financial liabilities - due to broker	(490)	(1,934)
Total investment liabilities	(490)	(1,934)
Net investment assets	308,765	335,345

7a Reconciliation of movement in investments

	Market value at 1 April 2013 £000	Purchases at cost £000	Sales proceeds £000	Change in market value £000	Market value at 31 March 2014 £000
Fixed interest	-	6,414	-	97	6,511
Equities	214,633	127,533	(142,769)	21,877	221,274
Pooled investment vehicles	80,844	7,228	(934)	840	87,978
	295,477	141,175	(143,703)	22,814	315,763
Other financial assets / (liabilities)					
Cash deposits	11,850			(405)	19,521
Broker balances	614			2	(850)
Dividends due	824			-	911
	13,288			(403)	19,582
Net financial assets	308,765			22,411	335,345

	Market value at 1 April 2012 £000	Purchases at cost £000	Sales proceeds £000	Change in market value £000	Market value at 31 March 2013 £000
Equities	169,629	43,346	(27,410)	29,068	214,633
Pooled investment vehicles	93,708	5,615	(25,617)	7,138	80,844
	263,337	48,961	(53,027)	36,206	295,477
Other financial assets / (liabilities)					
Cash deposits	3,388			252	11,850
Broker balances	(245)			1	614
Dividends due	690				824
	3,833			253	13,288
Net financial assets	267,170			36,459	308,765

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.

Following a change in accounting policy, transaction costs are no longer included in the cost of purchases and sale proceeds. As a result, the figures for 2012/13 have been restated, information on transaction costs can now be found in note 6 on investment management expenses. Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

7b Analysis of investments (at market value)

	Market value at 31 March 2013 £000	Market value at 31 March 2014 £000
Fixed income		
UK index linked	-	6,511
Equities		
UK quoted	32,742	42,178
Overseas quoted	181,891	179,096
	214,633	221,274
Pooled investment vehicles		
UK		
Managed funds - property	22,931	29,327
Managed funds - index linked	23,133	23,338
Managed funds - other bonds	22,550	24,039
Infrastructure and timber	1,334	1,703
Overseas		
Infrastructure and timber	10,896	9,571
	80,844	87,978

7c Investment managers and mandates

Manager	Mandate	Market value at 31 March 2013 £000	% of total funds %	Market value at 31 March 2014 £000	% of total funds %
Baillie Gifford	Global equities	191,885	62.2	107,901	32.2
In-house	Global high div equities	15,516	5.0	107,435	32.0
In-house	Private equity quoted	6,370	2.1	3,761	1.1
Total global equities		213,771	69.3	219,097	65.3
Baillie Gifford	Index linked gilts	23,133	7.5	23,338	7.0
In-house	Index linked gilts	-	-	14,106	4.2
Total index linked gilts		23,133	7.5	37,444	11.2
Baillie Gifford	Bonds	22,550	7.3	24,039	7.2
In-house	Secured loans	1,552	0.5	1,421	0.4
Total other bonds		24,102	7.8	25,460	7.6
Standard Life	Property managed fund	22,931	7.4	29,327	8.7
In-house	Infrastructure unquoted	8,484	2.7	8,627	2.6
In-house	Infrastructure quoted	5,427	1.8	5,739	1.7
In-house	Timber	2,897	0.9	2,647	0.8
In-house	Alternatives cash	859	0.3	-	-
Total alternative investment		17,667	5.7	17,013	5.1

7c Investment managers and mandates (cont'd)

Manager	Mandate	Market value at 31 March 2013 £000	% of total funds %	Market value at 31 March 2014 £000	% of total funds %
In-house	Cash	7,161	2.3	6,886	2.1
In-house	Transition	-	-	118	-
		7,161	2.3	7,004	2.1
Net financial assets		308,765	100.0	335,345	100.0

7d Investments representing more than 5% of the net assets of the Fund

	Market value at 31 March 2013 £000	% of net assets of the Fund %	Market value at 31 March 2014 £000	% of net assets of the Fund %
Standard Life Property Fund	22,931	7.4	29,327	8.7
Baillie Gifford Inv Grade Bond Fund	22,551	7.2	24,039	7.1
Baillie Gifford Index Linked Gilt Fund	23,132	7.4	23,338	6.9

7e Investments representing more than 5% of any investment class

	Class	Market value at 31 March 2013 £000	Percent of class 31 March 2013 %	Market value at 31 March 2014 £000	Percent of class 31 March 2014 %
UK Gov 1.125%Index Linked 22/11/37	Fixed int	-	-	1,226	18.8
UK Gov 2%Index Linked 26/01/35	Fixed int	-	-	1,179	18.1
UK Gov 1.25%Index Linked 22/11/32	Fixed int	-	-	1,170	18.0
UK Gov 0.75%Index Linked 22/03/34	Fixed int	-	-	988	15.2
UK Gov 0.625%Index Linked 22/03/40	Fixed int	-	-	987	15.2
UK Gov 4.125%Index Linked 22/07/30	Fixed int	-	-	961	14.8
Standard Life Property Fund	Pooled func	22,931	28.4	29,327	33.3
Baillie Gifford Inv Grade Bond Fund	Pooled func	22,551	27.9	24,039	27.3
Baillie Gifford Index Linked Gilt Fund	Pooled func	23,132	28.6	23,338	26.5

7f Securities lending

During the year Lothian Buses Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2014, £14.1m (2013 £9.2m) of securities were released to third parties. Collateral valued at 105.2% (2013 106.8%) of the market value of the securities on loan was held at that date.

8 Financial instruments

8a Classification of financial instruments

Accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the fair value amounts of financial assets and liabilities by category and net assets statement heading. No financial assets were reclassified during the accounting period.

All financial instruments are marked to market (at fair value) in the Fund's accounting records hence there is no difference between the carrying value and fair value.

	31 March 2013			31 March 2014		
	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000
Financial assets						
Investment assets						
Fixed interest	-			6,511		
Equities	214,633			221,274		
Pooled investments	80,844			87,978		
Cash		11,850			19,521	
Other investment balances		1,928			1,995	
	295,477	13,778	-	315,763	21,516	-
Other assets						
The City of Edinburgh Council		459			422	
Cash		1,913			1,523	
Debtors		894			912	
	-	3,266	-	-	2,857	-
Assets total	295,477	17,044	-	315,763	24,373	-
Financial liabilities						
Investment liabilities						
Other investment balances	(490)			(1,934)		
	(490)	-	-	(1,934)	-	-
Other liabilities						
Creditors			(121)			(1,077)
	-	-	(121)	-	-	(1,077)
Liabilities total	(490)	-	(121)	(1,934)	-	(1,077)
Net asset total	294,987	17,044	(121)	313,829	24,373	(1,077)
Total net financial instruments			311,910			337,125

8b Net gains and losses on financial instruments

	2012/13 £000	2013/14 £000
Designated as fair value through fund account	36,206	22,814
Loans and receivables	253	(403)
Financial liabilities at amortised cost	-	-
Total	36,459	22,411

8c Valuation of financial instruments carried at fair value

The valuation of financial instruments has been classified into three levels, according to the quality and reliability of information used to determine fair values.

Level 1
Financial instruments at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise quoted equities and unit trusts. Listed investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

Level 2
Financial instruments at Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3
Financial instruments at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include unquoted equity investments, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

The values of the investments in unlisted private equity, infrastructure and timber are based on valuations provided by the general partners to the funds in which the Fund has invested. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of International Financial Reporting Standards (IFRS). The valuations are usually undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

The following table provides an analysis of the financial assets and liabilities of the Fund grouped into Levels 1 to 3, based on the level at which the fair value is observable.

	31 March 2014			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Designated as fair value through fund account	304,489		11,274	315,763
Loans and receivables	24,373			24,373
Total financial assets	328,862	-	11,274	340,136
Financial liabilities				
Designated as fair value through fund account	(1,934)			(1,934)
Financial liabilities at amortised cost	(1,077)			(1,077)
Total financial liabilities	(3,011)	-	-	(3,011)
Net financial assets	325,851	-	11,274	337,125

	31 March 2013			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Designated as fair value through fund account	283,247		12,230	295,477
Loans and receivables	17,044			17,044
Total financial assets	300,291	-	12,230	312,521
Financial liabilities				
Designated as fair value through fund account	(490)			(490)
Financial liabilities at amortised cost	(121)			(121)
Total financial liabilities	(611)	-	-	(611)
Net financial assets	299,680	-	12,230	311,910

9 Nature and extent of risk arising from financial instruments

Risk and risk management

The Fund's primary aim is to ensure that all members and their dependants receive their benefits when they become payable. The investment strategy aims to maximise the returns from investments within reasonable risk parameters and hence minimise the long-term cost to the employer. The Fund achieves this by investing in a diverse range of assets to reduce risk to an acceptable level. In addition, the Fund ensures that sufficient cash is available to meet all liabilities when they are due to be paid.

Responsibility for the Fund's overall investment strategy rests with the Pensions Committee. The Investment Strategy Panel and the internal investment team monitor investment risks on a regular basis. Investment risk management tools are used to identify and analyse risks faced by the Fund's investments. Risks are reviewed regularly to reflect changes in activity and market conditions.

Types of investment risks

There are various ways of considering investment risks for pension funds. For the purposes of this note, market risk is the potential for an investor to experience losses from falls in the prices of investments. All financial instruments, including cash deposits, present a risk of loss of capital and risks vary depending on different asset classes.

Investment risk also changes over time as economic conditions and investor sentiment change. The Fund considers overall fluctuations in prices arising from a variety of sources: market risk, foreign exchange risk, interest rate risk, credit risk, etc. The different risks may, to some extent, offset each other.

The overall investment risk of the Fund depends on the actual mix of assets and encompasses all the different elements of risk.

The Fund manages these risks in a number of ways:

- assessing and establishing acceptable levels of market risk when setting overall investment strategy. Importantly, risk is considered relative to the liabilities of the Fund
- diversification of investments in terms of type of asset, investment styles, investment managers, geographical and industry sectors as well as individual securities
- taking stewardship responsibilities seriously and pursuing constructive engagement with the companies in which the Fund invests
- monitoring market risk and market conditions to ensure risk remains within tolerable levels.

The Fund may use equity futures contracts from time to time to manage market risk. Exchange traded options are not used by the Fund.

Sensitivity analysis

Asset prices have a tendency to fluctuate. The degree of such fluctuation is known as "volatility" and it differs by asset class. The table below sets out the long-term volatility assumptions used in the Fund's asset-liability modelling undertaken by the Fund's investment adviser KPMG:

Asset type	Potential price movement (+ or -)
Equities - developed markets	20.0%
Private equity	30.0%
Timber	30.0%
Secured loans	10.0%
Corporate bonds	11.0%
Index-linked gilts	8.5%
Infrastructure	8.0%
Property	13.0%
Cash	1.5%

Volatility is the standard deviation of annual returns. Broadly speaking, in two years out of three, the asset's change in value (which could be a gain or a loss) is expected to be lower than the volatility figure, but in one year out of three, the change in value is expected to be higher than the volatility figure.

Asset classes do not always move in line with each other. The extent to which assets move together is known as their "correlation". A lower correlation means that there is less risk of assets losing value at the same time. The overall Fund benefits from "diversification " because it invests in different asset classes, which don't all move in line with each other. Consequently, the aggregate risk at the Fund level is less than the total risk from all the individual assets in which the Fund invests. The following table shows the risks at the asset class level and the overall Fund level, with and without allowance for correlation.

Asset type	Value at 31 March 2014	% of fund	Potential Change + / -	Value on increase	Value on decrease
	£000	%	%	£000	£000
Equities - developed markets	215,335	64.2	20.0	258,402	172,268
Private equity	3,761	1.1	30.0	4,889	2,633
Timber	2,647	0.8	30.0	3,441	1,853
Secured loans	1,421	0.4	10.0	1,563	1,279
Corporate bonds	24,039	7.2	11.0	26,683	21,395
Index-linked gilts	37,444	11.2	8.5	40,627	34,261
Infrastructure	14,366	4.3	8.0	15,515	13,217
Property	29,327	8.7	13.0	33,140	25,514
Cash	7,005	2.1	1.5	7,110	6,900
Total [1]	335,345	100.0	16.7	391,370	279,320
Total [2]			14.4	383,635	287,055
Total [3]			13.6	380,952	289,738

[1] No allowance for correlations between assets
[2] Including allowance correlations for between assets
[3] Including allowance for correlation between assets and liabilities.

The value on increase/decrease columns illustrate the effect of the volatility. The actual annual change in value is expected to be lower than this in two years out of three, but higher in one year out of three.

It can be seen that the risk to the overall Fund *[2]* assets is lower than the total of the risks to the individual assets*[1]*.

However, because the purpose of a pension scheme is to make payments to scheme beneficiaries, the true risk of a pension scheme is not measured in absolute terms, but relative to its liabilities*[3]*. The risk is lower than the absolute asset risk, due to the impact of correlation with the discount rate used to value the liabilities.

This risk analysis incorporates volatility from market, interest rate, foreign exchange, credit, and all other sources of risk, and, importantly, makes allowance for how these risks may offset each other.

Credit risk
Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit risk in their pricing and consequently the risk of loss is implicitly provided for in the value of the Fund's assets and liabilities (as outlined in Market Risk above).

In essence, the Fund's entire investment portfolio is exposed to some sort of credit risk. However through the selection of counterparties, brokers and financial institutions the Fund reduces the credit risk that may occur through the failure to settle a transaction in a timely manner.

Cash deposits, derivatives and stock lending are the major areas of credit exposure where credit risk is not reflected in market prices.

Cash deposits
At 31 March 2014, cash deposits represented £21.0m, 6.2% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2014	Balances at 31 March 2013 £000	Balances at 31 March 2014 £000
Held for investment purposes			
Northern Trust Global Investment Limited - liquidity funds	*Aaa*	10,207	11,452
Northern Trust Company - cash deposits	*A1*	947	5,591
The City of Edinburgh Council - treasury management	*See below*	696	2,478
Total investment cash		11,850	19,521
Held for other purposes			
The City of Edinburgh Council - treasury management	*See below*	1,913	1,523
Total cash		13,763	21,044

The majority of Sterling cash deposits of the Fund are managed along with those of the administering authority (the City of Edinburgh Council) and other related organisations which are pooled for investment purposes as a treasury cash fund. Management of the cash fund is on a low risk basis, with security of the investments the key consideration while at the same time seeking innovative and secure cash management opportunities.

As well as lending monies to other local authorities, the Council has purchased UK Government Treasury Bills as well as Bonds and Floating Rate Notes with an explicit UK Government Guarantee.

The Fund's cash holding at the year end under its treasury management arrangements was held with the following institutions:

	Moody's Credit Rating at 31 March 2014	Balances at 31 March 2013 £000	Balances at 31 March 2014 £000
Money market funds			
Deutsche Bank AG, London	*Aaa*	284	527
Goldman Sachs	*Aaa*	270	295
Bank call accounts			
Bank of Scotland	*A2*	258	364
Royal Bank of Scotland	*Baa1*	144	137
Santander UK	*A2*	-	377
Barclays Bank	*A2*	255	367
Svenska Handelsbanken	*Aaa3*	368	566
Clydesdale Bank	*A2*	254	-
HSBC Bank	*Aa3*	-	546

(Cont'd)	Moody's Credit Rating at 31 March 2014	Balances at 31 March 2013 £000	Balances at 31 March 2014 £000
Bank certificates of deposit			
Standard Chartered	*A1*	100	-
Floating Rate Note			
Rabobank	*Aa2*	100	-
Building Society fixed term deposits			
Nationwide Building Society	*A2*	99	182
UK pseudo-sovereign risk instruments			
Other Local Authorities [1]	*n/a*	477	458
UK Government Treasury Bills	*Aa1*	-	182
		2,609	4,001

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2014 would have been 'Aa1'). Of the £458k on deposit with local authorities at 31 March 2014, £274k is with a local authority which has a 'Aa2' credit rating from Moody's.

No breaches of the Council's counterparty criteria occurred during the reporting period and the Fund does not expect any losses from non-performance by any of its counterparties in relation to deposits.

Securities lending

The Fund participates in a security lending programme as described above. The Fund is potentially exposed to credit risk in the event of the borrower of stock defaults. This risk is mitigated by the contractual commitment that borrowers provide collateral in excess of 100% of the value of the securities borrowed. In addition, Northern Trust has signed an agreement requiring it to make good any losses arising from the lending programme.

Liquidity risk

Liquidity risk reflects the risk that the Fund will not be able to meet its financial obligations as they fall due. The Fund therefore ensures that there is adequate cash and liquid resources to meet its commitments. Cashflow projections are prepared on a regular basis to understand and manage the timing of the Fund's cashflow. The majority (estimated to be approximately 85%) of the Fund's investments could be converted to cash within three months in a normal trading environment.

Refinancing risk

Refinancing risk is the risk that the Fund will be bound to replenish a significant proportion of its pension fund financial instruments at a time of unfavourable interest rates. The Fund is not bound by any obligation to replenish its investments and hence is not exposed to refinancing risk.

10 Actuarial statement

The Fund Actuary has provided a statement describing the funding arrangements of the Fund. This can be found in a separate section at the end of this section.

11 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £358m (2013 £321m).

This figure is used for statutory accounting purposes by Lothian Buses Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end.

The figure is only prepared for the purposes of IAS26 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

Financial assumptions	31 March 2013 % p.a.	31 March 2014 % p.a.
Inflation / pensions increase rate	2.8	2.8
Salary increase rate	5.1	5.1
Discount rate	4.5	4.3

*Salary increases were estimated at 1% p.a. nominal until 31 March 2015 reverting to the long term rate thereafter.

Longevity assumptions

The life expectancy assumption is based on the Fund's specific statistical analysis with improvements from 2008 in line with the Medium Cohort and a 1% p.a. underpin. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	Males	Females
Current pensioners	18.4	21.6
Future pensioners (assumed to be currently 45)	21.7	24.8

This assumption is the same as at 31 March 2013.

Commutation assumption

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

12 Debtors

	31 March 2013 £000	31 March 2014 £000
Contributions due - employers	650	654
Contributions due - employees	202	199
Pensions paid on behalf of employer	28	38
Sundry debtors	14	21
	894	912
Analysis of debtors		
Administering Authority	1	1
Lothian Buses plc	880	890
Other entities and individuals	13	21
	894	912

13 Creditors	31 March 2013 £000	31 March 2014 £000
Benefits payable	121	91
Miscellaneous creditors and accrued expenses	-	986
	121	1,077
Analysis of creditors		
Other entities and Individuals	121	1,077
	121	1,077

14 Additional Voluntary Contributions

Active members of the Lothian Pension Fund and the Lothian Buses Pension Fund have the option to pay additional voluntary contributions (AVCs). These AVCs are invested separately from the main funds, securing additional benefits on a money purchase basis for those members that have elected to contribute. The investment of the AVCs is managed by Standard Life and Prudential.

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

	2012/13 £000	2013/14 £000
Contributions during year		
Standard Life	395	450
Prudential	1,120	1,271
	1,515	1,721
Value at year end at 31 March		
Standard Life	5,968	6,253
Prudential	1,572	2,237
	7,540	8,490

15 Related party transactions

The City of Edinburgh Council

Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund are administered by the City of Edinburgh Council. Consequently there is a strong relationship between the Council and the pension funds.

The Investment and Pensions Division of the Council is responsible for administering the three pension funds. The Division receives an allocation of the overheads of the Council, based on the amount of central services consumed. This included the pension payroll service provided by the Council for part of 2013/14. In turn, the Division allocates its costs to the three funds. Costs directly attributable to a specific fund are charged to the relevant fund, costs that are common to all three funds are allocated on a defined basis.

Transactions between the Council and the Fund are managed via a holding account. Each month the Council is paid a cash sum leaving a working balance in the account to cover the next month's pension payroll costs and other expected costs.

Year end balance on holding account	31 March 2013 £000	31 March 2014 £000
	459	422

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2014, the Fund had an average investment balance of £6.6m (2013 £3.3m), interest earned was £34.9k (2013 £22.0k).

Year end balance on treasury management account	31 March 2013 £000	31 March 2014 £000
Held for investment purposes	696	2,478
Held for other purposes	1,913	1,523
	2,609	4,001

The Council owns 91.01% of the shares of Lothian Buses plc, the Fund being operated solely for the employees of Lothian Buses Plc.

Office accommodation- 144 Morrison Street, Edinburgh

Investment and Pensions Division of the Council has entered into an internal agreement with the Council for the provision of office accommodation at 144 Morrison Street in Edinburgh. The terms of the agreement are equivalent to those that would have been obtained had the accommodation been let on a commercial basis. In the accounts of the Fund the arrangement has been treated as a operational lease. The agreement was effective from November 2013. The Investment and Pensions Division is committed to making the following future payments.

	31 March 2013 £000	31 March 2014 £000
Within one year	-	-
Between one and five years	-	157
After five years	-	1,222
	-	1,379
Recognised as an expense during the year	-	33

The above expense has been allocated across the three Funds, Lothian Buses Pension Fund's share is £1.9k.

Key management personnel

During the period from 1 April 2013 to the date of issuing of these accounts, several employees of the City of Edinburgh Council held key positions in the financial management of the Lothian Buses Pension Fund. These employees and their financial relationship with the Fund (expressed as cash-equivalent transfer values or CETV) are:

Name	**Position held**	Accrued CETV as at 31 March 2013 £000	Accrued CETV as at 31 March 2014 £000
Alastair Maclean*	Director of Corporate Governance	67	115
Clare Scott	Investment and Pensions Service Manager	89	126
Struan Fairbairn	Legal and Risk Manager	1	9
John Burns	Pensions and Accounting Manager	349	386
Esmond Hamilton	Financial Controller	101	119
Bruce Miller	Investment Manager	90	112

* Also disclosed in the financial statements of the City of Edinburgh Council.

16 Contingent liabilities and contractual commitments

The Fund has commitments relating to outstanding call payments due on unquoted held in the infrastructure and timber parts of the portfolio. The amounts 'called' by these funds are irregular in both size and timing, taking place over a period of years from the date of each original commitment. The outstanding commitments at the year end are as follows:

	31 March 2013 £000	31 March 2014 £000
Outstanding investment commitments	3,041	466

17 Contingent assets

There were no contingent assets at the year end.

18 Impairment losses

No impairment losses have been identified during the year.

19 Prior year adjustment

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, the decision has been made to change the Fund's policy on accounting for investment management expenses. This means that investment management costs that are deducted from the value of an investment are now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments.

As a result of the above changes the results for the year ended 31 March 2013 have been restated. The change has the effect of increasing the change in market value of investments by £659k and increasing investment management expenses by £659k. The changes are reported in the Fund Account but the there is no change to the net increase in the Fund for the year ended 31 March 2013 of £40.462m. The adjustments can be summarised as follows:

	2012/13 Fund Accounts as restated £000	Changes made £000
Fund Account 2012/13		
Change in market value of investments	36,459	659
Investment management expenses	(1,706)	(659)

Lothian Buses Pension Fund

Actuarial Statement for 2013/14

This statement has been prepared in accordance with Regulation 31A(1)(d) of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2013/14.

Description of Funding Policy

The funding policy is set out in the administering authority's Funding Strategy Statement (FSS), dated March 2012. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the Fund;
- to minimise the degree of short-term change in the employer's contribution rate;
- maximise the returns from investments within reasonable and considered risk parameters, and hence minimise the cost to the employer;
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment;
- to help the employer manage its pension liabilities.
  The FSS sets out how the administering authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2011. This valuation revealed that the Fund's assets, which at 31 March 2011 were valued at £257 million, were sufficient to meet 112% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2011 valuation was £28 million.
Employer contributions for the period 1 January 2012 to 31 March 2015 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in my valuation report dated 16 December 2011.

Method

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

Assumptions

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

The key financial assumptions adopted for the 2011 valuation were as follows:

Financial assumptions	31 March 2011 % p.a. Nominal	% p.a. Real
Discount rate	5.8%	2.9%
Pay increases *	5.1%	2.2%
Price inflation/Pension increases	2.8%	-

* plus an allowance for promotional pay increases. Short term pay growth was assumed to be 2.4% p.a. for 2011/12, 3.1% p.a. for 2012/13, reverting to 5.1% p.a. thereafter.

The key demographic assumption was the allowance made for longevity. As a member of Club Vita, the baseline longevity assumptions adopted at this valuation were a bespoke set of VitaCurves that were specifically tailored to fit the membership profile of the Fund. Longevity improvements were in line with standard year of birth mortality tables, with medium cohort projections and a 1% p.a. underpin effective from 2008. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	18.4 years	21.6 years
Future Pensioners	21.7 years	24.8 years

Copies of the 2011 valuation report and Funding Strategy Statement are available on request from the City of Edinburgh Council, Administering authority to the Fund.

Experience over the period since April 2011

Experience has been poorer than expected since the 2011 valuation (excluding the effect of any membership movements). Real bond yields have fallen considerably, leading to an increase in liabilities. This has been partially offset by stronger than expected asset returns meaning that the funding level is likely to have fallen since the 2011 valuation.

The next actuarial valuation will be carried out as at 31 March 2014. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden

Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP

19 May 2014
Hymans Robertson LLP 20 Waterloo Street Glasgow
G2 6DB

Scottish Homes Pension Fund

Membership records

Status	Membership at 31/03/2012	Membership at 31/03/2013	Membership at 31/03/2014
Active	-	-	-
Deferred	650	626	595
Pensioners	999	978	956
Dependants	303	308	298
Total	1,952	1,912	1,849

Funding

As the Scottish Homes Pension Fund has no active members, benefits are funded by investment earnings and payments from the Scottish Government in line with the guarantee agreement.

Payments under the guarantee agreement are set at triennial actuarial valuations. The amount payable for the year ended 31 March 2014, of £771,000, was based on the actuarial valuation as at 31 March 2011.

The Fund's actuary has estimated the funding level to be 90.5% at 31 March 2014. The position has improved from 86.2% at the date of the last actuarial valuation, 31 March 2011. Work has commenced on the triennial actuarial valuation at 31 March 2014 where the actuary will recalculate the funding level based on up-to-date membership of the Fund. More information on funding can be found in the Actuarial Statement for 2013/14 at the end of this section.

Investment strategy

The funding agreement with the Scottish Government and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over the time. They allow for acceleration in the sale of equities and property and purchase of bonds if the actual funding level improves to the target funding level.

The Pensions Committee approved the Investment Strategy 2012-17 for Scottish Homes Pension Fund in October 2012. Over 2013/14, the actual funding level moved closer to the target funding level prescribed in the funding agreement. Hence the move to the long term strategy was accelerated and the current strategy allocation is now in line with the 2012-17 investment strategy, as shown in the table below. The table also shows the asset allocation limits under normal financial conditions.

	Strategic Allocation 31 March 2014 %	Long term Strategy 2012 - 2017 %	Permitted ranges %
Equities	30	30	20-35
Bonds	65	65	60-75
Property	5	5	0-10
Cash	0	0	0-5
Total	100	100	

The objectives of the Fund were redefined in December 2012 and are:

- over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
- over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

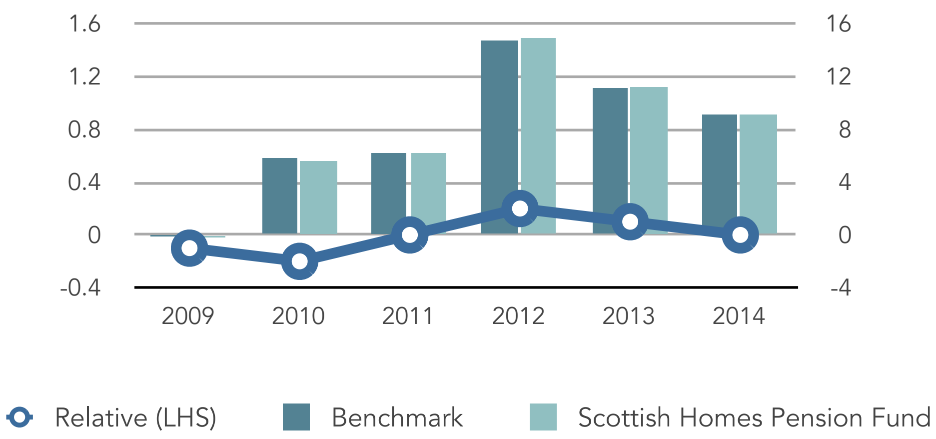
Investment performance

The absolute performance of Scottish Homes Pension Fund over the 12-month period was +2.1% and 3 year performance was +9.1% per annum. With a large allocation to bonds, the fund's performance over 2013/14 was affected by weak bond markets. Since inception in July 2005, the Fund has returned +8.0% per annum, well ahead of measures of inflation, and national average earnings.

Annualised returns to 31 March 2014 (% per year)

	1 year	3 years	Since inception (July 2005)
Scottish Homes Pension Fund	2.1	9.1	8.0
Benchmark	2.1	9.1	8.0
Retail Price Index (RPI)	2.5	3.1	3.3
Consumer Price Index (CPI)	1.7	2.6	2.8
National Average Earnings	1.5	0.9	2.3

Annualised 3 yearly returns ending 31 March (% per year)



	2009	2010	2011	2012	2013	2014
Fund	(0.2)	5.6	6.2	14.9	11.2	9.1
Benchmark	(0.1)	5.8	6.2	14.7	11.1	9.1
Relative	(0.1)	(0.2)	-	0.2	0.1	-

Scottish Homes Pension Fund

Fund Account for year ended 31 March 2014

2012/13 Restated* £000		Note	2013/14 £000
	Income		
794	Contributions from employer	*2*	791
-	Transfers from other schemes		-
794			791
	Less: expenditure		
7,070	Pension payments including increases		7,083
488	Lump sum retirement payments		329
2	Lump sum death benefits		15
82	Transfers to other schemes	*3*	9
61	Administrative expenses	*4*	57
7,703			7,493
(6,909)	**Net withdrawals from dealing with members**		(6,702)
	Returns on investments		
333	Investment income	*5*	339
15,511	Change in market value of investments	*7a, 8b*	2,742
(236)	Investment management expenses	*6*	(191)
15,608	**Net returns on investments**		2,890
8,699	**Net increase in the Fund during the year**		(3,812)
131,418	Net assets of the Fund at 1 April 2013		140,117
140,117	**Net assets of the Fund at 31 March 2014**	*8a, 8c*	136,305

*The results for the year ended 31 March 2013 have been restated to reflect a change in the accounting policy on investment management expenses. This change has the effect of increasing the change in market value of investment by £91k and increasing investment management expenses by £91k. There is no change in the net returns on investment. See note 19 for details.

Scottish Homes Pension Fund

Net Assets Statement as at 31 March 2014

31 March 2013 £000		Note	31 March 2014 £000
	Investments		
138,006	Assets		133,761
-	Liabilities		-
138,006		*7, 9*	133,761
	Current assets		
-	The City of Edinburgh Council	*15*	175
2,514	Cash balances	*9, 15*	2,383
55	Debtors	*12*	48
2,569			2,606
	Current liabilities		
(442)	The City of Edinburgh Council	*15*	-
(16)	Creditors	*13*	(62)
(458)			(62)
2,111	**Net current assets**		2,544
140,117	**Net assets of the Fund at 31 March 2014**	*8a, 8c*	136,305

JOHN BURNS FCMA CGMA
Pensions and Accounting Manager
June 2014

Notes to the net asset statement

The financial statements summarise the transactions of the Fund during the year and its net assets at the year end. They do not take account of the obligations to pay pensions and benefits which fall due after the end of the year. The actuarial position of the Fund, which does take account of such obligations, is discussed in the Actuarial Valuation section of this report and these financial statements should be read in conjunction with that information. In addition, as required by IAS26, the Actuarial Present Value of Promised Retirement Benefits is disclosed in the notes to these financial statements.

Notes to the Accounts

1 Events after the balance sheet date

There have been no events since 31 March 2014, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

2 Contributions

	2012/13 £000	2013/14 £000
Deficit funding	671	671
Administration expenses contribution	100	100
Strain costs	23	20
	794	791

The Scottish Homes Pension Fund is a single employer pension fund for employees of Scottish Homes. The Scottish Homes Pension Fund was set up under (Scottish) Statutory Instrument 315/2005. when Scottish Homes became Communities Scotland - part of the Scottish Government.

Following the actuarial valuation at 31 March 2011 deficit funding of £671,000 per year is to be paid by the Scottish Government over the period April 2012 to March 2015. In addition, the Scottish Government has agreed to pay £100,000 every year towards the cost of ongoing administration.

Where the Scottish Government makes certain decisions which result in additional benefits being paid out to a member, or benefits being paid early, this results in a "strain" on the Fund. The resulting pension strain costs are calculated and recharged in full.

The Fund consists of only deferred and pensioner members, hence no employee contributions were paid during the year.

3 Transfers out to other schemes

	2012/13 £000	2013/14 £000
Group transfers	-	-
Individual transfers	82	9
	82	9

4 Administrative expenses

	2012/13 £000	2013/14 £000
Employee costs	27	27
The City of Edinburgh Council - pension payroll costs	12	6
The City of Edinburgh Council - other support costs	8	7
System costs	5	5
Actuarial fees	6	7
External audit fees	1	1
Printing and postage	1	1
Depreciation	1	2
Office costs	-	1
Sundry costs less sundry income	-	-
	61	57

The Investment and Pensions Division of the Council is responsible for administering the three pension Funds. The Division receives an allocation of the overheads of the Council. In turn the Division allocates administration and investment costs to the three pension funds. Costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are allocated on a defined basis.

5 Investment income

	2012/13 £000	2013/14 £000
Property pooled investment income	316	326
Interest on cash deposits	16	13
Sundries	1	-
	333	339
Irrecoverable withholding tax	-	-
	333	339

6 Investment management expenses

	2012/13 £000	2013/14 £000
External management fees - invoiced	68	72
External management fees - deducted from capital	91	61
Transaction costs	13	2
Employee costs	23	24
Engagement and voting fees	2	2
Performance measurement fees	2	2
Investment consultancy fees	13	1
The City of Edinburgh Council - other support costs	3	3
Custodian fees	15	18
System costs	5	4
Legal fees	-	-
Office costs	-	1
Sundry costs	1	1
	236	191

Following a change in accounting policy, the expenses for 2012/13 have been restated to account for costs that were deducted from capital and therefore impacted the change in market value of investments reported in the Fund Account. The related costs are included above as external management fees deducted from capital. Investment transaction costs that were previously added to the cost of purchases or deducted from the proceeds are now accounted for as expenses and shown above as transaction costs.

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales (see note 7a - Reconciliation of movements in investments).

The Fund has not incurred any performance-related investment management fees in 2013/14 or 2012/13.

7 Net investment assets

	31 March 2013 £000	31 March 2014 £000
Pooled investment vehicles	138,006	133,761
Net investment assets	138,006	133,761

7a Reconciliation of movement in investments

	Value at 1 April 2013 £000	Purchases at cost £000	Sales proceeds £000	Change in market value £000	Value at 31 March 2014 £000
Pooled investment vehicles	138,006	21,435	(28,422)	2,742	133,761

	Value at 1 April 2012 £000	Purchases at cost £000	Sales proceeds £000	Change in market value £000	Value at 31 March 2013 £000
Pooled investment vehicles	129,886	4,785	(12,176)	15,511	138,006

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.

Following a change in accounting policy, transaction costs are no longer included in the cost of purchases and sale proceeds. As a result, the figures for 2012/13 have been restated, information on transaction costs can now be found in note 6 on investment management expenses. Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

7b Analysis of Investments (at market value)

	2012/13 £000	2013/14 £000
Pooled investment vehicles		
UK managed funds - property	11,352	6,960
UK managed funds - other	126,654	126,801
	138,006	133,761

7c Investment managers and mandates

Manager	Mandate	Market value at 31 March 2013 £000	% of total funds %	Market value at 31 March 2014 £000	% of total funds %
State Street	UK equity	12,351	8.9	8,777	6.6
			-		
State Street	N American equities	18,253	13.2	12,596	9.4
State Street	European equities	11,408	8.3	8,171	6.1
State Street	Pacific (ex Jpn) equities	4,661	3.4	3,225	2.4
State Street	Japanese equities	6,581	4.8	4,149	3.1
State Street	Emerging mkts equities	4,362	3.2	3,048	2.3
Total overseas equities		45,265	32.9	31,189	23.3
State Street	UK fixed interest	12,540	9.1	17,336	13.0
State Street	UK index-linked	56,498	40.9	69,499	51.9
Total fixed interest		69,038	50.0	86,835	64.9
Schroders	Property	7,509	5.4	6,960	5.2
Standard Life	Property	3,843	2.8	-	-
Total property		11,352	8.2	6,960	5.2
Net financial assets		138,006	100.0	133,761	100.0

7d

Investments representing more than 5% of the net assets of the Fund or 5% of any investment class
The Fund currently invests all its money in a range of pooled funds. Investments representing more than 5% of the net assets of the Fund or 5% of any investment class are described above.

7e Securities lending
The Fund has not participated in any securities lending arrangements in the last two years.

8 Financial instruments

8a Classification of financial instruments

Accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the fair value amounts of financial assets and liabilities by category and net assets statement heading. No financial assets were reclassified during the accounting period.

All financial instruments are marked to market (at fair value) in the Fund's accounting records hence there is no difference between the carrying value and fair value.

	31 March 2013			31 March 2014		
Financial assets	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000
Investment assets						
Pooled investments	138,006			133,761		
	138,006			133,761		
Other assets						
The City of Edinburgh Council		-			175	
Cash		2,514			2,383	
Debtors		55			48	
		2,569			2,606	
Assets total	138,006	2,569		133,761	2,606	
Financial liabilities						
Other liabilities						
The City of Edinburgh Council			(442)			-
Creditors			(16)			(62)
		-	(458)		-	(62)
Liabilities total		-	(458)		-	(62)
Net assets total	138,006	2,569	(458)	133,761	2,606	(62)
Total net financial instruments			140,117			136,305

8b Net gains and losses on financial instruments

	2012/13 £000	2013/14 £000
Designated as fair value through fund account	15,511	2,742
Loans and receivables	-	-
Financial liabilities at amortised cost	-	-
Total	15,511	2,742

8c Valuation of financial instruments carried at fair value

The valuation of financial instruments has been classified into three levels, according to the quality and reliability of information used to determine fair values.

Level 1
Financial instruments at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise quoted equities and unit trusts. Listed investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

Level 2
Financial instruments at Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3
Financial instruments at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include unquoted equity investments, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

The following table provides an analysis of the financial assets and liabilities of the pension fund grouped into Levels 1 to 3, based on the level at which the fair value is observable.

	31 March 2014			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Designated as fair value through fund account	133,761			133,761
Loans and receivables	2,606			2,606
Total financial assets	136,367	-	-	136,367
Financial liabilities				
Designated as fair value through fund account	-			-
Financial liabilities at amortised cost	(62)			(62)
Total financial liabilities	(62)	-	-	(62)
Net financial assets	136,305	-	-	136,305

	31 March 2013			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Designated as fair value through fund account	138,006			138,006
Loans and receivables	2,569			2,569
Total financial assets	140,575	-	-	140,575
Financial liabilities				
Designated as fair value through fund account	-			-
Financial liabilities at amortised cost	(458)			(458)
Total financial liabilities	(458)	-	-	(458)
Net financial assets	140,117	-	-	140,117

9 Nature and extent of risk arising from financial instruments

Risk and risk management
The Fund's primary aim is to ensure that all members and their dependants receive their benefits when they become payable. The funding objective is outlined in the guarantee document, agreed by the Administering Authority, the Scottish Government and the Fund's Actuary.

Responsibility for the Fund's overall investment strategy rests with the Pensions Committee. The Investment Strategy Panel and the internal investment team monitor investment risks on a regular basis. Investment risk management tools are used to identify and analyse risks faced by the Fund's investments.

Types of investment risks
There are various ways of considering investment risks for pension funds. For the purposes of this note, investment risk is the potential for an investor to experience losses from falls in the prices of investments. All financial instruments, including cash deposits, present a risk of loss of capital and risks vary depending on different asset classes.

Investment risk also changes over time as economic conditions and investor sentiment change. The Fund considers overall fluctuations in prices arising from a variety of sources: market risk, foreign exchange risk, interest rate risk, credit risk, etc. The different risks may, to some extent, offset each other.

The overall market risk of the Fund depends on the actual mix of assets and encompasses all the different elements of risk.

The Fund manages these risks in a number of ways:

- assessing and establishing acceptable levels of market risk when setting overall investment strategy. Importantly, risk is considered relative to the liabilities of the Fund
- diversification of investments in terms of type of asset, geographical and industry sectors as well as individual securities
- taking stewardship responsibilities seriously and pursuing constructive engagement with the companies in which the Fund invests
- monitoring market risk and market conditions to ensure risk remains within tolerable levels.

The Fund may use equity futures contracts from time to time to manage market risk. Exchange traded options are not used by the Fund.

Sensitivity analysis
Asset prices have a tendency to fluctuate. The degree of such fluctuation is known as "volatility" and it differs by asset class. The table below sets out the long-term volatility assumptions used in the Fund's asset-liability modelling:

Asset type	Potential price movement (+ or -)
Equities - Developed Markets	20.0%
Equities - Emerging Markets	30.0%
Fixed interest gilts	10.5%
Index-linked gilts	8.5%
Property	13.0%

Volatility is the standard deviation of annual returns. Broadly speaking, in two years out of three, the asset's change in value (which could be a gain or a loss) is expected to be lower than the volatility figure, but in one year out of three, the change in value is expected to be higher than the volatility figure.

Asset classes don't always move in line with each other. The extent to which assets move together is known as their "correlation". A lower correlation means that there is less risk of assets losing value at the same time. The overall Fund benefits from "diversification " because it invests in numerous different asset classes, which don't all move in line with each other. Consequently, the aggregate risk at the Fund level is less than the total risk from all the individual assets in which the Fund invests.

The following table shows the risks at the asset class level and the overall Fund level.

Asset type	Value at 31 March 2014 £000	% of fund %	Change + / - %	Value on increase £000	Value on decrease £000
Equities - Developed Markets	36,918	27.6	20.0	44,302	29,534
Equities - Emerging Markets	3,049	2.2	30.0	3,964	2,134
Fixed Interest Gilts	17,336	13.0	10.5	19,156	15,516
Index-Linked Gilts	69,498	52.0	8.5	75,405	63,591
Property	6,960	5.2	13.0	7,865	6,055
Total [1]	133,761	100.0	12.7	150,692	116,830
Total [2]			9.5	146,468	121,054
Total [3]			7.4	143,659	123,863

[1] No allowance for correlations between assets
[2] Including allowance for correlations between assets
[3] Including allowance for correlations between assets and liabilities

The value on increase/decrease columns illustrates the monetary effect of the volatility. The actual annual change in value is expected to be lower than this in two years out of three, but higher in one year out of three.

It can be seen that the risk to the overall Fund assets *[2]* is lower than the total of the risks to the individual assets *[1]*.

However, because the purpose of a pension scheme is to make payments to scheme beneficiaries, the true risk of a pension scheme is not measured in absolute terms, but relative to its liabilities *[3]*. The risk is lower than the absolute asset risk, due to the impact of correlation with the discount rate used to value the liabilities.

Credit risk
Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit risk in their pricing and consequently the risk of loss is implicitly provided for in the value of the funds assets and liabilities (as outlined in Market Risk above).

In essence, the Fund's entire investment portfolio is exposed to some sort of credit risk. However through the selection of counterparties, brokers and financial institutions the Fund reduces the credit risk that may occur through the failure to settle a transaction in a timely manner.

Cash deposits are a major area of credit exposure where credit risk is not reflected in market prices.

Cash deposits
At 31 March 2014 cash deposits represented £2.4m, 1.7% of total net assets. This was held as follows:

	Moody's Credit Rating at 31 March 2014	Balances at 31 March 2013 £000	Balances at 31 March 2014 £000
Held for investment purposes			
The City of Edinburgh Council - treasury management	*See below*	-	-
Total investment cash		-	-
Held for other purposes			
The City of Edinburgh Council - treasury management	*See below*	2,514	2,383
Total cash		2,514	2,383

All the cash deposits of the Fund are managed along with those of the administering authority (The City of Edinburgh Council) and other related organisations which are pooled for investment purposes as a treasury cash fund. Management of the cash fund is on a low risk basis, with security of the investments the key consideration while at the same time seeking innovative and secure cash investment opportunities.

As well as lending monies to other local authorities, the Council has purchased UK Government Treasury Bills as well as Bonds and Floating Rate Notes with an explicit UK Government Guarantee.
The Fund's cash holding under its treasury management arrangements at 31 March 2014 was held with the following institutions:

	Moody's credit rating at 31 March 2014	Balances at 31 March 2013 £000	Balances at 31 March 2014 £000
Money market funds			
Deutsche Bank AG, London	*Aaa*	273	314
Goldman Sachs	*Aaa*	260	175
Bank call accounts			
Bank of Scotland	*A2*	249	217
Royal Bank of Scotland	*Baa1*	139	82
Santander UK	*A2*	-	225
Barclays Bank	*A2*	245	219
Svenska Handelsbanken	*Aaa3*	355	337
HSBC Bank	*Aa3*	-	325
Bank near-call accounts			
Clydesdale Bank (15 Day Notice)	*Baa2*	245	-
Bank certificates of deposit			
Standard Chartered	*A1*	96	-
Floating Rate Note			
Rabobank	*Aa2*	96	-
Building society fixed term deposits			
Nationwide Building Society	*A2*	96	108
UK pseudo-sovereign risk instruments			
Other Local Authorities [1]	*n/a*	460	273
UK Government Treasury Bills	*Aa1*	-	108
		2,514	2,383

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2014 would have been 'Aa1'). Of the £273k above, £119k is with a local authority which has a 'Aa2' credit rating from Moody's.

No breaches of the Council's counterparty criteria occurred during the reporting period and the Fund does not expect any losses from non-performance by any of its counterparties in relation to deposits.

Liquidity risk
Liquidity risk reflects the risk that the Fund will not be able to meet its financial obligations as they fall due. The Fund therefore ensures that there is adequate cash and liquid resources to meet its commitments. Cashflow projections are prepared on a regular basis to understand and manage the timing of the Fund's cashflow.

The majority (estimated to be approximately 94%) of the Fund's investments could be converted to cash within three months in a normal trading environment.

Refinancing risk
Refinancing risk is the risk that the Fund will be bound to replenish a significant proportion of its pension fund financial instruments at a time of unfavourable interest rates. The Fund is not bound by any obligation to replenish its investments and hence is not exposed to refinancing risk.

10 Actuarial statement

The Fund Actuary has provided a statement describing the funding arrangements of the Fund. This can be found at the end of this section.

11 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £138m (2013 £136m). This figure is used for statutory accounting purposes by Scottish Homes Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end.

The figure is only prepared for the purposes of IAS26 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

Financial assumptions	31 March 2013 % p.a.	31 March 2014 % p.a.
Inflation / pensions increase rate	2.8	2.6
Discount rate	4.5	4.1

Longevity assumptions
The life expectancy assumption is based on standard SAPS mortality tables with improvements in line with Medium Cohort and a 1% p.a. underpin effective from 2008. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	Males	Females
Current pensioners	21.1	23.9
Future pensioners (assumed to be aged 45 as at 31 March 2011)	23.0	25.7

This assumption is the same as at 31 March 2013.

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

12 Debtors

	31 March 2013 £000	31 March 2014 £000
Sundry debtors	55	48
	55	48
Analysis of debtors		
Administering Authority	1	1
Scottish Government	29	20
Other entities and individuals	25	27
	55	48

13 Creditors

	31 March 2013 £000	31 March 2014 £000
Benefits payable	16	39
Miscellaneous creditors and accrued expenses	-	23
	16	62
Analysis of creditors		
Other entities and individuals	16	62
	16	62

14 Additional Voluntary Contributions

As the Fund has no active members, there are no AVC arrangements provided.

15 Related party transactions

The City of Edinburgh Council

Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund are administered by the City of Edinburgh Council. Consequently there is a strong relationship between the Council and the pension funds.

The Investment and Pensions Division of the Council is responsible for administering the three pension funds. The Division receives an allocation of the overheads of the Council, which is based on the amount of central services consumed. This includes the pension payroll service provided by the Council. In turn, the Division allocates its costs to the three funds. Costs directly attributable to a specific fund are charged to the relevant Fund; costs that are common to all three funds are allocated on a defined basis.

Transactions between the Council and the Fund are managed via a holding account. Each month the Council is paid a cash sum leaving a working balance in the account to cover the month's pension payroll costs and other expected costs.

	31 March 2013 £000	31 March 2014 £000
Year end balance on holding account	(442)	175

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2014, the Fund had an average investment balance of £2.3m (2013 £2.5m). Interest earned was £12.3k (2013 £16.5k).

Year end balance on treasury management account	31 March 2013 £000	31 March 2014 £000
Held for investment purposes	-	-
Held for other purposes	2,514	2,383
	2,514	2,383

Office accommodation- 144 Morrison Street, Edinburgh

Investment and Pensions Division of the Council has entered into an internal agreement with the Council for the provision of office accommodation at 144 Morrison Street in Edinburgh. The terms of the agreement are equivalent to those that would have been obtained had the accommodation been let on a commercial basis. In the accounts of the Fund the arrangement has been treated as a operational lease. The agreement was effective from November 2013. The Investment and Pensions Division is committed to making the following future payments.

	31 March 2013 £000	31 March 2014 £000
Within one year	-	-
Between one and five years	-	157
After five years	-	1,222
	-	1,379
Recognised as an expense during the year	-	33

The above expense has been allocated across the three Funds. Scottish Homes Pension Fund's share is £0.8k.

Key management personnel

During the period from 1 April 2013 to the date of issuing of these accounts, several employees of the City of Edinburgh Council held key positions in the financial management of the Fund. These employees and their financial relationship with the fund (expressed as cash-equivalent transfer values or CETV) are:

Name	Position held	Accrued CETV as at 31 March 2013 £000	Accrued CETV as at 31 March 2014 £000
Alastair Maclean*	Director of Corporate Governance	67	115
Clare Scott	Investment and Pensions Service Manager	89	126
Struan Fairbairn	Legal and Risk Manager	1	9
John Burns	Pensions and Accounting Manager	349	386
Esmond Hamilton	Financial Controller	101	119
Bruce Miller	Investment Manager	90	112

* Also disclosed in the financial statements of the City of Edinburgh Council.

16 Contingent liabilities and contractual commitments

There were no contingent liabilities or contractual commitments at the year end.

17 Contingent assets

There were no contingent assets at the year end.

18 Impairment losses

No impairment losses have been identified during the year.

19 Prior year adjustment

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, the decision has been made to change the Fund's policy on accounting for investment management expenses. This means that investment management costs that are deducted from the value of an investment are now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments.

As a result of the above changes the results for the year ended 31 March 2013 have been restated. The change has the effect of increasing the change in market value of investments by £91k and increasing investment management expenses by £91k. The changes are reported in the Fund Account but there is no change to the net increase in the Fund for the year ended 31 March 2013 of £8.699m. The adjustments can be summarised as follows:

	2012/13 Fund Accounts as restated £000	Changes made £000
Fund Account 2012/13		
Change in market value of investments	15,511	91
Investment management expenses	(236)	(91)

Scottish Homes Pension Fund Actuarial Statement for 2013/14

This statement has been prepared in accordance with Regulation 31A(1)(d) of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2013/14.

Description of Funding Policy

The administering authority's Funding Strategy Statement (FSS), dated March 2012, states that a bespoke funding strategy has been adopted for the Fund. Contributions payable by the Scottish Government (previously known as the Scottish Executive) as Guarantor are determined in line with a Scottish Executive Guarantee agreement dated June 2005. In broad terms, the funding strategy is to ensure that assets held by the Fund, together with any contributions payable by the Guarantor under the terms of the agreement, meet all of the Fund's liabilities until they are extinguished.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2011. This valuation revealed that the Fund's assets, which at 31 March 2011 were valued at £124 million, were sufficient to meet 86% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2011 valuation was £20 million.

The Guarantor's contributions for the period from 1 April 2012 to 31 March 2015 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in my valuation report dated 16 December 2011.

Method

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date.

Assumptions

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

The key financial assumptions adopted for the 2011 valuation were as follows:

Financial assumptions	31 March 2011	
	% p.a. Nominal	% p.a. Real
Discount rate (pensioners)	**3.9%**	**1.3%**
Discount rate (deferreds)	**4.3%**	**1.5%**
GMP increases before SPA	**5.1%**	**2.3%**
Price inflation/Pension increases (pensioners)	**2.6%**	**-**
Price inflation/Pension increases (deferreds)	**2.8%**	**-**

The key demographic assumption was the allowance made for longevity. The baseline longevity assumptions adopted at this valuation were in line with standard SAPS mortality tables, and included improvements based on medium cohort projections and a 1% p.a. underpin effective from 2008. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	**21.1 years**	**23.9 years**
Future Pensioners	**23.0 years**	**25.7 years**

Copies of the 2011 valuation report and Funding Strategy Statement are available on request from the City of Edinburgh Council, Administering Authority to the Fund.

Experience over the period since April 2011

The administering authority monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update was produced at 31 March 2014. It showed that the funding level (excluding the effect of any membership movements) had risen from 86% to 91%.

The next actuarial valuation will be carried out as at 31 March 2014. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden

Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP

19 May 2014

Hymans Robertson LLP 20 Waterloo Street Glasgow G2 6DB

Statement of responsibilities for the Statement of Accounts

The Administering Authority's responsibilities require it to:

- make arrangements for the proper administration of the financial affairs of the pension funds in its charge and to secure that one of its officers has the responsibility for the administration of those affairs. The Head of Finance serves as the Section 95 Officer for all of the Council's accounting arrangements, including those of the Lothian Pension Funds. For the Lothian Pension Funds, however, this Section 95 responsibility has been delegated to the Pensions and Accounting Manager.

- manage its affairs to secure economic, efficient and effective use of its resources and safeguard its assets.

The Pensions and Accounting Manager is responsible for the preparation of the Pension Funds' statement of accounts which, in terms of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 (the Code of Practice), is required to present a true and fair view of the financial position of the Pension Funds at the accounting date and their income and expenditure for the year (ended 31 March 2014).

In preparing this statement of accounts, the Pensions and Accounting Manager has:

- selected suitable accounting policies and then applied them consistently

- made judgements and estimates that were reasonable and prudent

- complied with the Code of Practice.

The Pensions and Accounting Manager has also:

- kept proper accounting records which were up to date

- taken reasonable steps for the prevention and detection of fraud and other irregularities.

The Statement of Accounts presents a true and fair view of the financial position of the Pension Funds as at 31 March 2014, and their income and expenditure for the year ended 31 March 2014.

JOHN BURNS, FCMA CGMA
Pensions and Accounting Manager
June 2014

Annual Governance Statement

Scope of Responsibility

The City of Edinburgh Council is responsible for ensuring that its business is conducted in accordance with the law and appropriate standards, and that public money is safeguarded, properly accounted for, and used economically, efficiently, effectively and ethically. The Council also has a duty to make arrangements to secure continuous improvement in the way its functions are carried out.

In discharging these responsibilities, elected members and senior officers are responsible for implementing effective arrangements for governing the Council’s affairs, and facilitating the effective exercise of its functions, including arrangements for the management of risk.

To this end, the Council has approved and adopted a Local Code of Corporate Governance that is consistent with the principles of the CIPFA / SOLACE framework "Delivering Good Governance in Local Government". This statement explains how the City of Edinburgh Council delivers good governance and reviews the effectiveness of those arrangements. It also includes a statement on internal financial control.

The Governance framework of the Council and Lothian Pension Funds

The governance framework, which was reviewed during 2012/13, comprises the systems, processes, cultures and values by which the Council and Lothian Pension Funds are directed and controlled. It also describes the way it engages with and accounts to the various stakeholders. It enables the Council and Lothian Pension Funds to monitor the achievement of their objectives and consider whether those objectives have led to the delivery of appropriate, cost-effective services.

The Council’s Local Code of Corporate Governance is supported by evidence of compliance which is regularly reviewed and considered by the Governance, Risk & Best Value Committee. The Council has implemented arrangements for monitoring each element of the framework and providing evidence of compliance. The Governance Manager has reviewed the arrangements and is satisfied that the Code continues to be adequate and effective. The framework meets the principles of effective governance.

The Funds place reliance upon the internal financial controls within the City of Edinburgh Council's financial systems and the monitoring in place to ensure the effectiveness of these controls. Within the overall control arrangements, the system of internal financial control is intended to ensure that assets are safeguarded, transactions are authorised and properly recorded, and material errors or irregularities are either prevented or would be detected within a timely period. The key elements of the Council’s governance framework include financial regulations, financial monitoring, financial and administrative procedures (including segregation of duties, management supervision, and a system of delegation and accountability).

The system includes:

- Budgeting systems;
- Reviews of financial and performance reports against forecasts;
- The preparation of regular financial reports which indicate actual expenditure against the forecasts; and
- Consideration of external and internal audit reports by the Governance, Risk and Best Value (GRBV) Committee (for Council) and by the Pensions Committee and Pensions Audit Sub-Committee (for Lothian Pension Funds).

These arrangements also include:

- identifying the Council's objectives in the Strategic plan, Community plan (SOA 4) and Service plans;
- identifying the objectives of the Funds in the Funding Strategy Statement, Statement of Investment Principles and Service Plan;
- monitoring of the achievement of objectives by the Council, Pensions Committee and senior officers;
- a systematic approach to monitoring service performance by Pensions Committee, senior officers and stakeholders, including the Consultative Panel and Independent Professional Observer;
- describing the role of the Council and committees in committee terms of reference and delegated functions, procedural standing orders and the scheme of delegation;
- Financial Rules and Regulations (or equivalent) that specify the controls over budgeting, income, expenditure and financial performance;
- the Council's Monitoring Officer reports on any non-compliance with laws and regulations of which he is made aware;
- Governance, Risk and Best Value Committee whose core functions comply with CIPFA standards and has an audit remit, and the Pensions Audit Sub-Committee in respect of the Lothian Pension Funds;
- comprehensive budget and expenditure monitoring systems;
- targets against which financial and operational performance can be assessed;
- clearly defined capital expenditure guidelines;
- formal project management disciplines;
- a Code of conduct for staff and Standards Commission code for elected members; and
- Member/Officer Protocol;
- a structured programme to ensure that Committee members have the required standard of knowledge and understanding of Local Government Pension Scheme matters;
- operating within clearly established investment guidelines defined by the Local Government Pension Scheme Investment Regulations and the Funds' Statement of Investment principles;
- compliance with the CIPFA Principles for Investment Decision Making in the Local Government Pension Scheme and the Myners Principles on investment;
- with the exception of managed funds, unlisted investments and property, all investments are held under custody by a global custodian. The Funds benefit from the custodian's extensive internal control framework; and
- benchmarking of services in terms of quality and cost against other Local Government Pension Scheme funds.

A significant part of the governance framework is the system of internal controls, which is based on an ongoing process to identify and prioritise risks to the achievement of the Group's objectives.

A review of all aspects of governance, internal controls and financial management was initiated by the Director of Corporate Governance in September 2011. The Corporate Management Team agreed a range of actions to further develop and enhance corporate oversight including procurement, the internal control framework, policies and procedures along with a further focus on governance, risk and assurance. This approach was agreed by Council on 23 August 2012.

Good progress has been made to implement a range of improvements and a full overview was provided to the Governance, Risk and Best Value Committee on 14 November 2013.

The Director of Corporate Governance commissioned a further independent assessment over the robustness of the systems of internal control. The results of the assessment were received in March 2013. Of a total of 56 combined recommendations, 12 of these served to mitigate weaknesses exposing the Council, either individually or collectively, to a combination or risk of significant loss or error. As of 30 April 2014, 2 remain outstanding both relating to procurement and purchasing processes.

In addition to the specific measures put in place to strengthen elements of the Council's financial control framework, following Council's approval of the adoption of a co-sourced model, risk management and internal audit functions are in place and working well. A full overview was considered by the Governance, Risk and Best Value Committee on 30 January and 22 May 2014.

While the system is designed to enable the Council to manage risk effectively, it cannot eliminate all risk of failure to implement policies and achieve objectives. Therefore, it provides a reasonable, but not absolute, assurance of effectiveness.

Review of effectiveness

The Local Code of Governance details the Council's arrangements for monitoring each element of the framework and providing evidence of compliance. The Council's Governance manager has reviewed the effectiveness of the Code and will report the result to the Governance, Risk and Best Value Committee in June 2014.

The Internal Audit Section operates in accordance with CIPFA's Code of Practice for Internal Audit. The Section undertakes an annual work programme based on agreed audit strategy and formal assessments of risk that are reviewed regularly. During the year, the Chief Internal Auditor reports to the Head of Legal, Risk and Compliance but had free access to the Chief Executive, all directors and elected members along with reporting directly to the Governance, Risk and best Value Committee.

The Chief Internal Auditor and Council's Governance Manager have provided an assurance statement on the effectiveness of the system of internal control, which was informed by:

- service directors' certified assurances;
- Council officers' management activities;
- Internal Audit review work;
- Audit Scotland's review work leading to its Annual Audit Report;
- risk management procedures;
- reports by external, statutory inspection agencies; and
- assurances provided by the Chief Executives / Directors of Finance group companies.

In compliance with standard accounting practice, the Head of Finance has provided the Chief Executive with a statement of the effectiveness of the Council's internal financial control system for the year ended 31st March 2014. It is the Head of Finance's opinion that reasonable assurance can be placed upon its effectiveness.

Section 95 of the Local Government (Scotland) Act 1973 states that "every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the authority has responsibility for the administration of those affairs". The Head of Finance serves as the Section 95 Officer for all of the Council's accounting arrangements, including those of the Lothian Pension Funds. For the Pension Funds, however, this Section 95 responsibility has been delegated to the Pensions and Accounting Manager.

In compliance with standard accounting practice, the Pension and Accounting Manager has provided the Chief Executive with a statement of the effectiveness of the internal financial control system of the Funds for the year ended 31 March 2014. It is the Pension and Accounting Manager's opinion that reasonable assurance can be placed upon its effectiveness.

For the Council, each service director has reviewed the arrangements in his / her service areas and reported on their assessment of the effectiveness of control arrangements, together with any potential areas requiring improvement, to the Chief Executive. Where improvement actions are identified, an action plan will be developed and subject to regular monitoring. In reviewing the overall governance framework, the Council has also considered any relevant third party reviews and recommendations.

These reviews have identified actions that will be taken to continue improvement in the following activities:

By the Council:

- policy review and development arrangements of the Council Committees;
- the control framework of the Council's legacy property services;
- the control framework within the Council's shared repairs service;
- the robustness of internal control systems;
- the delegation of authority to officers below Directors;
- the processes to ensure compliance with policies and procedures;
- the processes to ensure compliance with health and safety legislation, regulations and guidance;
- the mitigation of risks during a time of change of structures and service delivery;
- the procurement activities of the Council;
- the awareness and understanding of the employee code of conduct, anti bribery policy and procedure, disciplinary and grievance procedures, ICT acceptable use policy, fraud prevention policy and whistleblowing policy;
- the processes to ensure income is timeously received by the Council;
- the implementation of action plans agreed with external inspection agencies;
- the implementation of actions identified by service directors;
- the planning for and implementation of health and social care integration;
- the management and oversight of major programmes and projects by the Corporate Programme Office; and
- the delivery of internal improvement plans.

Certification

It is our opinion that in light of foregoing, reasonable assurance can be placed upon the adequacy and effectiveness of the systems of governance of the Funds. The annual review demonstrates sufficient evidence that the Code is operated effectively and the Council complies with the Local Code of Corporate Governance in all significant respects.

SUE BRUCE	ALASTAIR MACLEAN	COUNCILLOR ALASDAIR RANKIN
Chief Executive	Director of Corporate Governance	Convener of Pensions Committee
June 2014	June 2014	June 2014

Governance Compliance Statement

The Regulations that govern the management of Local Government Pension Scheme in Scotland require that a Governance Compliance Statement is published. This statement sets out the extent to which governance arrangements comply with best practice.

Principle		Full Compliance	Comments
Structure	The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing Council.	Yes	The City of Edinburgh Council acts as administering authority and delegates all pension scheme matters to a committee of seven members (Pensions Committee) made up as follows: - Five City of Edinburgh elected members Two external members from Lothian Pension Funds' Consultative Panel (one each from the employer and member representatives).
	That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	Yes	The Pensions Committee includes two external places for pension fund stakeholders i.e. one each from the employer and member representatives taken from the Lothian Pension Funds' Consultative Panel. Two members of the Consultative Panel also attend the Pensions Audit Sub-Committee. Fund members and employers are also represented by a Lothian Pension Funds' Consultative Panel. Membership includes six employer representatives and six member representatives. All members of the Consultative Panel are invited to attend the meeting of the Pensions Committee and receive the relevant papers prior to those meetings.
	That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes	The Pensions Audit Sub-Committee consisting of three members of the Pensions Committee, report to the Pensions Committee on their findings and recommendations. The Lothian Pension Funds' Consultative Panel attends the Pensions Committee meetings in an advisory, non-voting capacity and takes part in training events. Two members of the Panel are also full voting members of the Pensions Committee. Implementation of investment strategy is delegated to the Director of Corporate Governance, who takes advice from the Investment Strategy Panel. The Panel meets quarterly and reports to the Pensions Committee annually.

Principle		Full Compliance	Comments
Structure (cont'd)	That where a secondary committee or panel has been established, at least one seat of the main committee is allocated for a member from the secondary committee or panel.	Yes	Membership of the Lothian Pension Funds' Consultative Panel consists of the Convener of the Pensions Committee, the two external members of the Pensions Committee and ten other representatives. The Investment Strategy Panel consists of Director of Corporate Governance, Investment and Pensions Service Manager, Pensions and Accounting Manager, Investment Manager and three independent advisers.
Represent-ation	That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include employing authorities (including non-scheme employers, e.g. admitted bodies) and scheme members (including deferred and pensioner scheme members)	Yes	The Lothian Pension Funds' Consultative Panel consists of a mix of representatives: - six employer representatives from non-administering authority employers (of which two places are reserved for Lothian Buses plc and Scottish Government) - six member representatives including one pensioner representative, three members (active or deferred) appointed by the Trade Union Consultative Committee and two members (active or deferred) appointed through an alternative route.
	Where appropriate, independent professional observers, and expert advisors (on an ad-hoc basis).	Yes	An Independent Professional Observer was appointed in March 2013 to help Committee scrutinise advice. Three independent investment advisers sit on the Investment Strategy Panel. A separate specialist Pension Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the pension funds.
	That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Yes	The Lothian Pension Funds' Consultative Panel attends the Pensions Committee meetings in an advisory capacity and take part in all Committee training events. The Pensions Committee takes account of the views of the Lothian Pension Fund's Consultative Panel when making decisions.
Selection and Role of Lay Members	That committee or panel members are made fully aware of the status, role and function that they are required to perform on either a main or secondary committee.	Yes	A comprehensive training programme including induction is in place. Members of the Pensions Committee are expected to attend three days training each year and Lothian Pension Funds' Consultative Panel members one day's training each year. The members approval of a code of conduct is a condition of appointment of members to the Lothian Pension Funds' Consultative Panel.

Principle		Full Compliance	Comments
Selection and Role of Lay Members (cont'd)	That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes	The declaration of members' interests is a standard item on the agenda of the Pensions Committee and Pensions Audit Sub-Committee. A Code of Conduct also applies to all members of the Pension Committee and to the Lothian Pension Funds' Consultative Panel.
Voting	The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes	Five of the seven places in the Pensions Committee are held by elected members of the City of Edinburgh Council, which is required to retain a 2/3 majority in line with the Local Government (Scotland) Act 1973. The constitution of the Lothian Pension Funds' Consultative Panel clearly documents how one each of the employer and member representatives will be elected to the Pensions Committee.
Training / Facility Time / Expenses	a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision making process.	Yes	A Code of Conduct also applies to all members of the Pension Committee and to the Lothian Pension Funds' Consultative Panel.
	b) That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	Yes	The training policy ensures all members are treated equally. Members of the Lothian Pension Funds' Consultative Panel are encouraged to attend in-house training events. Advisers have their own professional development obligations.
	c) That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training.	Yes	Each Pensions Committee member receives at least three days of training each year. Attendance at meetings and training is monitored and reported.
Meetings frequency	a) That an administering authority's main committee or committees meet at least quarterly.	Yes	The Pensions Committee meets at least four times a year.

Principle		Full Compliance	Comments
Meetings frequency (cont'd)	b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committees sits.	Yes	The Lothian Pension Funds' Consultative Panel attends all the Pensions Committee meetings. Further meetings are held if necessary. The Pensions Sub-Committee is held before the Pensions Committee at least three times with further meetings held if necessary. The Investment Strategy Panel meets quarterly or more frequently as required.
	c) That an administering authority who does not include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Not applicable	
Access	That subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	Committee papers and minutes are publicly available on the Council's website and all Committee and Consultative Panel members have equal access.
Scope	That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The Pensions Committee deals with all matters relating to both the administration and investment of the Funds. A separate specialist Pension Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the pension funds.

Principle		Full Compliance	Comments
Publicity	That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes	The City of Edinburgh Council is responsible for the appointment of members to the Pensions Committee. However on an annual basis: - the employer representative to be nominated for the Pensions Committee is selected by the employer representatives of the Consultative Panel - the member representative to be nominated to the Pensions Committee is selected by the member representatives of the Consultative Panel. Membership of the Consultative Panel is rotated every three years. Lothian Pension Fund publishes governance documents and communicates regularly with employers and scheme members. Two members of the Consultative Panel are recruited by self nomination.

Risk Management Statement

The Fund is committed to a strong control environment to ensure that risks are identified, understood, managed and monitored appropriately. The risks (not taking into account of our controls) faced by the Fund change over time and ongoing management of risk is crucial.

The Funds also have a compliance policy and each manager is responsible for ensuring compliance within their area of responsibility. Risk management has been strengthened by the appointment of the Legal and Risk Manager in March 2013.

The most significant risks at 31 March 2013 were as follows:

	Before controls			After controls
Description	**Impact**	**Likelihood**	**Risk score**	**Risk score at 31 March 2013**
Under funding leading to pressure on employer contributions.	8	7	56	20
Recruitment and retention of appropriate key staff	8	7	56	24
Risk of incorrect pension payments	7	8	56	49
The collapse of an employer body member, leading to pressure on other employers	5	9	45	32
Fraud/theft of Council/Pension Fund assets	7	6	42	16

As at 31 March 2014, the most significant risks (taking account of controls), as assessed by the Investment and Pensions Service Management Team, were as follows:

	After controls			
Description	**Impact**	**Likelihood**	**Risk score**	**Risk target**
Business continuity issues (associated with our office move)	7	5	35	18
The collapse of an employer body member, leading to pressure on other employers	4	8	32	21
Recruitment and retention of appropriate key staff	5	6	30	16
Adverse movement against non-invest assumptions leading to pressure on employer contributions	5	5	25	20
Acting out-with proper authority/delegations (associated with updating our internal sub-delegation/signature policies)	6	4	24	4

Additional information

Key documents online

You can find further information on what we do and how we do it, on our website at www.lpf.org.uk/policy

- Actuarial Valuation reports
- Consultative Panel constitution and operation guidance
- Annual Report and Accounts
- Statement of Investment Principles
- Communications strategy
- Funding Strategy Statement
- Service Plan
- Trustee training policy

Fund advisers

Actuaries:	Hymans Robertson LLP
Auditor:	David McConnell, Assistant Director of Audit, Audit Scotland
Bankers:	Royal Bank of Scotland
Investment consultancy:	KPMG LLP Gordon Bagot Scott Jamieson
Investment custodians:	The Northern Trust Company
Investment managers:	Details can be found in the notes to the accounts.
Additional Voluntary Contributions (AVC) managers:	Standard Life Prudential
Property valuations:	CB Richard Ellis Ltd
Solicitors:	The City of Edinburgh Council

Comments and suggestions

We appreciate your comments and suggestions on this report. Please let us know which sections you found useful and if you have any suggestions for items to be included in the future. Please email your comments to pensions@lpf.org.uk

Accessibility

You can get this document on tape, in Braille, large print and various computer formats if you ask us. Please contact the Interpretation and Translation Service (ITS) on 0131 242 8181 and quote reference number 00819. The ITS can also give information on community language translations.

Contact details

If you would like further information about Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Home Pension Fund, please contact us.

Address: Lothian Pension Fund, Atria One, 144 Morrison Street, Edinburgh EH3 8EX
Telephone: 0131 529 4638 **Fax:** 0131 529 6229
Email: pensions@lpf.org.uk **Web:** www.lpf.org.uk

Lothian Pension Fund
Atria One
144 Morrison Street
Edinburgh
EH3 8EX

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Annual Statement by the Head of Internal Audit

To the members of the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund (the Funds), the Director of Corporate Governance and the Chief Executive

As Head of Internal Audit for the Funds I am pleased to present my annual statement on the adequacy and effectiveness of the Funds internal control system for the year ended 31 March 2014.

Respective responsibilities of management and internal auditors in relation to internal control

It is the responsibility of the Funds senior management to establish an appropriate and sound system of internal control and to monitor the continuing effectiveness of that system. It is the responsibility of the Head of Internal Audit to provide an annual overall assessment of the robustness of the internal control system. The Internal Audit Strategy ensures that I have in place a planning mechanism that allows me to deliver a formal opinion on the internal control environment within the Funds.

Sound internal controls

The main objectives of the Funds internal control systems are:

- To ensure that their aims and objectives can be met;
- To ensure adherence to management policies and directives;
- To safeguard assets;
- To ensure the relevance, reliability and integrity of information, so ensuring as far as possible the completeness and accuracy of records; and
- To ensure compliance with statutory requirements.

Any system of control can only ever provide reasonable and not absolute assurance that control weaknesses or irregularities do not exist or that there is no risk of material errors, losses, fraud, or breaches of laws or regulations. Accordingly, the Funds managers are continually seeking to improve the effectiveness of the systems of internal control.

The work of internal audit

Internal audit is an independent appraisal function appointed by the Funds for the review of the internal control system as a service to the organisation. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources.

The internal audit section operates in accordance with the Chartered Institute of Public Finance and Accountancy's Code of Practice for Internal Audit in Local Government in the United Kingdom. The Section undertakes an annual programme of work, agreed with the Funds senior management, which is reported to the Pensions Committee and Pensions Audit Sub-Committee.

The Annual Audit Plan is based upon the agreed strategy and is split between work that needs to:

- Be carried out annually on the major financial systems to support the Head of Internal Audit's opinion on financial controls which is used to inform the Pensions and Accounting Manager's statement of effectiveness of the internal financial control system.
- Support the Chief Executive, Director of Corporate Governance and Pensions Committee Convener's Annual Governance Statement.
- Ascertain the effectiveness of the controls that mitigate the risks that could prevent the Funds achieving their aims and objectives.

In addition, a rolling programme based upon risk is used to cover all other areas of internal control. This rolling programme together with the annual coverage helps to inform my opinion on the adequacy and effectiveness of the control environment.

All internal audit reports identifying system weaknesses and/or non-compliance with expected controls are brought to the attention of management and include appropriate recommendations and agreed action plans. It is management's responsibility to ensure that proper consideration is given to internal audit reports and that appropriate action is taken on audit recommendations. The internal auditor is required to ensure that appropriate arrangements are made to determine whether action has been taken on internal audit recommendations or that management has understood and assumed the risk of not taking action. Significant matters including non-compliance with audit recommendations arising from internal audit work are reported to the Pensions Audit Sub-Committee.

Basis of opinion

My evaluation of the control environment is informed by a number of sources:

- The certified assurances from the Investment and Pensions Service Manager.
- The audit work undertaken by internal audit during the year to 31 March 2014.
- Reports issued by the Council's external auditors, Audit Scotland, and other review agencies.
- Previous external and internal audit work and reports.
- My knowledge of the Funds governance, risk management and performance monitoring arrangements.

Opinion

It is my opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control system during the year to 31 March 2014.

9th June 2014

Richard Brown, Chief Internal Auditor

Date

STATEMENT OF RESPONSIBILITIES FOR THE STATEMENT OF ACCOUNTS

The Authority's Responsibilities

The Authority is required:

- to make arrangements for the proper administration of its financial affairs, including group interests, and to secure that one of its officers has the responsibility for the administration of those affairs. In this Authority, that officer is the Chief Financial Officer.

- to manage its affairs to secure economic, efficient and effective use of its resources and safeguard its assets.

- approve the Statement of Accounts.

The Chief Financial Officer's Responsibilities
The Chief Financial Officer is responsible for the preparation of the Authority's Statement of Accounts which, in terms of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom ('the Code of Practice'), is required to present a true and fair view of the financial position of the Authority at the accounting date and its income and expenditure for the year (ended 31 March 2014).

In preparing this statement of accounts, the Chief Financial Officer has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that were reasonable and prudent;
- complied with the Code of Practice, except where stated in the Policies and Notes to the Accounts.

The Chief Financial Officer has also:

- kept proper accounting records which were up to date;
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

Statement of Accounts

The Statement of Accounts presents a true and fair view of the financial position of the Council as at 31 March 2014, and its income and expenditure for the year ended 31 March 2014.

Hugh Dunn

HUGH DUNN, CPFA
Head of Finance
12 June 2014

Lothian Pension Funds Annual Report 2014

Statement on the system of internal financial control

Section 95 of the Local Government (Scotland) Act 1973 states that "every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the authority has responsibility for the administration of those affairs". The Head of Finance serves as the Section 95 Officer for all of the Council's accounting arrangements, including those of the Lothian Pension Funds. For the Pension Funds, however, this Section 95 responsibility has been delegated to the Pensions and Accounting Manager.

In compliance with standard accounting practice, the Pension and Accounting Manager is required to provide the Chief Executive with a statement of the effectiveness of the internal financial control system of the Funds for the year ended 31 March 2014.

The Funds place reliance upon the internal financial controls within the City of Edinburgh Council's financial systems and the monitoring in place to ensure the effectiveness of these controls. Accordingly, the "Statement on the system of internal financial control" by Hugh Dunn, Head of Finance, City of Edinburgh Council, dated 12 June 2014, is appended.

Within this overall control framework, specific arrangements for the Lothian Pension Funds also include:

- identifying the objectives of the Funds in Funding Strategy Statement, Statement of Investment Principles and Service Plan;
- monitoring of the achievement of objectives by the Pensions Committee, Consultative Panel and senior officers;
- the Council's Monitoring Officer reports on any non-compliance with laws and regulations of which he is made aware;
- the Funds' Legal and Risk Manager similarly reports on any non-compliance with laws and regulations, with a detailed compliance framework covering key activities;
- a risk management policy, including a regularly reviewed risk register, serves to manage risk to the Funds appropriately;
- the Pensions Audit-Sub Committee, whose core functions comply with CIPFA standards
- codes of conduct for elected members, Consultative Panel members and officers
- a structured programme to ensure that Committee members have the required standard of knowledge and understanding of Local Government Pension Scheme matters;
- operating within clearly established investment guidelines defined by the Local Government Pension Scheme Investment Regulations and the Funds' Statements of Investment Principles ;
- compliance with the CIPFA Principles for Investment Decision Making in the Local Government Pension Scheme and the Myners Principles on investment;
- with the exception of managed funds, unlisted investments and property, all investments are held under custody by a global custodian. The Funds benefit from the custodian's extensive internal control framework;
- benchmarking of services in terms of quality and cost against other Local Government Pension Scheme funds.

The Head of Internal Audit has provided an assurance statement on the effectiveness of the system of internal control, which is also appended. This was informed by:

- the certified assurances from the Investment and Pensions Service Manager
- senior officers' management activities
- Internal Audit's review work
- Audit Scotland's review work leading to its Annual Audit Report
- risk management procedures.

In light of the above, it is my opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the system of internal financial control for the Lothian Pension Funds.

JM Burns

John Burns
Pensions & Accounting Manager

Date: 12 June 2014

Pensions Committee

10.00 a.m., Tuesday, 17th June 2014

Statement of Investment Principles

Item number	5.5
Report number	
Executive/routine	
Wards	All

Executive summary

This report introduces the Lothian Pension Fund, Lothian Buses Fund and Scottish Homes Pension Fund (the Funds') revised Statement of Investment Principles (SIP) (appendix 1), which replaces that agreed by Committee in June 2013.

Links

Coalition pledges	
Council outcomes	CO26- The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	

Report

Statement of Investment Principles

Recommendations

1.1 That the Committee adopts the revised Statement of Investment Principles.

Background

2.1 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 require administering authorities to prepare, maintain and publish a written Statement of Investment Principles.

Main report

3.1 The Statement of Investment Principles is formally reviewed annually whether there are policy changes or not. It has been reviewed and the investment management benchmarks, objectives and structures of the Funds updated. There are no other material changes.

Measures of success

4.1 Success of the investment strategies will, among other things, be measured by the achievement of the investment and funding objectives of the Funds.

Financial impact

5.1 There are no direct financial implications as a result of this report.

Risk, policy, compliance and governance impact

6.1 The Statement of Investment Principles details how the risks, compliance and governance aspects of the Funds are managed. Such a statement is required under the Local Government Pension Scheme Regulations. Appendix C of the Statement illustrates compliance with the CIPFA principles.

Equalities impact

7.1 There are no equalities implications as a result of this report.

Sustainability impact

8.1 The Statement sets out the Funds' approach to responsible ownership and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with the Statement is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

9.1 The Consultative Panel for the Funds, comprising member and employer representatives, is integral to governance. The Statement is published on the Funds' website.

Background reading / external references

None

Alastair Maclean

Director of Corporate Governance

Contact: Bruce Miller, Investment Manager

E-mail: Bruce.Miller@edinburgh.gov.uk | Tel: 0131 469 3866

Links

Coalition pledges	
Council outcomes	CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	
Appendices	Appendix 1 - Statement of Investment Principles including: Appendix A – Investment Strategy Appendix B – Statement of Compliance with UK Stewardship Code Appendix C – Lothian Pension Funds' Compliance with the CIPFA Principles for Investment Decision Making in the Local Government Pension Scheme

LOTHIAN PENSION FUND, LOTHIAN BUSES PENSION FUND and SCOTTISH HOMES PENSION FUND (‘the Funds’)

STATEMENT OF INVESTMENT PRINCIPLES (June 2014)

1. Introduction

1.1 This Statement of Investment Principles was agreed by the Pensions Committee of the City of Edinburgh Council on 17 June 2014.

1.2 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 require administering authorities to prepare, maintain and publish a written Statement of Investment Principles (SIP). The SIP must be reviewed from time to time in accordance with any material changes in the Policy. In preparing this statement, the Committee has taken professional advice from the Investment Strategy Panel, which includes external advisers.

2. Governance

2.1 The City of Edinburgh Council (CEC) is the administering authority for the Lothian Pension Fund, the Lothian Buses Pension Fund and Scottish Homes Pension Fund.

2.2 The Pensions Committee (“the Committee”) of the City of Edinburgh Council has delegated responsibility for the supervision of the Funds.

2.3 This SIP sets out the principles governing decisions about the investments of the Funds. The Committee recognises the importance of corporate governance and corporate responsibility in ensuring the long term financial performance of the companies in which they invest.

2.4 The SIP forms part of a framework that includes

- The Statutory Regulations
- The Pensions Committee
- The Investment Strategy Panel
- The Lothian Pension Funds’ Consultative Panel
- The Funds’ Advisors
- The Funds’ Funding Strategy Statement.

3. Investment Objectives & Benchmarks

3.1 The primary aim of the Funds is to ensure that all members and their dependants receive their benefits when they become payable.

3.2 The funding objectives are documented in the Committee's Funding Strategy Statement. The primary funding objectives are:

- to ensure the long-term solvency of the Funds and that of sub funds
- to minimise the degree of short-term change in employer contribution rates
- to maximise the returns from investments within reasonable risk parameters, and hence minimise the cost to the employer
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment
- to help employers manage their pension liabilities
- where practical and cost effective, to make allowance for the different characteristics of different employers and groups of employers.

3.3 The Funds seek to control risk through investing in a diverse range of investments. The Pensions Committee sets an investment strategy for each Fund, taking into account the funding status and liabilities. The strategies are subject to regular review. Details of each Fund's strategic asset allocation are provided in Appendix A.

3.4 The Funds' focus within the strategic asset allocation is on risk, income and capital protection. The Funds are assessed relative to a benchmark, but success is also measured in terms of the level and growth of income and the volatility of absolute performance.

3.5 The investment objectives of the Funds are to achieve the same return as the benchmark over the long term economic cycle (typically five years or more). Over shorter periods, the Funds should perform better than the benchmark if markets fall significantly.

3.6 It is recognised that within Lothian Pension Fund, employers' circumstances vary and there may be demand from individual employers for a lower-risk investment strategy for their section of the Fund. The Fund will consider such requests subject to practical implementation of such strategies and if appropriate, a review of employer contribution rates. It is not practical for the Fund to offer individual employers full flexibility on asset allocation.

4. Investment Management Structure

4.1 The Funds employ a combination of managers with the aim of delivering, in aggregate, the objectives of each Fund. Each Fund employs different types of managers depending on the requirements of the Fund.

4.2 To reduce the risk that a Fund does not deliver its objective, performance and risk targets and controls are set for each manager relative to their benchmark. The details are included in formal fixed term Investment Management Agreements. In addition, managers and their performance are monitored on a regular basis.

4.3 The investment managers are responsible for the selection of individual holdings within each type of investment category within the parameters set out in their agreement.

4.4 The selection of investment managers complies fully with European Union directives on competitive tendering.

4.5 Specialist transition managers are employed to manage complex changes in investment strategy and/or manager(s).

4.6 Details of the Funds' investment managers are provided in Appendix A.

5. Underlying Investments

Types of Investment

5.1 The Committee has approved the use of the following different types of investment and income generating mechanisms to achieve their overall investment objectives:

- Listed and Unlisted Equities (including Managed Funds, Unit Trusts, Investment Trusts, Open Ended Investment Companies and Exchange Traded Funds),
- Bonds including index-linked and fixed interest bonds, issued by both government and corporations;
- Alternative investments (including Infrastructure, Property, Timber, Agriculture, Currency and other asset classes as agreed by the Investment Strategy Panel),
- Cash (including Treasury Bills and Money Market Funds),
- Derivatives,
- Stock lending,
- Commission recapture,
- Underwriting.

The Balance Between Different Types of Investments & Risks

5.2 The Funds seek to control risk through investing in a diverse range of investments. The Pensions Committee sets investment strategy for each Fund, taking into account the funding status and liabilities. The strategies are subject to regular review.

5.3 Asset liability modelling techniques, which measure the risk of the Fund relative to the liabilities, are used to assist in the strategy reviews, as appropriate.

5.4 The risk of the Funds performing differently to their benchmarks is monitored using an independent performance and risk specialist. The internal investment team and the Investment Strategy Panel monitor risks on a quarterly basis.

Expected return on investments

5.5 Each Fund expects its investments to produce a return over the long term above that of the investment return assumed in the actuarial valuation.

Realisation of investments

5.6 The majority of each Fund's investments are quoted on major stock markets and may be realised relatively quickly if required. A proportion of each Fund's investments (such as property, private equity and infrastructure) would take longer to be realised. The overall liquidity of each Fund's assets is considered in the light of potential demands for cash.

Stock Lending

5.7 Lothian Pension Fund and Lothian Buses Pension Fund lend a proportion of their investments in order to maximise additional income. Stock lending is conducted within the parameters prescribed in the regulations. Stock lending does not prevent any investments from being sold. Safeguards are in place to reduce the risk of financial loss in the event of default. These safeguards include receiving liquid collateral in excess of the value of the loan, indemnity agreement with the lending agent and regular reviews of credit-worthiness of potential borrowers.

Responsible Investment

5.8 The Pensions Committee believes that investing responsibly can affect the financial performance of companies. It has a responsibility to take environmental, social and governance issues seriously and where appropriate, to act upon them.

5.9 The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting.

5.10 The Funds seek to adhere to the FRC'S UK Stewardship Code, and encourage our appointed asset managers to do so too. Details of adherence to the Code are provided in Appendix B.

Safekeeping of Assets

5.11 The services of a global custodian are employed to ensure the safekeeping of investments.

Performance measurement

5.12 An independent provider is employed to calculate performance for the Funds. Each quarter, the Investment Strategy Panel considers the performance of the combined assets and each manager's portfolio against their respective benchmark. The Pensions Committee reviews performance on an annual basis.

6. Compliance

Regulations and Investment Limits

6.1 The Funds are compliant with the statutory restrictions set out in the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010.

The Regulations contain limits on the percentage of a pension fund that may be invested in certain asset types and provide for the limits to be raised, subject to certain requirements being met. The Committee resolved that the limits applicable to the Funds' investments in partnerships be raised in order to accommodate the strategic allocation to Alternative Investments, including infrastructure, and to Private Equity. The Committee decision was that:

- The limit in respect of all contributions into any single partnership be raised from 2% to 5%.
- The limit in respect of all contributions into partnerships be raised from 5% to 15%.

The Committee took proper advice in respect of this decision from the Investment Strategy Panel and from officers. This decision will apply for the period for which the Funds' strategic investment benchmarks include allocations to investments which involve investment in partnerships, unless investment considerations require an earlier review. This decision is compliant with the Regulations.

CIPFA Principles for Investment Decision Making in the Local Government Pension Scheme

6.2 Regulations require administering authorities to publish the extent to which they comply with guidance issued by the Scottish Ministers, which in turn refer to guidance issued by Chartered Institute of Public Finance and Accountancy. The Funds' compliance with the guidance is provided in Appendix C.

7. Review

7.1 The Pensions Committee will review this statement annually or more frequently if appropriate. The Committee will consult with such persons as it considers appropriate and take proper advice when revising the statement.

Lothian Pension Fund

Investment Strategy

	Benchmark from 31/03/14 (%)	Strategy 2012-2017 (%) [1]	Permitted Range % [1]
Listed Equities	64	60	
Private Equity	6	5	
Total Equities	**70**	**65**	**50 – 75**
Inflation linked Assets	**5**	**7**	**0 – 20**
Alternatives	**24**	**28**	**20 – 35**
Cash	**1**	**0**	**0 – 10**
TOTAL	**100**	**100**	

[1] Revised benchmark agreed by Committee October 2012 which will be implemented gradually over time.

Investment Management Structure at 30 April 2014

- 5 Global Equity Managers (external: Nordea, Cantillon, Harris; internal: 2 mandates), 8 Regional Equity Managers (external: Baillie Gifford, Invesco, Mondrian and UBS; internal: UK All Cap, UK Mid Cap, US and Europe ex-UK)
- Private equity investments in a range of direct funds, fund-of-funds and listed vehicles, some of which are managed internally.
- 1 Bond Manager (Internal)
- Alternative Investments include a range of direct funds, fund-of-funds and listed vehicles invested in infrastructure, secured loans, property and timber, some of which are managed internally.
- 1 Currency Manager (internal)
- Cash (Internal)

Lothian Buses Pension Fund

Investment Strategy

	Benchmark at 31/03/14 (%)	Strategy 2012-2017(%) [1]	Range within asset class (%)
Equities			
Listed Global Equities	62.5	55	
Private Equity	**0.0**		
Subtotal	**62.5**	**55**	45-65
Bonds			
Index Linked Gilts	10.0	15	10-30
Subtotal	**10.0**	**15**	
Alternative Investments			
Property	10.0	30	
Other, including corporate bonds	17.5		
Subtotal	**27.5**	**30**	**10-35**
Cash	**-**	**-**	**0-10**
TOTAL	**100.0**	**100**	

[1] Revised Strategy agreed by Committee in October 2012. The revised strategy will be implemented gradually.

Investment Management Structure at 30 April 2014

- Global equities: internal and Baillie Gifford
- Listed Private equity: internal
- Index linked Gilts: internal and Baillie Gifford
- Corporate bonds: Baillie Gifford
- Property: Standard Life
- Alternative Investments: internal and include secured loans, timber and infrastructure managed via a range of listed vehicles, direct funds and fund-of-funds.
- Cash (Internal)

APPENDIX A

Scottish Homes Pension Fund

Investment Strategy

	Strategic Benchmark at 01/04/2014 %	Strategy for 2012-2017 [1] %	Range for 2012-2017 [1] %
Equities			
UK	6.6	**30**	**20-35**
US	9.3		
Europe (ex UK)	6.0		
Pacific inc Japan	5.7		
Emerging markets	2.4		
Sub-total	**30.0**		
Bonds			
UK Fixed Interest Gilts	13.0	**65**	**60-75**
UK Index Linked Gilts	52.0		
Subtotal	**65.0**		
Property	**5.0**	**5**	**5-10**
Cash	**0.0**	**0**	**0-5**
TOTAL	**100.0**	**100**	**100**

[1] Agreed by Committee October 2012

Investment Manager Arrangements at 30 April 2014

Equities and bonds: State Street.
Property: Schroders.

Statement of Compliance with UK Stewardship Code	
Principle 1 Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.	We acknowledge our role as an asset owner under the Stewardship Code and therefore seek to hold to account our fund managers and service providers in respect of their commitments to the Code. In practice our policy is to apply the Code through a) The appointment of Hermes Equity Ownership Services (EOS) to assist in fulfilling our fiduciary responsibilities as long term shareholders. We believe that the monitoring of shareholdings by Hermes EOS enables us to provide the highest standards of stewardship on behalf of the beneficiaries of the pension funds. Hermes EOS has the expertise in corporate engagement to carry forward this work on an international basis. Their aim is to bring about positive long-term change at companies through a focussed and value-oriented approach. Engagements undertaken by Hermes EOS on our behalf are guided by the Hermes Responsible Ownership Principles http://www.hermes.co.uk/Portals/8/The_Hermes_Ownership_Principles_UK.pdf Besides engagement on an individual company level, through Hermes EOS, we also work to establish effective regulatory regimes in the various markets in which we invest to encourage governance structures that facilitate accountability of companies to their owners, give companies the certainty they need to plan for the future and to level the playing field to ensure companies are not disadvantaged for prioritising long-term profitability. b) As well as Hermes EOS, three of our Fund Managers, Baillie Gifford, State Street and UBS, take direct responsibility for stewardship issues, voting and engagement, in the funds which they manage on our behalf. These managers publish Statements of Compliance with the Stewardship code. Details are available on their websites at www.bailliegifford.com/pages/UKInstitutional/CorporateGovernance/CorporateGovernaceSRI.aspx http://www.ubs.com/global/en/asset_management/responsible_investment.html http://www.ssga.com/webapp/features/proxy_voting_policy.jsp?country=GB&language=EN_ c) Through our membership of the Local Authority Pension Fund Forum (LAPFF), we keep informed of potential issues of concern at both individual companies and across the market as a whole, which leads to collaborative engagement.

Statement of Compliance with UK Stewardship Code	
Principle 2 Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.	Our relationship with Hermes EOS enables us effectively to manage conflicts of interest in relation to our stewardship work. Hermes EOS conflicts of interest policy, which explains how it manages conflicts on our behalf, can be found at http://hermes.yellowtailcms.co.uk/Portals/8/Conflicts_of_interest_policy.pdf. We also encourage the asset managers employed by the Funds to have effective policies addressing potential conflicts of interest. In respect of conflicts of interest within the Funds, Pensions Committee members are required to make declarations of interest prior to Committee meetings. Our policy of constructive engagement with companies is consistent with the Funds' fiduciary responsibilities.
Principle 3 Institutional investors should monitor their investee companies.	Day-to-day responsibility for monitoring our equity holdings is delegated to Hermes EOS, Baillie Gifford, State Street and UBS. We expect them to monitor companies, intervene where necessary, and report back regularly on activity. Details are provided quarterly on the Funds' website. This includes both the total number of company meetings where the Funds have voted and details of individual companies where we have voted against company management. LAPFF also monitors and engages with companies and provides an 'Alerts' service which highlights concerns over corporate governance issues. The internal investment management team adhere to the Funds' compliance policy on insider information. In order to foster a positive working relationship with an individual company and to build trust, Hermes EOS may be willing to become an insider. In such circumstances, the relevant information will not be passed to the internal team until after it is no longer inside information.

Statement of Compliance with UK Stewardship Code	
Principle 4 Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.	As highlighted above, responsibility for day-to-day interaction with companies is delegated, including the escalation of engagement when necessary. We expect the approach to engagement on our behalf to be value orientated and focussed on long term sustainable profitability. We expect Hermes EOS, Baillie Gifford, State Street and UBS to disclose their guidelines for such activities in their own statements of adherence to the Code. We may also propose escalation of activity through the Local Authority Pension Fund Forum. Consistent with our fiduciary duty to beneficiaries, we also participate in shareholder litigation. We pursue compensation for any losses sustained because of inappropriate actions by company directors in order to encourage improved conduct in the future.
Principle 5 Institutional investors should be willing to act collectively with other investors where appropriate	We seek to work collaboratively with other institutional shareholders in order to maximise the influence that we can have on individual companies. We do this through: - membership of the Local Authority Pension Fund Forum, which engages with companies over environmental, social and governance issues on behalf of its members. - the appointment of Hermes EOS also signals our commitment to the benefits of collective shareholder engagement. Hermes EOS pools together investors' resources to create an engagement service which aims to protect and enhance shareholder value. Hermes EOS represents us at many national, regional and global organisations through which we seek to enhance our effectiveness by working collaboratively with other institutions. Among these are: the UNPRI and its Clearinghouse for engagements (as well as a number of more localised UNPRI initiatives); the International Corporate Governance Network; the Asian Corporate Governance Association; the Canadian Coalition for Good Governance , Eumedion and the NAPF's Shareholders Advisory Group. Hermes EOS seeks to work with these organisations and also alongside other individual investors to effect change most efficiently. - being a signatory of the UN Principles for Responsible Investment (PRI) in our own right. - being a signatory since 2009 to the Carbon Disclosure Project (CDP) Information Request. The information gathered by CDP forms the largest database of corporate climate change information in the world.

Statement of Compliance with UK Stewardship Code	
Principle 6 Institutional investors should have a clear policy on voting and disclosure of voting activity.	The emphasis of our voting policy is to promote best practice. We seek to vote on all shares held. The Funds have an active stock lending programme but consider recalling stock from a loan where it appears that this would be an appropriate way to safeguard the Funds' financial interests. Our preference is for managers to vote on the Funds' behalf and for responsible stewardship to be integral to the investment decision making process. We are comfortable with delegation of voting to Baillie Gifford and UBS for the funds they manage. State Street vote on our behalf because the investment is in a pooled fund. The managers' voting policies can be found at the websites mentioned above. For the remaining funds, Hermes EOS votes consistently, across the portfolios it covers, and makes voting decisions based on a thorough analysis of publicly available information and always take account of a company's individual circumstances. Hermes EOS informs companies where it has concerns and seeks a resolution prior to taking the decision to vote against management. In this way, it uses our votes as a lever for positive change at companies. Underpinning voting decisions are Hermes EOS Regional Corporate Governance policies which can be found at the "How we invest" section of our website. We disclose our historic voting information on our website. This includes the total number of companies where the Funds voted and details of individual companies where we have voted against company management. We disclose in arrears so that we are transparent and accountable but dialogue with companies in our portfolios is not compromised.
Principle 7 Institutional investors should report periodically on their stewardship and voting activities.	We report annually on stewardship activity through a specific section in the Funds' annual report and accounts and on our website. We also report annually on stewardship issues to the Pensions Committee. We have reviewed this Statement in June 2014. We will review the Statement annually.
	For further information please contact Marlyn.McConaghie @edinburgh.gov.uk

Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund (the Funds), Compliance with the CIPFA Principles for Investment Decision Making in the Local Government Pension Scheme.

The Funds comply with the six CIPFA Principles. Details of the principles and the Funds' compliance are described below.

Principle 1 – Effective decision making
Administering authorities should ensure that decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and monitor their implementation; and
Those persons or organisations should have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

- The Funds' Trustee Training Policy (comprising a compulsory training seminar for all new trustees and ongoing training of at least three days per year for all Committee Members) provides Committee members with sufficient knowledge to be able to evaluate and challenge the advice they receive. All committee members have met the pro rata minimum requirement for training during the reporting period, 1 April 2013 to 31 March 2014.

- Standards relating to the administration of the Committee's business are strictly up-held.

- The Pensions Committee focuses on setting the strategy for the Funds and monitoring performance. The Committee delegates the day-to-day running of the Funds to the Director of Corporate Governance.

- The Director of Corporate Governance is responsible for the provision of the training plan for Committee to help them to make effective decisions to ensure that they are fully aware of their statutory and fiduciary responsibilities, and to regularly remind them of their stewardship role.

- The Investment Strategy Panel oversees the Funds' investments. This includes implementing the agreed strategies, reviewing structure, funding monitoring, performance and risk and tactical asset allocation. The Investment Strategy Panel meets quarterly and is made up of experienced investment professionals, including independent advisers.

- The in-house team undertakes day-to-day monitoring of the Funds. The team includes personnel with suitable professional qualifications and experience to provide the necessary skills, knowledge, advice and resources to support the Investment Strategy Panel and the Pensions Committee.

- Conflicts of interest are managed actively. At each Committee meeting, elected members (acting as 'trustees' of the Funds) are asked to highlight conflicts of interest. The Lothian Pension Funds' Consultative Panel, which includes representative members and employers, attend Committee meetings. Committee take into account the Consultative Panel's views when making decisions. A Code of Conduct applies to members of the Committee and Consultative Panel.

- The Funds have a Compliance Policy which ensures conflicts of interest are highlighted and managed appropriately.

Principle 2 – Clear Objectives
Overall investment objectives should be set out for the fund that take account of the scheme's liabilities, the potential impact on local council tax payers, the strength of the covenant of the participating employers, and the attitude to risk of both the administering authority and the scheme employers, and these should be clearly communicated to advisers and investment managers.

- The Statement of Investment Principles and the Funding Strategy Statement define the Funds' primary funding objectives.

- Asset-liability modelling is undertaken with the help of external advisers to aid the setting of investment strategy in order to understand risks. Each Fund has a scheme-specific investment strategy.

- The attitude to risk of employers and the administering authority is specifically taken into account in the setting of strategy.

- Reviews of investment strategy focus on the split between broad asset classes (equities, bonds and alternative investments).

- Investment Management Agreements set clear benchmarks and risk parameters to achieve and include the requirement to comply with the Funds' Statement of Investment Principles.

- Appointments of advisers are reviewed regularly. Investment and actuarial advisers are appointed under separate contract. Procurement of advisers is conducted within European Union procurement regulations.

- The setting of the Funding Strategy included specific consideration of the need to maintain stability in employer contribution rates.

Principle 3 – Risk and liabilities
In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.
These include the implications for council tax payers; the strength of the covenant of participating authorities; the risk of their default, and longevity risk.

- The Funds take advice from the scheme's actuary regarding the nature of its liabilities. Asset-liability modelling is undertaken periodically to aid the setting of investment strategy, and these exercises specifically take account of covenant strength and longevity risk.

- It is recognised that within Lothian Pension Fund, employers' circumstances vary and there may be demand from individual employers for a lower-risk investment strategy for their section of the Fund. The Fund will consider such requests subject to practical implementation of such strategies and if appropriate, a review of employer contribution rates. It is not practical for the Fund to offer individual employers full flexibility on asset allocation.

- The Funding objectives for the Funds are expressed in relation to the solvency and employer contribution rates. The Funds regularly assesses the covenants of the Funds' participating employers.

- The Director of Corporate Governance is responsible for ensuring appropriate controls of the Funds. Controls are subject to internal audit and results of audits are submitted to the Pensions Audit Sub Committee and/or the Pensions Committee.

- The Funds maintain a risk register which is reviewed on a quarterly basis.

Principle 4 – Performance assessment
Arrangements should be in place for the formal measurement of the performance of the investments, investment managers and advisers. Administering authorities should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members.

- The Funds' performance and risk analysis is produced by an independent external provider.

- The internal investment team and Investment Strategy Panel assess Fund Managers' performance on a regular basis.

- The Funds' contracts with its advisers are regularly market tested.

- The Investment Strategy Panel assesses its own performance on a regular basis, typically annually.

- Training and attendance of members of the Pensions Committee and the Consultative Panel are monitored and reported on a regular basis. The composition of the Committee and Consultative Panel is reviewed on a regular basis.

Principle 5 – Responsible ownership
Administering authorities should adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.
A statement of the authority's policy on responsible ownership should be included in the Statement of Investment Principles.
Administering authorities should report periodically to members on the discharge of such responsibilities.

- The Funds' policy on responsible ownership is included in the statement on the FRC's Stewardship Code (see Appendix B of the Statement of Investment Principles).
- Details of the Funds' voting and engagements are available on the Funds' website. The Funds' annual report and accounts includes a summary of the Funds' approach to responsible investment. A summary of the report and accounts is sent to members. The full report is available on the website and is sent to members on request.

Principle 6 – Transparency and reporting
Administering authorities should act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives; and Provide regular communication to members in the form they consider most appropriate.

- Meetings of the Pensions Committee are open to the public. Members of the public are allowed to provide deputation at Committee meetings. All Committee papers are available on the City of Edinburgh Council's website. The Lothian Pension Funds' Consultative Panel, which includes representatives from all major stakeholders, joins the Committee at all meetings.
- The Committee's remit covers wider pension scheme issues, other than the management and investment of funds.
- The Funds' policy statements, including the Communications Strategy, Statement of Investment Principles and Funding Strategy Statement are maintained regularly. Stakeholders are consulted on changes. Documents are available on the Funds' website.
- The Funds produce an Annual Report & Accounts, a summary of which is sent to members. The full report is available on the website, and is sent to members on request.
- The Funds also produce regular newsletters for members as well as an annual benefit statement. Regular briefings are also provided to employers. The Funds' website is updated regularly.

Pensions Committee

10.00 a.m., Tuesday, 17 June 2014

Investment Strategy Panel Activity

Item number	5.6
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to provide an update on the activity of the Investment Strategy Panel ("the Panel") for the year to 31 March 2014. The Terms of Reference for the Panel were agreed by the Pensions Committee in June 2013.

The focus of the Panel has been on the implementation of the investment strategies of the pension funds, and particularly on reducing volatility without sacrificing returns. The Panel has also continued to oversee the performance and asset allocation of the investments.

Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	

Report

Investment Strategy Panel Activity

Recommendations

1.1 That Committee notes the activities of the Investment Strategy Panel during the financial year 2013/14.

Background

2.1 The purpose of this report is to provide an update on the activity of the Investment Strategy Panel for the year to 31 March 2014.

2.2 The Investment Strategy Panel ("the Panel") currently comprises four officers (the Director of Corporate Governance, the Investment and Pensions Service Manager, the Investment Manager and the Pensions and Accounting Manager) and three investment consultants (KPMG, represented by David O'Hara, and two independent advisors, Gordon Bagot and Scott Jamieson).

2.3 The Terms of Reference for the Panel were agreed by the Pensions Committee in June 2013.

Main report

3.1 The Panel meets quarterly and considers all aspects of the Funds' investments. Regular activities include reporting to and making recommendations about investment strategy to the Committee, directing and monitoring strategy implementation and risk and advising the Director of Corporate Governance on investment structure and managers.

3.2 In addition to the regular agenda, at each meeting the Panel also considers special items. The primary focus for the Panel during 2013/14 has been the implementation of the investment strategies for all three pension funds agreed by Pensions Committee in October 2012. This has involved:

- Detailed reviews and analysis of the internal team's research into complementary equity strategies that will produce improved and appropriate risk-adjusted returns;
- Analysis of the impact of new strategies on the overall equities of the funds;
- Agreeing the benchmark indices and performance targets of individual mandates including restructuring of the index-linked asset portfolio to align it better with the Fund objectives;

- A review of bond manager strategies, outlook for bond returns and an assessment of the Lothian Pension Fund's existing bond mandate;
- Establishing the timetables for the change of strategies,
- Analysis of the transitions of assets.

3.3 Other special items considered during 2013/14 included:

- Cashflow projections for unlisted assets;
- A review of the Funds' investment mandates, including objectives and controls for suitability;
- The review of investment operations conducted by an external independent consultant;
- Alternative funding approaches for the Scottish Homes Pension Fund;
- Draft Statement of Investment Principles;
- Review of Panel effectiveness.

3.4 Panel's reviews and decisions have resulted in:

- Progress of the implementation of the pension funds' investment strategies, as detailed elsewhere on the agenda;
- Reduced expected volatility in the equity portfolios of Lothian Pension Fund and the Lothian Buses Pension Fund;
- Mandates for each of the investment portfolios including objectives and controls;
- Indicative timescales for further implementation of the investment strategies.

3.5 A key area of the Panel's remit is the monitoring and assessment of the Funds' investment performance and its investment risk, both for each overall fund, but also for each investment mandate. During 2013/14, the internal team, working with the Funds' independent performance measurer and Panel, has spent time considering the most effective ways of ensuring that the Funds and their managers are taking the appropriate risk so that the Funds achieve their objectives over the long term. The aim is to introduce new performance indicators that will be useful tools to measure and demonstrate volatility of investment performance. These will be introduced as the investment strategy matures and performance history of the investment strategy is established.

3.6 Over 2014/15, the Investment Strategy Panel will focus on:

- implementation of the strategy for the three Funds, including changes to the actual allocations at the asset class level and potential changes to the structure within asset classes;
- continuing to scrutinise the management of the individual portfolios, potentially involving further rationalisation and mandate changes;
- continuing to explore other suitable alternative investment opportunities;
- exploring alternative funding approaches for the Scottish Homes Pension Fund and other conclusions resulting from the 2014 actuarial valuation.

3.7 Importantly, the focus of the Panel is the long term asset returns of the Funds rather than the short term vacillations of the investment markets, and deploying the Funds' long term capital at an appropriate level of risk.

Measures of success

4.1 The investment performance of the pension funds is crucial to the achievement of the required investment return which impacts on the funding level and employer contributions. The objectives for the investments are:

- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
- Over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

Financial impact

5.1 This report details the investment activities of the Investment Strategy Panel. The investment performance of the three Funds has a significant impact on the funding levels and potentially on the contributions required from employers.

Risk, policy, compliance and governance impact

6.1 Investment strategy is a key determinant of funding level, risk and volatility of employer contribution rates. The Funds' investment strategies are aimed at reducing the risk without sacrificing returns.

There is no governance impact as a result of this report. Committee delegates the implementation of investment strategy to the Director of Corporate Governance, who takes advice from the Investment Strategy Panel. The Investment Strategy Panel is an important element of the governance of the pension fund investments.

Equalities impact

7.1 There are no equalities implications as a result of this report.

Sustainability impact

8.1 The Statement of Investment Principles (covered elsewhere on the agenda) sets out the Funds' approach as responsible asset owners, and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with it is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

9.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading / external references

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Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	
Appendices	None

Pensions Committee

10.00 a.m., Tuesday, 17 June 2014

Investment & Funding Update – Lothian Pension Fund

Item number	5.7
Report number	
Executive/routine	
Wards	All

Executive summary

This report provides an update on the investments and funding position of the Lothian Pension Fund to 31 March 2014.

Over the twelve months to 31 March 2014, investment market returns were mixed (developed market equities positive; emerging market equities and bonds negative).

The Fund produced a return of 6.8% over the year. The benchmark return was 5.2%.

The Fund's actuary is currently undertaking the triennial valuation and will report Lothian Pension Fund's funding level (the ratio of assets to liabilities) later in the year. Market yields point to an improvement since the estimate at end March 2013 (87%).

The Fund's Investment Strategy 2012-17 is being implemented gradually. Fund risk was reduced over the year, primarily through a reorganisation of equity mandates.

Links

Coalition pledges	
Council outcomes	CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	

Report

Investment & Funding Update – Lothian Pension Fund

Recommendations

1.1 That the Pensions Committee notes the performance, funding update and asset allocation of the Lothian Pension Fund.

Background

2.1 The purpose of the report is to provide an update on the investments and funding position of the Lothian Pension Fund to 31 March 2014.

2.2 The investment performance of the Fund has a significant impact on the funding level and potentially on the contributions required by employers.

Main report

Market Background to 31 March 2014

3.1 UK investors in developed market equities and UK property were well rewarded over 2013/14; not so happy were investors in emerging market equities and UK gilts. UK, Europe ex-UK and US equities generated returns of 9%, 14% and 11% respectively in sterling terms; UK property returned 12%; emerging market equities fell more than 10% in sterling terms; and conventional and index-linked gilts were down 3% and 4% respectively.

3.2 2013/14 was a year of 'firsts' at the Bank of England and at the Federal Reserve in the US. The new governor at the Bank of England, Canadian Mark Carney, is the first non-British governor of the UK's central bank, while Janet Yellen is the first woman chair of the US central bank. If they had not known it before, both chairs discovered how investment market participants hang on the every word of key policymakers. Carney discovered that while 'forward guidance' sounds like a good idea, it can be a tricky concept; Yellen moved markets by suggesting that interest rates could rise six months after QE tapering was complete.

3.3 With the Bank of England's official interest rate pegged at 0.5%, the lowest rate in its 320 year history by some margin and quantitative easing (bond buying by the central bank) continuing, the new governor appears more concerned about the economy's growth potential than the risks of inflation. Carney is not alone amongst global policymakers, but 2013/14 was the year when outgoing chairman of the US central bank, Ben Bernanke, alerted the world that monetary policy had been so easy for so long that a change was overdue. The word tapering entered the financial market lexicon to describe a reduction in the pace of quantitative easing by central banks, effectively a tightening in monetary policy.

3.4 The price movements of equities, bonds and currencies over 2013/14 largely demonstrated the vulnerability of countries around the world to tapering. Worst affected were the prices of assets in countries with large current account deficits where central banks increased interest rates to defend their currencies. This tightening of monetary policy portends slower economic growth and potential repayment problems for issuers of foreign currency denominated debt.

Investment Performance to 31 March 2014

3.5 The Fund's investment objectives agreed by Pensions Committee in December 2012 are:

- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
- Over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

3.6 The Fund has achieved returns in excess of the strategic allocation over the last year and over the longer term timeframes shown in the table.

% per annum	1 Year	3 Years	10 Years
Lothian Pension Fund	+6.8	+7.6	+8.3
Benchmark	+5.2	+7.2	+7.4
Relative	+1.6	+0.4	+0.9

3.7 Over 2013/14, the Fund performed better than the strategic allocation when markets were falling and outperformed by a smaller margin when markets were rising. The structure of the equity pool of assets and the currency hedge were helpful in achieving an outcome of lower volatility. The changes to investment management arrangements described in 3.19 below had the effect of lowering the expected volatility of the Fund and increasing diversification.

3.8 Notable performance within each asset class is as follows:

- The Fund's Equity investments, managed by the internal team and several external managers, combined to produce a return of +7.2% over the year. Strong returns in most developed markets were offset by weak returns in Asian and emerging markets.
- The Fund's Index-Linked investments delivered a return of -7.1% over the year with the index-linked gilt portfolio falling over 4% as real yields increased and gold falling by a quarter. The Fund's small holding in gold correlates well with very long term index-linked gilts and is designed to provide protection against an unexpected rise in inflation.
- The Fund's Alternative investment performance was +5.3% over the year. Within Alternatives, the Fund's property assets provided a very strong return +13.8% while other real assets, including infrastructure and timber, and corporate bonds produced returns of +0.3% and +1.3% respectively.
- The target return for Alternatives is inflation plus 3.5% per annum. It is important to note that the true value and returns on the unlisted investments in the Alternatives portfolio will not be known until assets are realised, perhaps not for several years. Investments are made in Alternative asset classes due to the attractive expected long-term returns and the diversification they aim to provide. Short term performance data should therefore be treated with caution.

3.9 The Fund's return over the year was ahead of the benchmark return. The main contributors were the equity portfolios and property assets. The emerging markets portfolios were behind their respective benchmark returns

3.10 The Investment Strategy Panel advises the Director of Corporate Governance on the appropriate investment management structure required to implement the Fund's investment strategy and on the process for the appointment and monitoring of external investment managers. In addition, it is responsible for setting objectives and restrictions for internally managed portfolios. It monitors the risk and performance of all portfolios. Panel and the internal investment team monitor all managers on a regular basis using a traffic light system. Performance, continuity of investment process, philosophy, people and ownership, are considered in the monitoring process. Where there are concerns over a manager, more regular and in-depth monitoring is undertaken.

Funding Level

3.11 The funding level is the ratio of the pension scheme's assets to liabilities. At the last actuarial valuation three years ago, the funding level was 96% at 31 March

2011, and last year, the actuary estimated the funding level to be 87% at 31 March 2013. Work has commenced on the triennial actuarial valuation at 31 March 2014. The actuary will be assessing the need to make changes to assumptions based on the latest and best data available, such as changes to mortality assumptions, to make the most accurate assessment of the funding level. The results are expected to be considered by the Pensions Committee in March 2015.

3.12 Over 2013/14, the positive performance of asset values and the increase in real gilt yields, which causes the value of liabilities to fall, will have caused the funding level to improve *all other things being equal*. However, the Fund is very likely to remain in a deficit position, which means that assets are insufficient to meet liabilities based on the assumptions made. This is why the Fund invests in growth assets, such as equities, to achieve full funding in the future. It is worth noting that the monetary value of the deficit is expected to have increased since the 2011 actuarial valuation because the Fund and the liabilities have increased.

Investment Strategy

3.13 The Pensions Committee approved the Investment Strategy 2012-17 for Lothian Pension Fund in October 2012. The investment strategy is set at the broad asset class level of Equities, Index-Linked gilts and Alternatives, which are the key determinants of investment risk and return.

	Long Term Strategy Allocation 2012-17 %	Permitted Range %
Equities	65	50-75
Index-Linked Assets	7	0-20
Alternatives	28	20-35
Cash	0	0-10
TOTAL	100	

3.14 The strategy makes a small reduction in the allocation to Equities (including private equity) and a small increase in the allocation to Index-Linked gilts and Alternatives. It recognises the latent inflation potential at the heart of current central bank monetary policy and maintains significant exposure to real investments, such as Index-Linked gilts and Equities, which have a history of protecting purchasing power, after the effects of inflation have been taken into account.

Asset Allocation and Strategy Implementation

3.15 The implementation of the Investment Strategy 2012-17 is planned to proceed at a measured pace as investment opportunities become available and as research on opportunities is completed, and this is reflected in the interim strategy allocation shown in the table below. The Investment Strategy Panel and the internal team have focussed their efforts during 2013/14 on reducing risk and delivering the performance objectives of the Fund described above. The Investment Strategy Panel reviews asset allocation on a quarterly basis and the internal team reviews it monthly.

3.16 Actual asset allocations relative to the strategic allocation will vary over time due to differential performance of asset classes and managers. Differences between actual and strategy allocations need to be balanced against the cost of switching assets between managers.

3.17 At 31 March 2014, the Fund had an overweight position in equities and cash, and was underweight index-linked assets and alternatives, especially Other Bonds, compared to the interim strategy at 31 March 2014. The table below shows the changes in actual allocation over the financial year 2013/14 and the current interim strategy allocation at end March 2014.

	Manager	Actual Allocation 31 March 2013 %	Actual Allocation 31 March 2014 %	Interim Strategy Allocation 31 March 2014 %
EQUITIES				
UK All Cap	Internal	12.9	2.3	2.0
UK Mid Cap	Internal	2.0	2.3	1.8
Europe (ex UK)	Internal	6.3	2.3	2.1
US	Internal	7.3	2.3	2.1
Pacific	BG	7.8	3.5	3.9
Pacific	Invesco Perpetual	3.4	3.2	2.8
Emerging Markets	Mondrian	2.7	2.1	2.5
Emerging Markets	UBS	2.7	2.1	2.5
Global High Dividend Yield	Internal	5.0	14.8	14.6
Global Low Volatility	Internal	0.0	17.1	17.5
Global	Lazard	6.4	0.0	0.0
Global	Cantillon	5.4	5.5	5.0
Global	Nordea	0.0	3.7	3.7
Global	Harris	3.8	4.1	3.5
Private Equity	Various	6.6	5.6	6.0
Currency Hedge [1]	Internal	-0.5	0.2	0.0
Subtotal		**71.8**	**71.2**	**70.0**
INDEX-LINKED ASSETS				
Index-linked gilts/gold	Internal	4.1	3.9	5.0
Subtotal		**4.1**	**3.9**	**5.0**
ALTERNATIVES				
Property	Various	8.9	8.8	10.0
Other Real Assets [2]	Various	6.8	7.6	8.0
Other Bonds [3]	Rogge	4.9	4.6	6.0
Subtotal		**20.6**	**21.0**	**24.0**
Cash	Internal	3.5	3.8	**1.0**
TOTAL		**100.0**	**100.0**	**100.0**

Equities

3.18 A key objective of the Fund's investment strategy is to reduce risk. The Fund took a major step in this direction within its equity holdings during 2013/14 by transitioning assets into three global mandates, two managed internally and one managed by Nordea, which was appointed to the Fund's global equities framework in 2012 following an EU tender process. The mandates were funded from three internal regional portfolios, the Lazard global equity portfolio, which was terminated, and the Baillie Gifford Pacific portfolio, which was reduced in size. The new mandates have lowered Fund risk and are expected to perform relatively well when equity markets are weak and produce positive absolute returns in rising equity markets.

- The Fund has also moved decisively away from portfolios that are constructed along market capitalisation lines, which are regarded as suboptimal. All the equity mandates are now unconstrained by the tracking error measurement of risk, and the focus will be on capital preservation and the sustainability of income generation.
- The transition to the new portfolios has increased the equity assets managed by the internal team. Approximately two thirds of the Fund's equities are managed internally with the majority of these in low cost, low turnover strategies, which are expected to enhance the Fund's risk-adjusted returns over the long term.
- The internal team and the Investment Strategy Panel continue to research and review complementary equity strategies that can provide a suitable risk-adjusted return for the Fund.
- The Fund also hedges exposures to the currencies of overseas listed equities with the explicit aim of reducing volatility rather than making a return. The Fund therefore maintains exposure to currencies that are expected to reduce volatility - fall as equities rise - and hedges exposure to currencies that are expected to increase volatility – rise as equities rise.

Index-Linked Assets

3.19 The Fund's strategy entails a small increase in index-linked assets (gilts, bonds and gold), which provides diversification, some insurance against an unexpected rise in inflation and a return broadly in line with the Fund's liabilities. With index-linked gilts offering investors with negative real yields, the Fund increased exposure to index-linked assets by only £13m over 2013/14. However the duration of the portfolio was extended by purchasing gilts of longer maturities to reflect the long-term nature of Fund liabilities.

Alternative Investments

3.20 The Fund's actual allocation to alternative investments, which includes assets such as infrastructure, bond-like assets and timber, increased over 2013/14. Many of these investments are unlisted and increasing exposure is dependent on finding attractive opportunities. Exposure to infrastructure assets was increased by £45m with a focus on secondary fund interests, selective primary fund commitments and co-investments alongside the Fund's existing manager/fund relationships. Recent investments have been made in UK Private Finance Initiative (PFI) projects, such as schools and hospitals, which offer stable income over the term of the concession periods and some protection against inflation. The Fund continues to monitor developments with the Pensions Infrastructure Platform (PIP), which will be considered once it becomes available. New timberland investments also continue to be appraised.

- Despite the new investments in 2013/14, there was little change in the percentage of Fund assets in alternative investments because of the growth in the Fund size due to relative movements in asset prices. Equity investments provided stronger returns than most alternative investments in the Fund.
- The Fund has a strategic allocation to bond assets within Alternatives because there may be opportunities to use its strong, long-term capital position to purchase sound assets at attractive prices from sellers, such as financial institutions who are rebuilding balance sheets in deleveraging economies. However attractive bond investments have become increasingly difficult to find as yields are low and yield spreads have narrowed dramatically. With a target return of 3.5% in excess of inflation for the Alternatives portfolio, most bond related investments require the use of leverage to achieve such a target and are generally relatively risky. However, the Fund is actively reviewing and assessing investment opportunities.
- A review of the Fund's corporate bond exposure has been undertaken and since the end of the year, the Fund's manager of corporate bonds, Rogge, has been terminated. The assets have been transitioned into index-linked gilts and US Treasuries.

3.21 The Fund makes commitments to unlisted investments and the timing of these is uncertain as it depends on the manager being able to purchase assets. Details of outstanding commitments as at 31 March 2014 were as follows:

	Unfunded Commitments in Local Currency			**TOTAL**
	US$ m	**Euros m**	**£ m**	**£ m**
Private Equity	77	14	6	64
Infrastructure	15	74	2	72
Timber	-	-	-	-
	92	**88**	**8**	**136**

3.22 Implementation of the investment strategy requires a continuing assessment of internal and external management options, appraisal of the risks of internal and external management and the required resources and financial implications of greater internal management (including systems and staffing). The Fund's investment operations were reviewed during 2013/14 and the findings reported to the Pensions Committee in March. Progress to implement the key recommendations and address the key risks for the Fund is continuing in

2014/15. In addition, preparatory work is in progress to make an application to gain FCA authorisation.

Conclusion

3.23 The absolute performance of Lothian Pension Fund over the twelve month period was +6.8%. Three year performance is +7.6% per annum. Over ten years, the Fund returned +8.3% per annum.

3.24 The triennial actuarial valuation, which reassess all the inputs and assumptions involved in determining the funding level, is currently underway. Based on the performance of the Fund's assets and the rise in real gilt yields, which affect the value of liabilities, the funding level is expected to have improved over the last 12 months.

3.25 Implementation of the investment strategy has progressed over the last twelve months with a reorganisation the Fund's equity assets into lower risk mandates including a new global portfolio managed internally. Restructuring of the index-linked asset portfolio is well advanced. The Investment Strategy Panel and internal team continue to focus on implementation of the investment strategy with a focus on increasing the allocation to alternative investments where possible and on researching and funding complementary equity strategies.

Measures of success

4.1 The investment performance of the funds is crucial to the achievement of the required investment return which impacts on the funding level and employer contributions. The objectives for the investments are:

- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
- Over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

Financial impact

5.1 This report details the investment performance of the Lothian Pension Fund. The investment performance has a significant impact on the funding levels and potentially on the contributions required from employers.

Risk, policy, compliance and governance impact

6.1 Investment strategy is a key determinant of funding level, risk and volatility of employer contribution rates. The Fund's investment strategy is aimed at reducing the risk without sacrificing returns.

There is no governance impact as a result of this report. Committee delegates the implementation of investment strategy to the Director of Corporate Governance, who takes advice from the Investment Strategy Panel. The Investment Strategy Panel is an important element of the governance of the pension fund investments.

Equalities impact

7.1 There are no equalities implications as a result of this report.

Sustainability impact

8.1 The Statement of Investment Principles (covered elsewhere on the agenda) sets out the Funds' approach as responsible asset owners, and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with it is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

9.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading / external references

None

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Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	
Appendices	None

Pensions Committee

10.00 a.m., Tuesday, 17 June 2014

Investment & Funding Update – Lothian Buses Pension Fund

Item number	5.8
Report number	
Executive/routine	
Wards	All

Executive summary

This report provides an update on the investments and funding position of the Lothian Buses Pension Fund.

Over the twelve months to 31 March 2014, investment market returns were mixed (developed market equities positive; emerging market equities and bonds negative).

The Fund produced a return of 8.9% over the year. The benchmark return was 5.1%.

The Fund's actuary is currently undertaking the triennial valuation and will report on Lothian Buses Pension Fund's funding level (the ratio of assets to liabilities) later in the year. Market yields point to an improvement since the funding level estimates at 31 March 2013 (80% and 103% on a gilts and ongoing basis, respectively).

The Fund's Investment Strategy 2012-17 is being implemented gradually. Fund risk was reduced over the year through a reorganisation of the Fund's equities and increased allocation to index linked gilts.

Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	

Report

Investment & Funding Update - Lothian Buses Pension Fund

Recommendations

1.1 That the Pensions Committee notes the performance, funding update and asset allocation of the Lothian Buses Pension Fund.

Background

2.1 The purpose of the report is to provide an update on the investments and funding position of the Lothian Buses Pension Fund to 31 March 2014.

2.2 The investment performance of the Fund has a significant impact on the funding level and potentially on the contributions required by the employer, Lothian Buses plc.

Main report

Investment Performance to 31 March 2014

3.1 The Fund's investment objectives agreed in December 2012 are:

- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
- Over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

3.2 The Fund has achieved returns in excess of the strategic allocation over the last year and over the longer term timeframes shown in the table.

% per annum	1 Year	3 Years	10 Years
Lothian Buses Pension Fund	+8.9	+10.0	+9.9
Benchmark	+5.1	+7.7	+8.4
Relative	+3.8	+2.3	+1.4

3.3 UK investors in developed market equities and UK property were well rewarded over 2013/14; not so happy were investors in emerging market equities and UK gilts. UK, Europe ex-UK and US equities generated returns of 9%, 14% and 11% respectively in sterling terms; UK property returned 12%; emerging market equities fell more than 10% in sterling terms; and conventional and index-linked gilts were down 3% and 4% respectively.

3.4 Over 2013/14, asset allocation has proved very beneficial to performance. The fund was overweight high returning equity assets (+11.8%) and underweight negative returning index-linked gilts (-6.0%). This contributed to the performance being more volatile than the strategy. (The Fund reduced risk in mid-February 2014 by reducing equities and restructuring the equity assets as described below.)

3.5 The Fund's Alternative investments, which include property, infrastructure and timber, rose 6.3% over the year. However, returns from Alternatives should be assessed over much longer periods due to the nature of the investments. The target return is inflation plus 3.5% per annum.

Funding Level

3.6 The funding level is the ratio of the pension scheme's assets to liabilities. At the last actuarial valuation three years ago, the funding level on an ongoing basis was estimated to be 112% at 31 March 2011, and last year, the actuary estimated the funding level to be 103% at 31 March 2013. The positive performance of asset values and the increase in real gilt yields over 2013/14, which causes the value of liabilities to fall, will have caused the funding level to improve all other things being equal at 31 March 2014.

3.7 Work has commenced on the triennial actuarial valuation at 31 March 2014. The actuary will be assessing the need to make changes to assumptions based on the latest and best data available, such as changes to mortality assumptions, to make the most accurate assessment of the funding level.

3.8 As the Fund is closed to new members and the liabilities are expected to mature further over time, the funding basis will be reviewed during the 2014 actuarial valuation. On the more prudent 'gilts basis', the funding levels were 87% and 80% at 31 March 2011 and 31 March 2013 respectively. As the Fund is likely to be a deficit on a 'gilts' basis at 31 March 2014, the assets do not over the liabilities, so the Fund continues to invest in growth assets, such as equities, to achieve full funding in the future.

Investment Strategy

3.9 The Pensions Committee approved the Investment Strategy 2012-17 for Lothian Buses Pension Fund in October 2012. The investment strategy is set at the broad asset class level of equities, index-linked gilts and alternatives, which are the key determinants of investment risk and return.

	Long Term Strategy Allocation 2012-17 %	Permitted Range %
Equities	55	45-65
Index-Linked Assets	15	10-30
Alternatives	30	10-35
Cash	0	0-10
TOTAL	**100**	

3.10 The strategy reduces the allocation to equities (including private equity) and increases the allocation to index-linked gilts and alternatives. It recognises the latent inflation potential at the heart of current central bank monetary policy and maintains significant exposure to real investments, such as index-linked gilts and equities, which have a history of protecting purchasing power, after the effects of inflation have been taken into account.

Asset Allocation and Strategy Implementation

3.11 The implementation of the Investment Strategy 2012-17 is planned to proceed at a measured pace as investment opportunities become available and as research on opportunities is completed, and this is reflected in the interim strategy allocation shown in the table below. The Investment Strategy Panel and the internal team have focussed efforts during 2013/14 on reducing risk and delivering the performance objectives of the Fund described above.

3.12 The Investment Strategy Panel reviews asset allocation on a quarterly basis and the internal team reviews it monthly. Differences between actual and strategy allocations need to be balanced against the cost of switching assets between managers.

3.13 At 31 March 2014, the Fund had an overweight position in equities, index-linked assets and cash compared to the interim strategy allocation. Alternative investments are underweight the interim strategy allocation partly because of the relative movement in the Fund’s assets as equities outperformed the alternatives by a significant margin. In addition, many of these investments are unlisted and increasing exposure is dependent on finding attractive opportunities.

3.14 The table below shows the changes in actual allocation over the financial year 2013/14 and the current interim strategy allocation at end March 2014.

	Manager	Actual Allocation 31 March 2013 %	Actual Allocation 31 March 2014 %	Interim Strategy Allocation 31 March 2014 %
EQUITIES				
Global Alpha	Baillie Gifford	60	32	
Global High Dividend Yield	Internal	5	32	
Private Equity	Internal	2	1	
Subtotal		67	65	62.5
INDEX-LINKED ASSETS				
Index-linked bonds	Baillie Gifford	8	7	
Index-linked gilts	Internal	0	4	
Subtotal		8	11	10
ALTERNATIVES				
Property	Standard Life	8	9	
Other Real Assets [1]	Various	6	5	
Other Bonds [2]	Baillie Gifford	8	8	
Subtotal		21	21	27.5
Cash	Internal	4	2	0
TOTAL		100	100	100

[1] Includes infrastructure and timber

[2] Includes corporate bonds and loans

3.15 The Investment Strategy Panel and the internal team have focussed their efforts during 2013/14 on reducing the actual allocation to equities, restructuring the equity pool of assets and increasing the exposure to index-linked assets. These changes should reduce risk and deliver the return objectives of the Fund described above. A small increase was also made to property exposure. Opportunities to increase the Fund's investment in infrastructure were appraised including primary and secondary opportunities, but no new investments were made.

3.16 The changes made in 2013/14 are described below:

- The Fund reduced the actual allocation to equities in mid-February 2014 by switching 4% of assets from equities into an internally managed index-linked gilts portfolio. This has increased the diversification of the overall Fund and lowered risk.

- At the same time, the Fund altered the structure of the existing investment mandates by increasing the amount invested internally in high quality income-producing equities and reducing the proportion allocated to the Baillie Gifford global equity mandate. This has increased the diversification of the equities, increased income generation and lowered risk. The equity assets are expected to perform relatively well when equity markets are weak and produce positive absolute returns in rising equity markets.
- The transition has increased the equity assets managed by the internal team. Half of the Fund's equities are now managed internally in a low cost, low turnover strategy.
- The increased allocation to index-linked gilts is in line with the Fund's long term strategy. They provide diversification, some insurance against an unexpected rise in inflation and a return broadly in line with the Fund's liabilities.
- The Fund's actual allocation to Alternatives was stable over the year. Investment in property, however, was increased by approximately 1%. Many of the alternative investments are unlisted and increasing exposure is dependent on finding attractive opportunities. The Fund continues to appraise investment opportunities in infrastructure and timber assets.

3.17 The Fund makes commitments to unlisted investments and the timing of these is uncertain as they depend on the manager being able to purchase assets. Details of outstanding commitments as at 31 March 2014 were as follows:

	Unfunded Commitments in Local Currency			**TOTAL**
	US$ m	**Euros m**	**£ m**	**£ m**
Infrastructure	0	3.0	0.1	2.6

3.18 The general thrust of strategy implementation going forward will be a gradual reduction in the equity allocation and an increase in index-linked gilts and alternative investments when they become available.

Conclusion

3.19 The absolute performance of Lothian Buses Pension Fund over the twelve month period is +8.9%. Three year performance is +10.0% per annum. Over ten years, the Fund returned +9.9% per annum.

3.20 The triennial actuarial valuation, which reassess all the inputs and assumptions involved in determining the funding level, is currently underway. Based on the performance of the Fund's assets and the movement of real gilt yields, which affect the value of liabilities, the funding level is expected to have improved over the last twelve months. As the Fund is closed to new members and the liabilities are expected to mature further over time, the funding basis will be reviewed during the 2014 actuarial valuation.

3.21 Implementation of the investment strategy has progressed over the last twelve months with an increase in the actual allocation to index-linked assets and a significant reorganisation of the Fund's equity assets, both designed to lower overall risk in the Fund. Future changes are planned at a gradual pace with a focus on increasing the allocation to index-linked gilts and alternative investments and reducing the equity allocation.

Measures of success

4.1 The investment performance of the funds is crucial to the achievement of the required investment return which impacts on the funding level and employer contributions. The objectives for the investments are:

- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
- Over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

Financial impact

5.1 This report details the investment performance of the Lothian Buses Pension Fund. The investment performance has a significant impact on the funding levels and potentially on the contributions required from the employer, Lothian Buses plc.

Risk, policy, compliance and governance impact

6.1 Investment Strategy is the main determinant of funding level and volatility of employer contribution rates. The Investment Strategy is aimed at reducing the risk without sacrificing returns. There is no governance impact as a result of this report. Committee delegates the implementation of investment strategy to the Director of Corporate Governance, who takes advice from the Investment Strategy Panel. The Investment Strategy Panel is an important element of the governance of the pension fund investments.

Equalities impact

7.1 There are no equalities implications as a result of this report.

Sustainability impact

8.1 The Statement of Investment Principles (covered elsewhere on the agenda) sets out the Funds' approach as responsible asset owners, and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with it is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

9.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading / external references

None

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Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	
Appendices	None

Pensions Committee

10.00 a.m., Tuesday, 17 June 2014

Investment & Funding Update – Scottish Homes Pension Fund

Item number	5.9
Report number	
Executive/routine	
Wards	All

Executive summary

Over the twelve months to 31 March 2014 the Fund produced a return of 2.1%. The Fund's actuary has estimated that the Scottish Homes Pension Fund's funding level (the ratio of assets to liabilities) was 90.5% at 31 March 2014. The actuary is currently undertaking the 2014 actuarial valuation and will reassess the underlying assumptions. As reported to Committee in March 2014, a review of the funding strategy is underway.

Changes to the Fund's asset allocation agreed by the Pensions Committee in October 2012 have been implemented. Further work to reduce the risk within the Fund's equities is the outstanding element of the implementation of the strategy. Further progress will be made once discussions with the Scottish Government on funding issues ahead of the 2014 actuarial valuation are complete.

Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	

Report

Investment & Funding Update – Scottish Homes Pension Fund

Recommendations

1.1 That the Pensions Committee notes the performance, funding level and asset allocation of the Scottish Homes Pension Fund.

Background

2.1 The purpose of this report is to provide an update on the investments and funding level of the Scottish Homes Pension Fund to 31 March 2014.

2.2 The investment performance of the Fund has a significant impact on the funding level and potentially on the contributions required from the Scottish Government.

Main report

Investment Performance to 31 March 2014

3.1 The Fund's objectives agreed by Committee in December 2012 are:

- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the benchmark;
- Over shorter periods, the Fund should perform better than the benchmark if markets fall significantly.

3.2 The Fund's annualised performance over the year and longer-term periods is shown in the table below. The Fund has performed in line with its benchmark over all timeframes. The Fund's equity and bond assets have been managed passively since Q4 2010.

% per annum	1 Year	3 Years	Since Inception (July 2005)
Scottish Homes Pension Fund	+2.1	+9.1	+8.0
Benchmark	+2.1	+9.1	+8.0
Relative	+0.0	+0.0	+0.0

3.3 Over the year to 31 March 2014, the Fund's volatility was similar to that of the benchmark. The funding agreement and investment strategy of the Fund are being reviewed to explore alternative funding approaches.

Funding Level

3.4 The funding level (ratio of assets to liabilities) and its position relative to its target (as specified in the funding agreement with the Scottish Government) are monitored quarterly by both the Fund's actuary and the Investment Strategy Panel.

3.5 The actuary has estimated a funding level of 90.5% as at 31 March 2014, which means that assets are insufficient to meet liabilities based on the assumptions made. The position has improved from 86.2% at the date of the last actuarial valuation on 31 March 2011. Healthy returns from the Fund's assets over the 3 year period have been partially offset by a decline in real gilt yields, which has caused an increase in the value of liabilities.

3.6 Over the same period, the target funding level has increased from 89.5% to 91.5%. (Under the agreement with the Scottish Government, the target funding level increases gradually over time to reach 100% by 2044). The shortfall of the funding level relative to target has therefore decreased over the three year period since the last actuarial valuation due to strong investment returns over the period.

3.7 As reported to Committee in March 2014, Scottish Government has indicated their willingness to review the funding strategy. Options to potentially reduce the impact of short term market movements on contributions and reduce the likelihood (and size) of further contributions being required from Scottish Government are being explored. The conclusions of the review and the 2014 actuarial valuation will be considered by Pensions Committee by March 2015 at the latest.

Investment Strategy and Asset Allocation

3.8 Pensions Committee approved the Investment Strategy 2012-17 in October 2012. The investment strategy is set at the broad asset class level of equities, bonds and property, which are the key determinants of investment risk and return. The strategy reduces the allocation to equities and property and increases the allocation to bonds.

3.9 The funding agreement with the Scottish Government and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over the time. They allow for acceleration in the sale of equities and property and purchase of bonds if the actual funding level improves to the target funding level.

3.10 Over 2013/14, the actual funding level moved closer to the target funding level and so the move to the long term strategy was accelerated. Two changes to the strategy allocation were made during the year and these are shown in the table below. The current strategy allocation is now in line with the long term strategy for Scottish Homes Pension Fund.

Scottish Homes Pension Fund - Evolution of Strategy 2013/14				
Asset Class	**Strategy Allocation 31 March 2013 %**	**Strategy Allocation 1 September 2013 %**	**Strategy Allocation 29 November 2013 %**	**Long Term Strategy Allocation 2012-17 %**
Equities	40	35	30	30
Bonds	50	60	65	65
Property	10	5	5	5
Cash	**0**	0	0	0
TOTAL	**100**	**100**	**100**	

3.11 The changes to the Fund's equity and bond allocations were made within the mandate managed by State Street. Holdings in the Standard Life Property pooled fund were sold at the end of August 2013.

3.12 Over the year assets are withdrawn from the investment manager(s) to pay pensions (approximately £650,000 per month).

3.13 Further work to reduce the risk within the Fund's equities is the outstanding element of the implementation of the strategy. This has been put on hold pending the review of the funding agreement (noted above). Further progress will be made once discussions with the Scottish Government are complete and when any change to the funding agreement is agreed.

3.14 The Fund's actual allocation to each manager and asset class at 31 March 2014 is shown in the table below, together with the long term strategy.

Asset Class	Manager	Actual Allocation 31 March 2014 %	Long Term Strategy Allocation 2012-17 %	Permitted Ranges %
Equities				
UK	State Street	6.6		
US	State Street	9.4		
Europe Ex-UK	State Street	6.1		
Asia Pacific	State Street	2.4		
Japan	State Street	3.1		
Emerging Markets	State Street	2.3		
Subtotal		**29.9**	**30**	**20 - 35**
Bonds				
Index-linked gilts	State Street	52.0		
Fixed income gilts	State Street	13.0		
Sub total		**64.9**	**65**	**60 - 75**
Property				
Property	Schroders	5.2		
Sub total		**5.2**	**5**	**0 - 10**
Cash		0.0	0	**0 - 5**
TOTAL		**100.0**	**100**	

Conclusions

3.15 The absolute performance of Scottish Homes Pension Fund is positive over the 12 month period to 31 March 2014 with a return of +2.1%. Three year performance is 9.1% per annum.

3.16 The returns for Scottish Homes Pension Fund over one and three years and since inception to 31 March 20134 are in-line with the benchmark.

3.17 Funding levels are monitored by the Fund actuary and Investment Strategy Panel quarterly. The estimated actual funding level at 31 March 2014 was 90.5%, below the target funding level of 91.5%.

3.18 The funding agreement and investment strategy of the Fund are being reviewed to explore alternative funding approaches to the current mark-to-market approach.

Measures of success

4.1 The investment performance of the funds is crucial to the achievement of the required investment return which impacts on the funding level and employer contributions. The objectives for the investments are:

- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
- Over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

Financial impact

5.1 This report details the investment performance and funding level of the Scottish Homes Pension Fund. The investment performance has a significant impact on the funding level and potentially on the contributions required from the Scottish Government.

Risk, policy, compliance and governance impact

6.1 Investment strategy is a key determinant of funding level, risk and volatility of employer contribution rates.

There is no governance impact as a result of this report. Committee delegates the implementation of investment strategy to the Director of Corporate Governance, who takes advice from the Investment Strategy Panel. The Panel is an important element of the governance of the pension fund investments.

Equalities impact

7.1 There are no equalities implications as a result of this report.

Sustainability impact

8.1 The Statement of Investment Principles (covered elsewhere on the agenda) sets out the Funds' approach as responsible asset owners, and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with it is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

9.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds. There is a dedicated place on the Consultative Panel for the Scottish Government.

Background reading / external references

None

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Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	
Appendices	

Pensions Committee

10.00 a.m., Tuesday, 17th June 2014

Reform of the Local Government Pension Scheme in Scotland and Regulatory Update

Item number	5.10
Report number	
Executive/routine	
Wards	All

Executive summary

Progress continues to be made towards implementation of a new Local Government Pension Scheme (LGPS) in Scotland from 1 April 2015. Consultation on draft LGPS (Scotland) Regulations 2014 (Benefits and Administration) has concluded. These and further separate Regulations covering transitional provisions and scheme governance will follow over the coming months. Delays by the Scottish Public Pensions Agency in laying these Regulations, however, have led to some concerns being expressed as to risk to successful implementation. The consultation on the structure of the LGPS in Scotland is expected to be a focus of attention for the new national Scheme Advisory Board, once this is constituted in April 2015.

Coverage of matters affecting the LGPS in England and Wales and other pensions reform matters is included for reference.

Further regular updates will be provided to Pensions Committee.

Links

Coalition pledges	
Council outcomes	CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	

Report

Reform of the Local Government Pension Scheme in Scotland and Regulatory Update

Recommendations

1.1 Pensions Committee should note the regulatory update provided in this report.

Background

Reform of the LGPS in Scotland 2015

2.1 This report is the latest in a series of regular updates on public service pension reform and specifically the implications of fundamental change to the design and governance of the Local Government Pension Scheme (LGPS) in Scotland.

2.2 Heads of Agreement on the new LGPS in Scotland were published on 12 December 2013.

2.3 Consultation by the Scottish Public Pensions Agency (SPPA) on draft Local Government Pension Scheme (Scotland) Regulations 2014 closed on 14 February 2014. Responses have been submitted by CoSLA and also the Scottish Pensions Liaison Group (SPLG).

2.4 This Council has also responded to a separate consultation on proposals for governance of the new LGPS.

Main report

LGPS in Scotland 2015 – Regulations

3.1 The Scottish Public Pensions Agency has advised of delays to the anticipated timetable for both the writing and subsequent laying of the Regulations for the new LGPS.

3.2 Following the recent consultation, LGPS (Scotland) Regulations 2014 (Benefits and Administration) are expected to be signed by May 2014 and laid before the summer recess of the Scottish Parliament in June 2014.

3.3 Transitional Regulations establish the legislative basis for the preservation of benefit entitlements from the current final salary scheme to the new career average scheme. The Scottish Public Pensions Agency has advised that, whilst draft Transitional Regulations should be issued for consultation before the summer recess, it is expected that these will not be laid until September 2014.

3.4 CoSLA has expressed its concerns to the Scottish Government as to the potential impact of these regulatory delays. Software suppliers of both payroll and pensions administration have requested clarity of the new scheme requirements at the earliest juncture. It is hoped, however, that similarity to the new LGPS in England and Wales, which took effect from 1 April 2014, may mitigate the impact of regulatory delay. However, communications to members and employers cannot be finalised until requisite details are confirmed.

LGPS in Scotland 2015 – Governance

3.5 Following the Heads of Agreement on scheme design, the tri-partite negotiating body, Scottish Local Government Pension Scheme Advisory Group (SLOGPAG) has begun to consider the details of a new governance structure for the LGPS. Committee is reminded that the Public Service Pensions Act 2013 requires the establishment of a new governance structure, both at a Fund and national level. At the local Fund level a Scheme Manager (with responsibility for the management of the scheme) and a Pensions Board (with responsibility for assisting the management of the scheme) are required for each Fund. At a national level, a Scheme Advisory Board (with responsibility for advising Scottish Ministers) is also mandated. Governance Regulations are expected to be issued for consultation over the coming months.

LGPS in Scotland 2015 – Communications

3.6 SLOGPAG has established a Communications Sub-Group to provide Scottish local authority pension funds with a common source of reliable and relevant material for member and employer communication. It consists of communications specialists from the Strathclyde, Lothian and North East of Scotland Pension Funds, as well as representatives from SLOGPAG and Scottish Public Pensions Agency. Further technical advice is being provided by the Local Government Association (LGA). Scottish Funds have indicated that they would be prepared to contribute up to £5,000 each towards the costs of joint publicity material. This would be contained within the Lothian Pension Fund budget.

3.7 The main items of work either completed or being progressed by the Sub-Group are as follows:

- Communications Plan
- Heads of Agreement Newsletter
- LGPS 2015 logo, website and video
- Modellers and calculators
- Guides for members

LGPS in England and Wales 2014

3.8 A new career average revalued earnings (CARE) scheme was implemented in England & Wales on 1 April 2014. Transitional Regulations were laid by Parliament as late as 10 March 2014. Although very similar to the forthcoming scheme in Scotland, there remain distinct differences; definition of pensionable pay, pay protection principles, member contribution rate calculations, application of employer cost capping being a few salient examples. At present, it is too early to assess how local authorities have coped with the additional administrative burden of LGPS reform.

LGPS in England and Wales - consultation on structural reform

3.9 On 1 May 2014, the Department for Communities and Local Government (DCLG) has launched a formal consultation on opportunities for collaboration, cost savings and efficiencies for the LGPS in England and Wales. This follows analysis undertaken by Hymans Robertson on behalf of DCLG which detailed cost-benefit analysis of potential options; up to 10 common investment vehicles and merging into 5 to 10 funds. Fund merger is not the government's preferred option. Instead it proposes to leave decisions on asset allocation with the individual funds and the use of collective investment vehicles to invest more efficiently and the greater use of passive management for listed assets.

Budget 2014 – Potential impact upon LGPS

3.10 In the budget statement on 19 March 2014, the Chancellor announced that, following primary legislation to be put in place over the next year, from April 2015, the tax rules relating to drawdown of defined contribution (DC) pension arrangements would be relaxed. Members of DC schemes will be able to use their DC funds much more flexibly. Specifically, the whole pension pot could be taken at any time from retirement, subject only to tax at the individual's marginal rate (apart from the pension commencement lump sum, which will remain tax free).

3.11 The April 2015 proposals only apply to DC pensions. However, there are implications for defined benefit (DB) pension arrangements. In particular, members of public sector DB schemes will be banned from transferring out to DC schemes. This will prevent a significant drain on the Exchequer arising from a large number of transfers from unfunded schemes. Transfers from public sector DB schemes to other DB schemes will not be affected.

3.12 The Government is also considering whether similar measures are needed to prevent or restrict transfers from private sector DB schemes to DC. Funded public sector schemes such as the LGPS may be subject to a similar ban but the decision could be influenced by the treatment of private sector schemes. The Government says that it may permit transfers from private sector DB toDC schemes 'if the risks and issues around doing so can be shown to be manageable'.

3.13 This change could have an impact on the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund. If a significant number of members choose to transfer the value of their benefits out to take advantage of this greater flexibility, this could have cashflow, investment and funding implications.

Pensions Bill 2013 update (now Pensions Act 2014)

3.14 As reported previously, the Pensions Bill 2013 proposal to end contracting-out would result in additional National Insurance costs for LGPS employers and employees of 3.4% and 1.4% of relevant earnings respectively. LGA and CoSLA have expressed concerns as to the financial impact on local authority employers and LGPS funds. To-date, however, there remains no indication that additional Government grant support will be forthcoming.

3.15 Consideration of a separate Commons amendment to the Bill took place in the House of Lords on 8 April 2014. Both Houses agreed on the text of the Bill. On 14 May 2014, Royal Assent was granted for the Pensions Act 2014.

Measures of success

4.1 This report is purely advisory at this stage.

Financial impact

5.1 There are no financial implications arising directly from this report. However changes to the LGPS in Scotland will have financial consequences for Lothian Pension Fund and Lothian Buses Pension Fund, participating employers and members. These will be addressed in future reports to the Pensions Committee.

Risk, policy, compliance and governance impact

6.1 From a governance perspective, this report is purely advisory at this stage. In due course, a revised governance structure for the LGPS in Scotland will require changes to be made by the City of Edinburgh Council, as administering authority of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

6.2 The delay in transitional regulations for the new LGPS presents a risk that administration services may be adversely impacted and communications to members and employers will be delayed.

6.3 There is a risk that taxation changes for defined contribution pensions schemes may have an impact on the cashflow, investment and funding of the pension funds.

Equalities impact

7.1 There are no adverse equalities impacts arising from this report. Changes to the design of the LGPS are subject to Equality Impact Assessment by the Scottish Government.

Sustainability impact

8.1 There are no adverse sustainability impacts arising from this report. The Public Service Pensions Act 2013 aims to make pensions more sustainable.

Consultation and engagement

9.1 Lothian Pension Fund is committed, on an ongoing basis, to keeping its employers and members fully informed of all the key developments on reform of the LGPS in Scotland. Consultation will take place at appropriate times.

Background reading / external references

Heads of Agreement on the new Local Government Pension Scheme in Scotland were published on 12 December 2013. These are available on the Lothian Pension Fund web-site through the following link:

http://www.sppa.gov.uk/Documents/Local%20Government/Useful%20Resources/Consultations/2014/LGPS_Heads%20of%20Agreement_231213.pdf

Consultation on draft Local Government Pension Scheme (Scotland) Regulations 2014 can be viewed at:

http://www.sppa.gov.uk/Documents/Local%20Government/Useful%20Resources/Consultations/2014/LGPS_Scotland_Regulations_2014_070114.pdf

Similarly, please see links to the consultation on proposals for governance in the LGPS in Scotland, together with the response from this Council.

The UK Government has responded to the call for evidence by publishing a consultation on principles for reform, which provides fuller details of the Government's proposals. You can access this consultation at:
https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies.

The Department for Communities and Local Government's (DCLG) response to the call for evidence on the future structure of the Local Government Pension Scheme in England and Wales can be seen at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307920/LGPS_call_for_evidence_response.pdf

A link to HM Treasury's consultation "Freedom and choice in pensions" is below

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/294795/freedom_and_choice_in_pensions_web_210314.pdf

Alastair Maclean

Director of Corporate Governance

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Links

Coalition pledges	
Council outcomes	CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	
Appendices	None

Pensions Committee

10.00 a.m., Tuesday, 17th June 2014

Risk Management

Item number	5.11
Report number	
Executive/routine	
Wards	All

Executive summary

The pension funds' risk management procedures require us to:

(i) maintain a detailed operational risk register which sets out all the risks identified and assessed by the officers on an ongoing basis, the degree of risk associated in each case and our action to mitigate these risks (the "**Operational Risk Register**"); and

(ii) produce a summary report of the risk register for the Pensions Committee and the Pensions Audit Sub-Committee which highlights the material risks facing the pension funds and identifies any new risks/concerns and the progress being made over time by the officers in mitigating the relevant risks (the "**Quarterly Risk Overview**").

The Operational Risk Register has been issued to the conveners of the Pensions Committee and the Pensions Audit-Sub-Committee.

The Quarterly Risk Overview, as at 22nd May 2014, is set out in the appendix to this report.

Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	

Report

Risk Management

Recommendations

1.1 We recommend the Committee notes the Quarterly Risk Overview.

Measures of success

2.1 Improved visibility of the risks facing the pension funds and progress in analysing/mitigating these risks. Regular, focused and relevant risk updates to the Pensions Committee and Pensions Audit Sub-Committee should increase general awareness and allow productive analysis/feedback by the Pensions Committee/Audit Sub-Committee members on these fundamental issues.

2.2 Ultimately, risk management should lead to less third party exposure, an improved financial position and have a positive impact on the reputation of the pension funds.

Financial impact

3.1 There are no direct financial implications as a result of this report.

Risk, policy, compliance and governance impact

4.1 Please see the Quarterly Risk Overview appended to this report.

Equalities impact

5.1 None.

Sustainability impact

6.1 None.

Consultation and engagement

7.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading / external references

None.

Alastair Maclean

Director of Corporate Governance

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Links

Coalition pledges	
Council outcomes	CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	
Appendices	Appendix 1 - Quarterly Risk Summary as at 22nd May 2014

QUARTERLY RISK OVERVIEW

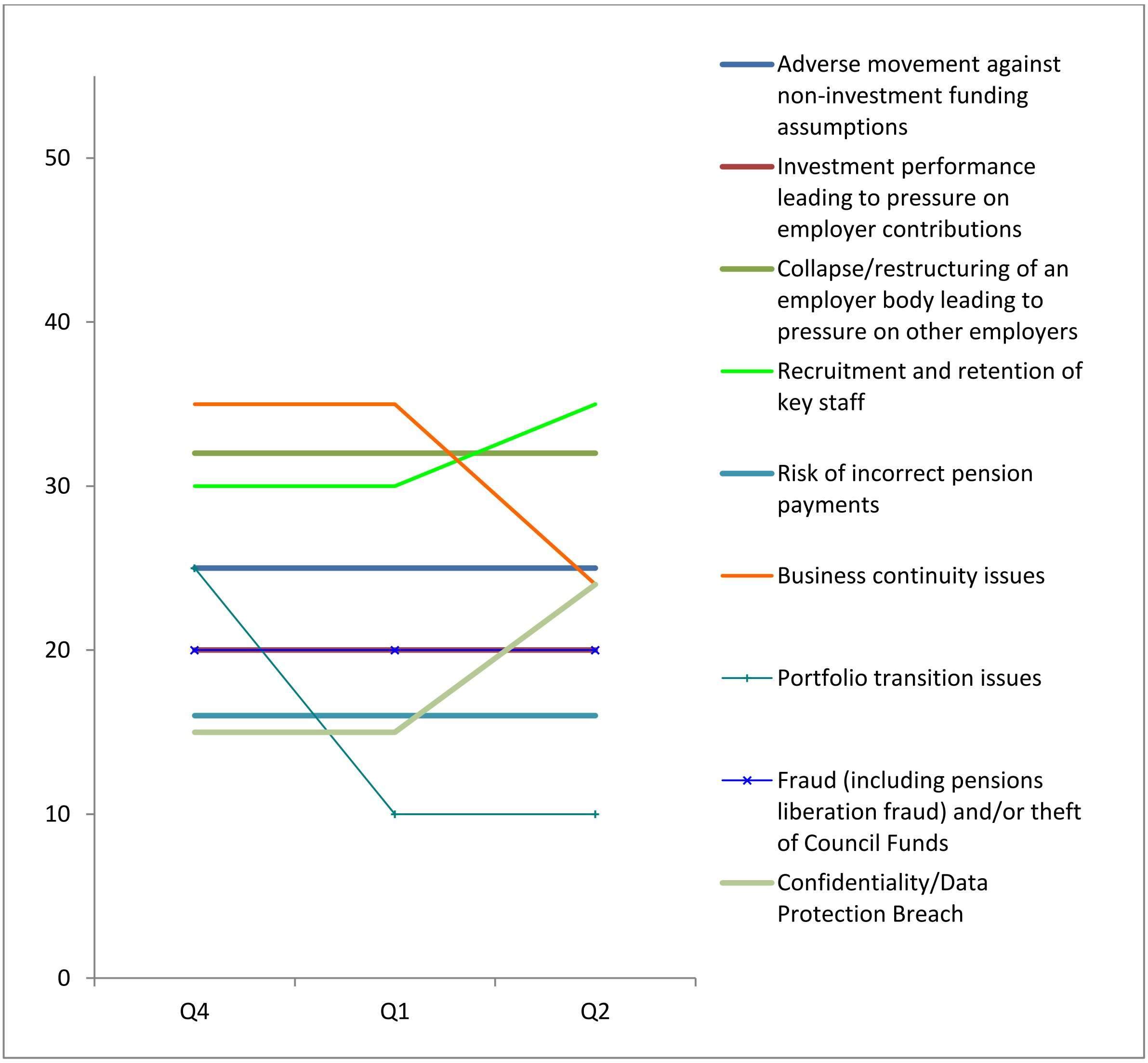
22 May 2014

UPDATE ON MOST NOTABLE RISKS

Risk	Update
Investment performance leading to pressure on employer contribution	The new lower volitility investment strategy continues to be implemented to mitigate this risk and more detailed reporting on the Investment Strategy has been produced for the Pensions Committee.
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions	Meetings have been held with the Funds' Actuary to schedule analysis on employer contributions and funding assumptions ahead of the 2014 actuarial valuation.
Collapse/restructuring of an employer body leading to pressure on other employers	Engagement with employers and guarantors is underway as part of the preparation for the 2014 actuarial valuation. This will feed into the 2014 actuarial valuation and lead to other arrangements to mitigate the impact on other employers in the Fund. We continue to analyse the results from the responses to the employer survey and are chasing for final responses.
Recruitment and retention of key staff	This risk has been increased from the last quarter as the likelihood of a departure has increased in light of the anticipated improvement in economic and market conditions in the private sector. We continue to liaise with Human Resources to assess options to mitigate this risk. Contingency plans are being compiled for the internal investment portfolios in the event of significant staff turnover. We have now recruited a temporary Finance Manager following the resignation of the previous postholder. Following an unsuccessful internal recruitment exercise, external advertising is underway. We are also looking to recruit a newly qualified solicitor to assist with progressing with the authorisation by the Financial Conduct Authority and provide appropriate cover for, the Legal & Risk function.

Risk of incorrect pension payments	This risk continues to be low and has reduced further, now that the payroll system has largely been integrated and the annual pension increase in April/May has been implemented on the new system . There is however a need to achieve full integration/automation to reduce reliance on manual intervention in some processes. Once this is achieved we would anticipate this risk being further reduced to the extent that it would not be worthwhile highlighting to the Committee.
Business continuity issues (accommodation, staff etc.)	Having now moved to new offices in Atria One, and been operating within the building for several weeks, this risk has now been significantly reduced. We are monitoring our existing systems and procedures within the new offices and expect to make refinements to these to account for our new circumstances, but would not anticipate this risk appearing in future reports unless a particular issue had been identified.
Members' Confidential Data is lost or made public / breach of Data Protection Act	We have had a number of minor, unrelated, data protection breaches over the last few months, which have been quickly identified and reported in accordance with Council's procedures. This has however prompted us to take action to ensure that we are doing all we can to mitigate any further (and potentially more serious) breaches, including (i) a review by ICT of our systems and procudures, (ii) a review of our contracts with suppliers which involve material levels of personal data, (iii) a review of whether Lothian Pension Fund should be a separately registered division within the City of Edinburgh Council for Data Protection purposes, and (iv) compulsory data protection and infromation security refresher training for all staff. There is currently some uncertainty around the removal and disposal of confidential waste from the Fund's new office. We have taken short-term action to manage the safe handling of confidential waste but need a permanent solution.
Acting out-with proper authority / delegations	We continue to act within the appropriate proper authorities and have taken appropriate action to update our internal sub-delegations. We anticipate that an updated set of sub-delegations will be in place shortly.
Fraud (including pensions liberation fraud) and/or theft of pension fund monies	The risk around Fraud remains the same but we continue to see increasing numbers of more sophisticated scams which, while not themselves amounting to illegal Pensions liberation, are of a nature that could result in our members potentially losing a substantial portion of their benefits, at the expense of their receiving a relatively modest up-front lump sum. We have reported these cases to the FCA, HMRC and The Pensions Regulator and in certain cases have required to instruct external solicitors to take a robust line to deter suspicious schemes. We continue to monitor this process to ensure that it does not have a disproportionate impact on our timescales and process for completing transfer-out requests within our own services level commitments and the regulatory timescales.
Breach of contract	We are in the process of finalising a full review of all our contracts and creating a comprehensive contract database, which will link up with the Council's procurement team. We anticipate that this risk should be significantly reduced once this review has been completed and any material issues addressed.

NOTABLE RISKS: PROGRESSION OF CURRENT RISK (ACCOUNTING FOR CONTROLS) IN LAST THREE QUARTERS

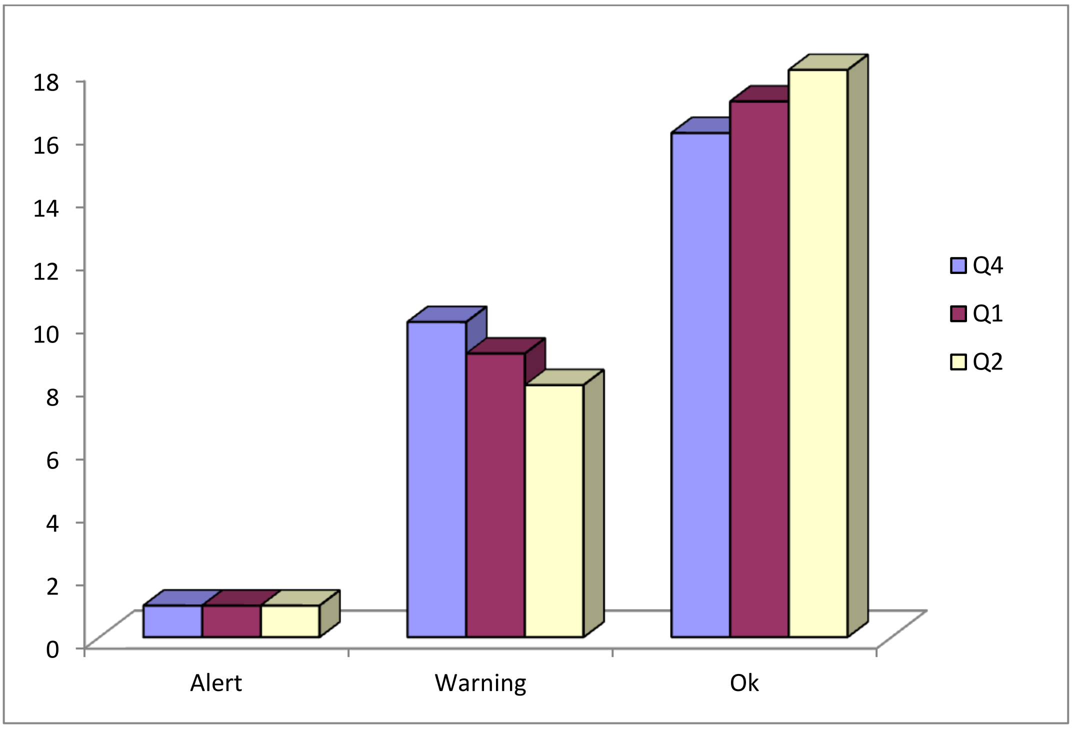


OTHER KEY POINTS

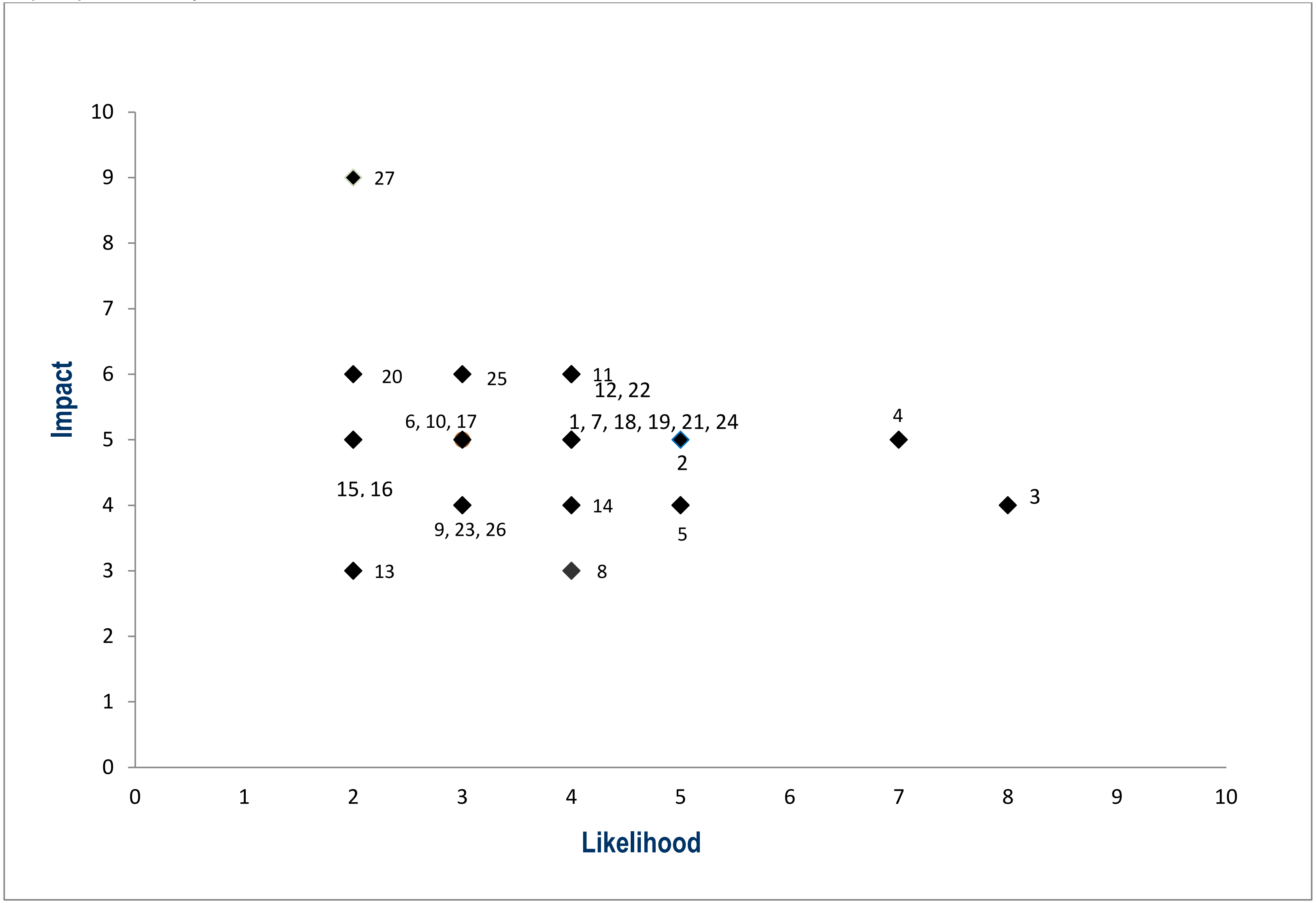
	Comments
New significant risks	None
Other new risks	None
New controls	Recruitment of a temporary Finance Manager. Annual review of our transfer-out /pensions liberation policy. Compulsory refresher training on Data Protection and Information Security.
Eliminated risks	None

	Comments
Notable initiatives / actions	Assessment and ongoing monitoring of the systems and processes surrounding our operation from new offices in the Atria One building. Working closely with the Information Compliance and ICT teams to implement a review of our systems, procedures and contracts from a Data Protection and Information Security perspective. The Investment & Pensions Service Manager is liaising with HR to discuss and consider options and research appropriate benchmarking for the remuneration of the Investment Team. Recruitment of a Finance Manager and newly qualified solicitor. Employer survey and ongoing engagement as part of the preparations for the 2014 actuarial valuation.
Material Litigation	None.

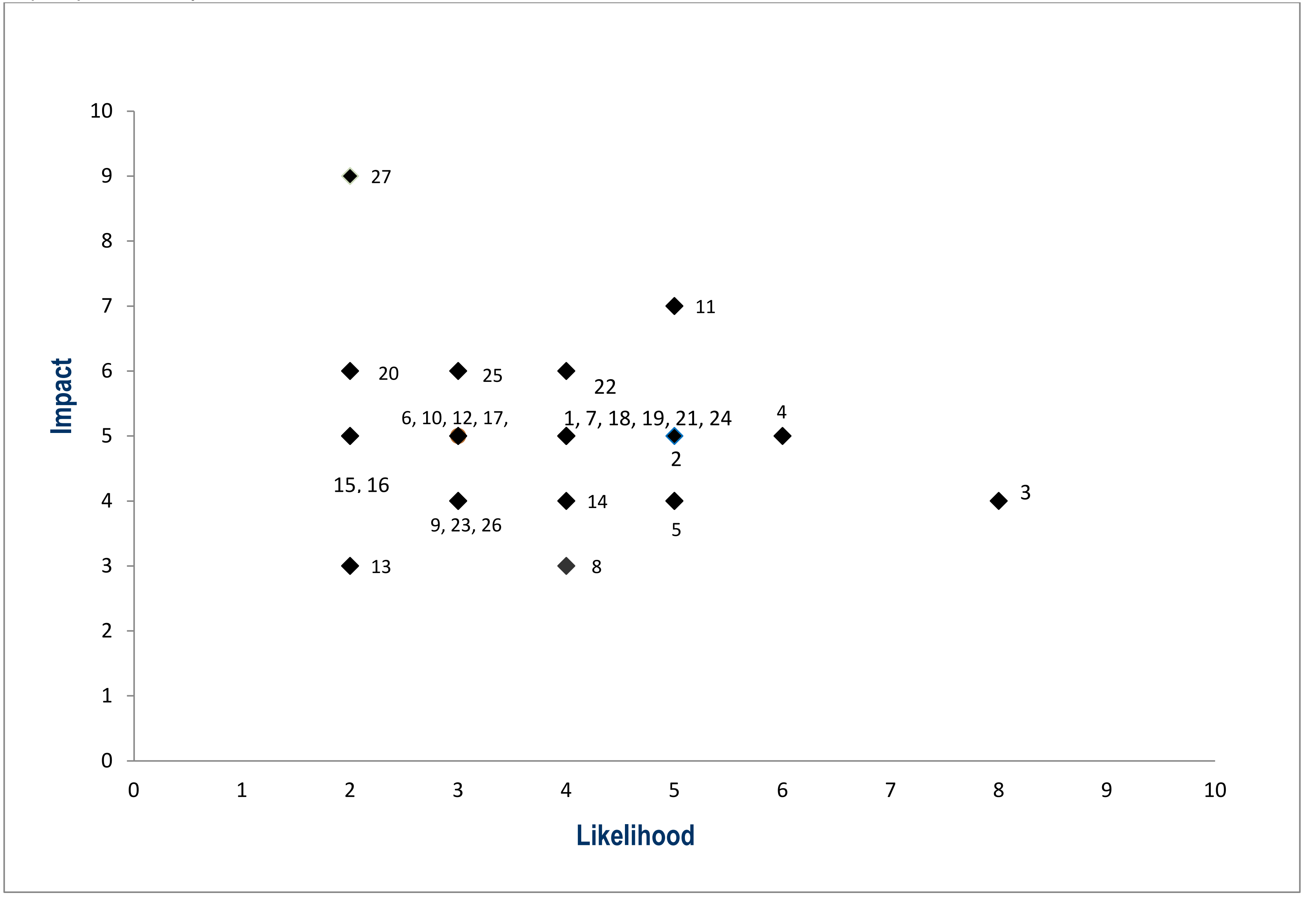
All Risks: Status Overview



Q2 (2014) All Risks: Impact and Likelihood Overview



Q1 (2014) All Risks: Impact and Likelihood Overview



Key: Risks by Number

1	Investment Performance pressure on employer contributions	15	Market abuse by investment team
2	Adverse Movement - pressure on employer contributions	16	Portfolio transition issues
3	Collapse of an employer	17	Disclosure of confidential information
4	Retention of key staff	18	Material breach of contract
5	Fraud or theft of Council/Pension Fund assets	19	Regulatory breach
6	Staff negligence	20	FOI process in accordance with law
7	Failure of IT systems	21	Incorrect communication with members
8	Employers HR decisions without consideration of fund	22	Acting in accordance with proper authority/delegations
9	Elected members take decisions against sound advice	23	Inappropriate use of pension fund monies
10	Failure to complete annual accounts	24	Procurement/framework breach
11	Business continuity issues	25	Non-compliance with the new LGPS
12	Members' confidential data is breached	26	Claim or liability arising from shared services
13	Loss due to stock lending default	27	Late Payment of Pensions
14	Risk of incorrect pension payments		

Pensions Committee

10.00am, Tuesday, 17 June 2014

Appointments - Pensions Audit Sub-Committee

Item number	5.12
Report number	
Executive/routine	
Wards	all

Executive summary

Committee is invited to appoint a member to the Pensions Audit Sub-Committee from the membership of the Pensions Committee.

Links

Coalition pledges	
Council outcomes	CO25
Single Outcome Agreement	

EDINBVRGH
THE CITY OF EDINBURGH COUNCIL

Report

Name of report

Recommendations

1.1 Committee is invited to appoint one of its members as a member of the Pensions Audit Sub-Committee.

Background

2.1 Following the resignation of Councillor Orr, the membership of the Sub-Committee currently consists of Councillors Cook and Rose. Eric Maclennan and Eric Adair attend as non-voting representatives of the Consultative Panel.

Main report

3.1 The Pensions Audit Sub-Committee undertakes the audit scrutiny of the pension funds. It is expected to meet three times a year and covers issues relating to financial statements, internal and external audit and the risk control framework.

3.2 Committee is invited to appoint a member to the Pensions Audit Sub-Committee from the membership of the Pensions Committee.

Measures of success

4.1 Not applicable.

Financial impact

5.1 Not applicable.

Risk, policy, compliance and governance impact

6.1 It is good governance to have a full compliment of sub-committee members.

Equalities impact

7.1 Not applicable.

Sustainability impact

8.1 Not applicable.

Consultation and engagement

9.1 Not applicable.

Background reading/external references

Pensions Committee minute 18 December 2012

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Links

Coalition pledges	
Council outcomes	CO25 – The Council has efficient and effective services that deliver on objectives
Single Outcome Agreement	
Appendices	