

Pensions Committee

2.30 p.m., Wednesday, 25 March 2015

2015-2018 Service Plan and Budget

Item number	5.9
Report number	
Executive/routine	
Wards	All

Executive summary

The Lothian Pension Fund's Service Plan is reviewed on an annual basis to ensure its key performance indicators and objectives are up-to-date, clear, challenging and achievable.

The draft Service Plan for 2015-2018 is provided as Appendix 1.

The Service Plan provides details of the pension fund's key challenges over the coming years including implementation of the new local government pension scheme, governance changes leading to increased scrutiny as well as ongoing funding challenges.

Links

Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

2015-2018 Service Plan and Budget

Recommendations

The Pensions Committee is requested to:

- 1.1 Approve the Service Plan 2015-2018 and the budget for 2015-2016, together with provision of requisite financing to the investment special purposes vehicles; and
- 1.2 Note the indicative budgets for years 2016-2017 and 2017-2018.

Background

- 2.1 The Lothian Pension Fund's Service Plan is reviewed on an annual basis to ensure its key performance indicators and objectives are up-to-date, clear, challenging and achievable.

Main report

- 3.1 The draft Service Plan for 2015-2018 is provided as Appendix 1.
- 3.2 The Fund's objectives have been realigned to:
 - Customer First;
 - Honest & Transparent
 - Working Together; and
 - Forward Thinking.
- 3.3 The Service Plan provides details of the pension fund's key challenges over the coming years including changes to the local government pension scheme and governance.
- 3.4 The proposed budget is shown at Appendix 1, page 10. The main points to note are summarised below at "Financial Impact".

Measures of success

- 4.1 The funds key measures of success are:
 - Meeting key performance indicators; and
 - Achieving key actions set out in the Service Plan.

Financial impact

- 5.1 The proposed budget for invoiced expenditures for 2015-2016 of £11,894K and indicative figures of £12,495K for 2016-2017 and £13,375K for 2017-2018 are provided at Appendix 1, page 10.
- 5.2 The Service Plan also includes, for the first time, indicative costs of un-invoiced investment fees which are deducted from capital. This increased cost transparency also aligns to the best practice accounting methodology adopted at the 2013-2014 Annual Report. Committee is reminded that investment fees are difficult to predict accurately in the short term as fees are typically based on market values which can be volatile. Equally, transaction costs are difficult to estimate as they are dependent on the level of trading which may be affected, for example, by changes in investment managers' mandates or opportunities in the market. This reinforces the need for the totality of investment costs to be considered in the context of investment performance. Un-invoiced costs are estimated to be £18,924K for year 2015-2016.
- 5.3 The proposed budget also includes a £10,000K contingency, as previously agreed by Committee at its meeting of 23 September 2014, to be utilised in the specific event of significant departures from the internal investment team compelling the outsourcing of the investment management function.
- 5.4 The following areas account for the principal reductions in the budget for direct expenditure from 2014-2015 to 2015-2016 of £978K:
- Investment fees paid directly to external managers is reduced by £1,353K as a result of investment portfolios transferred in-house during 2014-2015. The budget assumes no further changes to the portfolios;
 - In line with market best practice, the intention is to subscribe to research from brokers directly, that is not to pay for research via commission on trading. An additional £500K has been included within 'Third Party Payments'. All other things being equal, transaction costs incurred will be lower as a result.
 - As the internal team has developed, opportunities for direct investment have increased and a budget of £200K has been introduced to enable the team to pursue investments where costs may be incurred during the due diligence process before the investment is made.
 - In order to strengthen investment research and controls, a new solicitor post is included. An additional portfolio manager post, to provide enhanced strategic investment analysis, is also budgeted. Such costs total £125K.
 - Reflecting strong income from stock lending during 2014-2015 and favourable changes in relevant withholding tax, the budget for 2015-2016 has been increased by £800K.
 - The budget includes allowance for Central Support Costs which are provisional, pending receipt of final calculations from the City of Edinburgh Council. However the Fund intends to introduce a Service

Level Agreement for key services provided to the Fund to ensure clarity on service and costs in the future.

- Requisite funding has been provided in respect of the administrative and operating outlays of the two special purpose vehicles, wholly owned and controlled by City of Edinburgh Council. One special purpose vehicle has been established to directly employ certain internal investment staff, with the other for the purpose of seeking Financial Conduct Authority (FCA) registration for relevant investment activities. Indicative provision had already been made in the budget for FCA registration, as well as the core employee cost provision. Additional revenue outlays, whilst still to be finalised, are not significant in overall terms.

Capital Budget

- The working capital requirements of the two special purpose vehicles, reflecting the timing difference between outlays and billing receipts, will be met by the provision of loan facilities of amounts not exceeding £250K for the staffing company, LPFE Limited, and £75K for the regulated investment services company, LPFI Limited. These financing arrangements should provide the companies with sufficient operational flexibility within the overall framework of Council financial controls, with the total principal amounts including a contingency margin. Cash will be drawn-down from the loan facilities (not beyond the agreed upper level) as and when required. Interest will be charged on the net amount drawn down, the rate will be linked to the Royal Bank of Scotland base rate. The loan facilities will need to continue as long as Lothian Pension Funds uses the companies as service providers and the amount drawn down will be reviewed on a regular basis. If at any point the companies are no longer required the loans will be repaid in full.
- Share capital of 50,000 Euros (c£36,240) is anticipated to be the regulatory capital sum which FCA may require in order to grant authorisation to LPFI Limited.

5.5 The budget is also shown split between pension administration and investment consistent with the split shown in the annual report and accounts. For pension administration, an increase in budget of £61K is proposed. One vacant post and budgeted overtime has been removed from the budget but this is offset by increased employer pension contributions. Based on current membership numbers, the budgeted cost per member is £25.46. This compares to £24.90 for 2013-2014 and projected £24.28 for 2014-2015. An additional four posts are currently vacant and have been maintained in the budget for 2015-2016. Excluding these vacancies, the cost per member is £24.09. Given recent relatively high staff turnover, the intention is to monitor the service provision whilst reviewing options for further efficiencies. Resource requirements will be reviewed on an ongoing basis and will also reflect the continuing drive to enhance the data quality of member records.

Risk, policy, compliance and governance impact

- 6.1 The service plan includes plans in place to manage key risks to the pension funds.

Equalities impact

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

Sustainability impact

- 8.1 There are no adverse equalities impacts arising from this report.

Consultation and engagement

- 9.1 Consultation and engagement via a number of sources has informed the service plan including:
- Customer insight including surveys and meetings;
 - Feedback from the Fund's Customer Service Excellence assessment;
 - Staff survey and staff meetings.
- 9.2 In addition, the Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to governance.

Background reading/external references

Not applicable

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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

Single Outcome Agreement

Appendices Appendix 1 – Draft Lothian Pension Fund Service Plan 2015-2018



Service Plan 2015 - 2018



Service Plan 2015 - 2018

Introduction

The City of Edinburgh Council is the administering authority for the Local Government Pension Scheme in the Lothian area. The Council administers the benefits and invests the assets of three Local Government Pension Scheme (LGPS) funds, Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

Lothian Pension Fund is the second largest Local Government Pension Fund in Scotland with assets of approximately £4.5 billion, 100 employers with active members and over 70,000 members.

The Lothian Buses Pension Fund holds assets of £0.4 billion and 3,900 members, while Scottish Homes Pension Fund investments amount to £0.13 billion with 1,800 members.

How the Fund is run

All pension matters are delegated to the Pensions Committee of the Council and its members act as 'quasi trustees'. The day to day running of the Fund is delegated to the Investment and Pensions Division under the supervision of the Director of Corporate Governance.

A Pension Board, made up of 5 employers and 5 union members, assists the Pensions Committee in securing compliance with legislation and other requirements imposed by the Pensions Regulator.

Investment strategy guidance to the Committee is provided by the Investment Strategy Panel, which includes senior officers and specialist investment advisers.

The Fund has its own internal investment team who manage approximately 60% of assets. It also appoints external managers to invest in specific investment markets. Additionally, internal staff provide the pension administration, accounting and ICT functions.

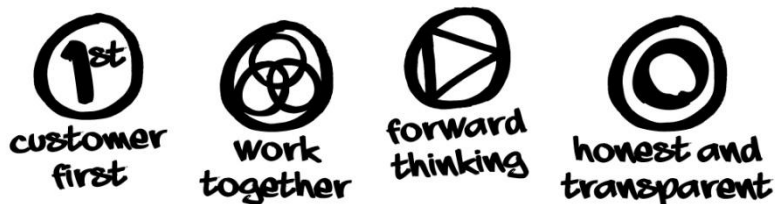
The Fund maintains a comprehensive website for easy access to all relevant pension information and this is found at www.lpf.org.uk. This includes the Annual Report & Accounts of the three pension funds.

Policies

The policies of the Fund, including the Statement of Investment Principles, Funding Strategy Statement, Pensions Administration Strategy and Pensions Discretions Policy are published on the Fund's website.

Our Service

The Fund is committed to continuously developing to provide the best possible service to our customers. To ensure we meet this aim we have set the following four objectives for our service to:



- We put our customers first and aim to provide the very best service.
- Our people are at the very heart of our business and we work together to deliver our service.
- We strive to improve our services by thinking ahead and developing new solutions.
- We are committed to supporting a culture of honesty and transparency.

To enable us to achieve these objectives we must:

- meet our statutory **responsibilities**
- develop **our service** beyond our statutory responsibilities taking into account internal and external influences. This will ensure that the Fund continuously improves to deal with the potential demands of the future.

Our Responsibilities

The Fund is responsible for all aspects of the pension funds, including investment, administration and accounting. The principal responsibilities are:

- Carrying out the funding strategy aimed at ensuring the assets of the Fund are sufficient to meet pension liabilities.
- Investing fund assets, implementing investment strategy and investing responsibly.
- Administering pension services including calculating and paying benefits.
- Safe keeping and accounting of fund assets and preparing the Fund's annual report and accounts.
- Providing an excellent service to key stakeholders, including, members of the Fund and employers.
- Ensuring the Fund has committed, knowledgeable and customer-focused staff.

To ensure we meet our responsibilities, we use a range of indicators covering different aspects of the service. We set challenging targets for the performance indicators and monitor performance against the targets on a regular basis.

Key Performance Indicators*

Performance Indicators	Target & (Actual)*				
	2013/ 2014	2014/ 2015	2015/ 2016	2016/ 2017	2017/ 2018

Customers

Maintain Customer Service Excellence Standard (CSE)	Retain award (Yes)	Retain award (Yes)	Retain	Retain	Retain
Overall satisfaction of employers, active members and pensioners measured by surveys	86% (85%)	86% (88%)*	87%	88%	89%
Proportion of active members receiving a benefit statement and time of year when statement is issued	Over 95% by Sept (96%)	Over 95% by Aug (96%)	Over 96% by Aug	Aim to have all members' benefit statements up-to-date monthly	

Forward Thinking

Performance and Risk of Lothian Pension Fund	*Actual 9.8%pa. Benchmark 8.8%pa	Meet benchmark over rolling 5 year periods with lower risk with risk/return measures including performance in rising and falling markets			
Proportion of critical pensions administration work completed within standards	Greater than 90% (91%)	Greater than 90% (89%)*	Greater than 90%	Greater than 90%	Greater than 90%

Honest & Transparent

Audit of annual report	Unqualified opinion (Yes)	Unqualified opinion			
Percentage by value of pension contributions received within 19 days of the end of the month to which they relate	98% (96%)*	98% (98.7%)*	99%	99%	99%
Data quality - compliance with best practice as defined by The Pensions Regulator	Fully compliant (Yes)	Fully compliant (TBC)	Fully compliant		
Monthly pension payroll paid on time	n/a	Yes (Yes)*	Yes	Yes	Yes

Working Together

Level of sickness absence	4.0% (2.2%)	4.0% (2.3%)*	4.0%	4.0%	4.0%
Annual staff survey question to determine satisfaction with present job	60% (63%)	65% (65%)	67%	69%	71%
All staff complete at least two days training per year	2 days (Yes)	2 days (Yes)*	Yes	Yes	Yes

* Performance at financial year to date at the time of writing is shown in brackets against previous targets

Continuous improvement

We are committed to continuously improving our service and we take a number of factors into account when developing the service including:

Political & Regulatory	<p>The Local Government Pension Scheme in Scotland changes to a career average scheme with effect from April 2015. Governance arrangements are also changing, both for the Fund as well as the Scheme at a national level. In addition the Pensions Regulator will take on the role of regulatory oversight of public sector pension schemes. A review of the structure of the LGPS in Scotland is expected to be undertaken. From April 2015, members over age 55 will be able to transfer their LGPS benefits to defined contribution arrangements and have full access to the cash transferred. The Fund is also looking to gain authorization from the Financial Conduct Authority. The abolishment of contracting out of the State Earnings Related Pension Scheme will mean increases in national insurance contributions for employers and members, as well as an onus on the Fund to reconcile members' contracting out with those of the government.</p>
Economic	<p>Continuing budgetary constraints across the public sector are expected to lead to further reductions in employee numbers. There is also a risk that members decide to opt-out of the Fund on grounds of affordability or lack of appreciation of the value of pension benefits. Together with the new pension freedom and pension auto-enrolment, these could impact on the Fund's membership and liabilities. Economic growth in most parts of the world appears to be stuttering and yields on government bonds continue to move to historic lows. The results of the 2014 actuarial valuation and employer covenant analysis have highlighted the need for different funding and investment options for certain employers. With increased pressure on employer contributions, there continues to be a need to improve efficiency and reduce costs.</p>
Customer Insight	<p>The Fund has a wide range of internal and external customers. We use a variety of engagement techniques to develop our understanding of different customer groups and our staff. Their needs, experiences of our service and their perception of the Fund help us to continually improve and become more efficient and effective.</p>
Technology	<p>Advances in information technology facilitating on-line self-services and data transfer for both scheme members and employers.</p>
Environmental	<p>The Fund continues to strive to be an active shareholder to enhance the long-term value of our investments.</p>
Scrutiny & Benchmarking	<p>The Fund uses feedback from scrutiny of services to help. Such scrutiny includes internal and external audit, cost benchmarking and external awards (Customer Service Excellence and Investors in People).</p>
Risk Management	<p>The Fund is committed to a strong control environment to ensure that risks are identified, understood, managed and monitored appropriately. The risks faced by the Fund change over time and ongoing management of risk is crucial.</p>



Customer First

The Fund has a range of customers including members of the Fund, employers, government departments and regulators. We aim to provide our customers with the very best service.

Our Customer Service Excellence award demonstrates that we consistently strive to meet our customers' needs.

We also need to continue to strive improve our partnership working with our employers to deliver the service our customers expect.

The general lack of awareness of our members of the value of their pension benefits, and the contributions made by their employer, is a concern. The changes to the pension scheme in 2015 give an ideal opportunity to ensure the scheme is appreciated as a valuable part of an employee's remuneration.

Developments in technology mean we have are able to give customers greater access to information regarding their pension.

Action	Description
<p>Develop and improve customer insight</p>	<ul style="list-style-type: none"> – Develop and refresh our insight of our customers to ensure we capture changing needs – Develop our understanding of the ways customers contact us. Continue to regularly engage with all customer groups using a variety of techniques including mystery shopping and transactional surveys. – Improve analysis of consultations to ensure it remains integral to our service.
<p>Develop and improve customer awareness</p>	<ul style="list-style-type: none"> – Continue communication of new scheme benefits to members – Communicate with members on new pension freedom – Improve external communications and understanding of investment strategy.
<p>Improve timeliness and quality of customer service</p>	<ul style="list-style-type: none"> – Complete roll-out of “employer on-line” system. – Partnership accountability – continue to monitor and publish performance against service standards to ensure we have an effective and accountable partnership with employers. – Enhance members’ first point of contact with the Fund. – Re-assess our service standards and targets for members.
<p>Develop and improve our information and access</p>	<ul style="list-style-type: none"> – Update member on-line system for new scheme regulations – Improved access to services via member on-line system – Monitor the Fund’s trail social media for communicating with stakeholders. – Review and update the Fund’s new website based on feedback from employers and members.



Forward Thinking

The new Local Government Pension Scheme in Scotland taking effect from April 2015 brings significant challenges for the Fund. There are significant communication needs to explain career average pension schemes to both members and employers.

The administration will be more complex for both the Fund and employers. By striving to continually improve our performance, the Fund will be position to meet these challenges.

The results of the 2014 actuarial valuation and employer covenant analysis have highlighted the need for different funding and investment options for certain employers. New ways of working such as sharing services and the ongoing development of the internal investment team continue to be prioritised.

Action	Description
Embedding new Scheme benefits	<ul style="list-style-type: none"> – Reinforce communication of the new scheme benefits to employers and members – Put in place revised internal processes and procedures
Provide an efficient, accurate and effective service	<ul style="list-style-type: none"> – Improve systems skills and data analysis, particularly performance statistics and data quality measures – Reconcile members' contracting out records (GMPs) with those of the government – Continue to explore further efficiencies
Monitor financial and economic pressures and scheme maturity	<ul style="list-style-type: none"> – Manage the risks of the participating employers including updates of admission agreements – Implement different funding and investment options for certain employers in Lothian Pension Fund with new unitisation approach – Review investment strategies for Lothian Buses Pension Fund and Scottish Homes Pension Fund following the 2014 actuarial valuations – Monitor membership and cash flow
Shared services	<ul style="list-style-type: none"> – Develop shared-service arrangement with Falkirk Pension Fund



Honest & Transparent

The Fund is committed to supporting a culture of openness, honesty and transparency, both internally and externally. Members and employers are an integral part of the Fund's governance.

From April 2015, all public sector pension schemes will be subject to greater scrutiny by the Pensions Regulator. The Fund also has a new Pension Board, made up of employers and members and a new national Scheme Advisory Board is being established which will provide advice to Scottish Ministers on desirability of changes to the scheme in the future.

By adopting an open culture, the Fund encourages staff to contribute to the continuous improvement of the service. This includes learning from mistakes in a positive way.

The risks faced by the Fund change over time and ongoing management of risk is crucial. The Fund is committed to a strong control environment to ensure that risks are identified, understood, managed and monitored appropriately. Risks are reported on a regular basis to the Pensions Committee and Pension Board.

Action	Description
Ensure effective Governance	<ul style="list-style-type: none"> – Embed the new Pension Board in to the Fund's governance – Continue to improve the Fund's approach to training for the Pensions Committee and Pension Board – Review standards against the requirements of the Pensions Regulator Code – Monitor and respond to the requirements of the Scheme Advsiory Board – Participate in the review of the structure of the LGPS in Scotland
Risk is managed effectively	<ul style="list-style-type: none"> – Progress with application for authorisation from Financial Conduct Authority to improve investment controls – Review and update procedure manuals – Integrate environmental, social and governance research more extensively into investment decision making – Progress with updates of employer admission agreements

Working Together



Our people are at the very heart of our business and key to delivering our responsibilities and objectives. We work hard to equip our staff with the right skills and support to drive the service forward. Staff receive support in studying for professional qualifications related to the service.

As a relatively small team of 50, there are risks associated if the Fund were to experience high staff turnover, particularly in key positions requiring specialist knowledge. Following a review of options to manage such risks associated with the internal investment team, the employment of specialist investment staff was transferred to a special purpose vehicle in March 2015 to facilitate relevant and appropriate terms and conditions. Consideration will be given in due course to a phase two where all the pension fund staff would be transferred to the special purpose vehicle.

Action	Description
Develop trust between line managers and staff	<ul style="list-style-type: none"> – Continue to have regular team meetings and 1-to-1s with all staff to discuss progress, achievements and changes – Ensure all team meetings are engaging, encourage suggestions and provide feedback on suggestions
Communicate effectively, especially around change	<ul style="list-style-type: none"> – Continue to communicate regularly via face-to-face briefings and via email on issues affecting the division
Ensure team is robust and sustainable	<ul style="list-style-type: none"> – Follow up actions following the transfer of the investment team to the special purpose vehicle – Monitor and manage potential change in team dynamics and morale following the transfer – Consider potential for further transfer of pension fund staff
Celebrate Success	<ul style="list-style-type: none"> – More proactive approach to celebrating successes of key milestones – Put in place annual achievement newsletter – Improve communication of performance indicators
Ensure development and training for all staff	<ul style="list-style-type: none"> – Continue to promote learning and development opportunities for all – Deliver programme of internal Continuous Professional Development sessions – Develop ICT and project management skills

Our Budget

The budget for 2015-16 and indicative figures for 2016-2017 and 2017-2018 and are as follows:

	Projected 2014/15 £000	Budget 2014/15 £000	Movement £000	Budget 2015/16 £000	Movement £000	Budget 2016/17 £000	Movement £000	Budget 2017/18 £000
Employees	2,051	2,253	236	2,489	89	2,578	85	2,663
Property Costs	180	77	111	188	2	190	2	192
Plant and Transport	28	26	11	37	4	41	0	41
Supplies and Services	916	952	143	1,095	-20	1,075	0	1,075
Third Party Payments	595	522	764	1,286	-172	1,114	50	1,164
Investment Managers Fees	7,815	9,453	-1,353	8,100	688	8,788	743	9,531
Support Costs	273	281	-5	276	10	286	0	286
Capital Funding	80	80	0	80	0	80	0	80
Gross Expenditure (Invoiced)	11,938	13,644	-93	13,551	601	14,152	880	15,032
Receipts	-67	-52	-105	-157	0	-157	0	-157
Income - Fire	-20	-20	20	0	0	0	0	0
Income - Other	-1,750	-700	-800	-1,500	0	-1,500	0	-1,500
Total Income	-1,837	-772	-885	-1,657	0	-1,657	0	-1,657
Net Expenditure (Invoiced)	10,101	12,872	-978	11,894	601	12,495	880	13,375

Indicative Expenditure (Uninvoiced)

Property Operational Costs	n/a	n/a	n/a	1,000	50	1,050	53	1,103
Investment fees deducted from Capital	n/a	n/a	n/a	15,624	781	16,405	820	17,225
Transaction Costs	n/a	n/a	n/a	2,300	115	2,415	121	2,536
Net Expenditure (Uninvoiced)	n/a	n/a	n/a	18,924	946	19,870	994	20,864
Total Indicative Expenditure	n/a	n/a	n/a	30,818	1,547	32,365	1,874	34,239

Total Expenditure apportioned:

Pension Administration	1,945	1,980	61	2,041	69	2,110	90	2,200
Investment Management	n/a	n/a	n/a	28,777	1,478	30,255	1,784	32,039

Our Budget continued

The budget for 2015-16 and indicative figures for 2016-2017 and 2017-2018 and are as follows:

Capital Expenditure

	Projected 2014/15 £000	Budget 2014/15 £000	Movement £000	Budget 2015/16 £000	Movement £000	Budget 2016/17 £000	Movement £000	Budget 2017/18 £000
Atria One Fixtures & Fittings	34	34	-34	0	0	0	0	0
Loan Facility - LPFE	n/a	0	250	250	-250	0	0	0
- LPFI	n/a	0	75	75	-75	0	0	0
LPFI Share Capital	n/a	0	36	36	-36	0	0	0
Total Capital Expenditure	34	34	327	361	-361	0	0	0

Investment Manager Contingency

Investment Managers Fee Contingency	0	10,000	0	10,000	0	10,000	0	10,000
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