

Notice of meeting and agenda

Pensions Committee

2.30pm, Wednesday 24 June 2015

Dunedin 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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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 Pensions Board 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 If any.

4. Minute

- 4.1 Previous Minute 25 March 2015 – Submitted for approval as a correct record (circulated)

5. Reports

- 5.1 Considerations and matters to be raised by the Pension Board regarding any items on the agenda
- 5.2 Referrals and Recommendations from Pensions Audit Sub-Committee – verbal update from the Convener of the Sub-Committee
- 5.3 Agenda Planning – report by the Director of Corporate Governance (circulated)
- 5.4 Appointments – Pensions Audit Sub-Committee – report by the Director of Corporate Governance (circulated)
- 5.5 Funding Strategy – Employer Appeals and Cessations - report by the Director of Corporate Governance (circulated)
- 5.6 Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund Annual Report 2015 (& Accounts) Unaudited - report by the Director of Corporate Governance (circulated)
- 5.7 Statement of Investment Principles - report by the Director of Corporate Governance (circulated)
- 5.8 Investment Strategy Panel Activity - report by the Director of Corporate Governance (circulated)
- 5.9 Annual Investment Update – Lothian Pension Fund - report by the Director of Corporate Governance (circulated)
- 5.10 Annual Investment Update – Lothian Buses Pension Fund - report by the Director of Corporate Governance (circulated)
- 5.11 Annual Investment Update – Scottish Homes Pension Fund- report by the Director of Corporate Governance (circulated)

5.12 Risk Management Summary - 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 Richard Lamont.

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.

Item 4.1 - Minutes

Pensions Committee

2.30pm, Wednesday 25 March 2015

Present

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

Consultative Panel Members Present:

Eric Adair, Helen Carter, Sharon Dalli, Eric MacLennan and Owen Murdoch

1. Minutes

Decision

To approve the minute of the Pensions Committee of 17 December 2014 as a correct record.

2. Funding Strategy Statement

(a) Deputation by Centre for the Moving Image and Festival City Theatres Trust

Ken Hay, Chief Executive (Centre of the Moving Image), Duncan Hendry, Chief Executive (Festival City Theatres Trust), Ian Dickson, Finance Director (Centre for the Moving Image) and Iain Ross, Finance Director (Festival City Theatres Trust) advised the Committee that the proposed funding strategy would discriminate against a group of charitable organisations and would lead to a significant impact on their ability to deliver their charitable objectives. The proposals would treat 27 Community Admission Bodies as high risk and would result in significant additional costs from April 2015 which in some cases could see employers' contributions quadrupling by 2017/18.

The deputation asked that the implementation of the funding strategy be postponed to allow for sufficient time for reconsideration of the approach, to consider alternatives with the City of Edinburgh Council, to commission an economic and social impact study and to meet formally with the group of affected small charitable employers.

(b) Report by the Director of Corporate Governance

Approval was sought for the revised Lothian Pension Funds' Funding Strategy Statement which had been reviewed as part of the actuarial valuation process. The review of the Funding Strategy Statement took into account the actuarial valuation results, consultation feedback from Fund employers, results of the review of the employer covenant, revised guidance from CIPFA and the forthcoming changes to the Local Government Pension Scheme.

Decision

- 1) The Pensions Committee notes the responses received as part of the consultation process.
- 2) Whilst fully endorsing the proposed funding strategy as a prudent measure to protect the interests of Lothian Pension Fund and its employers, Pensions Committee also recognises that the lower-risk investment contribution strategy may have significant cashflow implications. Accordingly, the revised Funding Strategy Statement is approved subject to the following paragraph being inserted into section 8.2:

“If there are specific circumstance where an employer may assert that the lower-risk funding strategy would place its future existence in jeopardy and therefore a less prudent funding strategy should prove advantageous to Lothian Pension Fund and the employer, then an appeal may be submitted to Lothian Pension Fund no later than 15 months after the date of the actuarial valuation. An appeal should include an alternative funding proposal recognising the need for the employer to meet their pension liabilities. Any such appeal would be considered by the Director of Corporate Governance in consultation with the Convener of the Pensions Committee, Convener of the Pensions Audit Sub-Committee and the Independent Professional Observer and the decision reported subsequently to the Pensions Committee. In order for any appeal to be upheld, support from any respective “aligned body” or guarantor would be required, together with approval of the Fund’s Actuary. Should such appeal be successful, then a revised “Rates and adjustments certificate” would be issued. Pending determination of any appeal, the actuarial valuation “Rates and adjustments certificate” would remain applicable.”

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

3. Agenda Planning

Details were provided of potential reports for future Pensions Committee and Pensions Audit Sub-Committee meetings in June and September 2015.

Decision

To note the agenda planning document.

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

4. External Audit – Annual Audit Plan 2014-15

Audit Scotland, the external auditor, had outlined its planned programme of work to support the statutory audit in 2014/15.

A representative from Audit Scotland attended for this item.

Decision

- 1) To note the Annual Audit Plan 2014-15, 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 2014-15 for the audit fee.
- 4) To note that progress against the Annual Audit Plan 2014-15 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.)

5. Internal Audit Plan for 2015-16

Details were provided of the planned Internal Audit activities for the financial year 2015/16 which had been designed to focus on the key areas of risk faced by the Pension Fund.

Decision

To note the planned audit activity for 2015/16.

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

6. Pension Fund Governance

On 17 December 2014 the Pensions Committee had approved the governance documentation in respect to the new arrangements set to commence on 1 April 2015. Since then the 2015 regulations have been finalised and an update was provided on these developments.

Discussion focussed on the arrangements for appointing the union membership of the Pension Board. It was noted that officers would liaise with Unison to ensure there was clarity on this matter.

Decision

- 1) To note the updates in the report by the Director of Corporate Governance in relation to the implementation of the new governance arrangements by City of Edinburgh Council for the pension funds that it administers.

- 2) To note the updates to the Pension Board Constitution, Nomination and Appointments Procedure and the Training and Attendance Policy.
- 3) To note the appointments of the Member and Employer Representatives as full members of the Committee by the Council on 12 March 2015 and the need for Council to endorse the appointment of Richard Lamont as the Employer Representative, with Darren May instead taking up the position as an employer member on the Pension Board.
- 4) To note that Gary Cross of UNITE had withdrawn his application for the Pension Board and to approve the appointment of the membership of the Pension Board as otherwise set out in the report, and delegate authority to the Director of Corporate Governance to appoint the union members.
- 5) To note the cessation of the Consultative Panel with effect from 31 March 2015 and to thank its members for their significant contributions to the Funds' governance.

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

7. Reform of the Local Government Pension Scheme in Scotland and Regulatory Update (excluding Governance)

An update was provided on progress in implementing a new Local Government Pension Scheme in Scotland from 1 April 2015. Approval was also sought for the Administering Authority (Discretions) Policy Statement which had been updated to include discretions required under the new Scheme.

Decision

- 1) To note the report.
- 2) To approve the Administering Authority (discretions) Policy Statement, as shown at appendix 1 of the Director of Corporate Governance's report and delegate authority to the Director of Corporate Governance to amend section 36 of the policy (transfers) once the national position was clear.

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

8. 2014 Actuarial Valuation for Lothian Pension Fund

The Lothian Pension Fund was required by law to undertake an actuarial valuation every three years. Details were provided of the actuarial valuation of the Lothian Pension Fund on data as at 31 March 2014.

Decision

- 1) To note the results of the 2014 Actuarial Valuation report for the Lothian Pension Fund.
- 2) To agree the investment of an index-linked government bond portfolio alongside the core investment strategy of Lothian Pension Fund, representing the share of assets for certain employers for whom a different investment strategy was to be implemented.

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

9. 2014 Actuarial Valuation for Lothian Buses Pension Fund

The Lothian Buses Pension Fund is required by law to undertake an actuarial valuation every three years. Details were provided of the actuarial valuation of the Lothian Buses Pension Fund on data as at 31 March 2014.

Decision

To note the 2014 actuarial valuation for the Lothian Buses Pension Fund.

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

10. 2015-2018 Service Plan and Budget

Approval was sought for the Service Plan 2015-18 and the budget for 2015-16. The Service Plan included details of the pension fund's key challenges.

Decision

- 1) To approve the Service Plan 2015-2018 and the budget for 2015-16, together with provision of requisite financing to the investment special purpose vehicles.
- 2) To note the indicative budgets for years 2016-17 and 2017-18.

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

11. Internal Investment Controls and FCA Update

A summary was provided of the key matters in relation to the investment controls and the development of the in-house operations.

Decision

To note the progress made in relation to referring its internal controls and in establishing a Financial Conduct Authority (FCA) authorised structure.

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

12. Update on Employers Participating in Lothian Pension Fund

An update was provided on employers who were currently looking to join or leave the Fund and other matters affecting employers participating in the Fund.

Decision

To note the changes to the employers participating in Lothian Pension Fund.

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

13. Overpayment of Pension

Approval was sought not to pursue recovery of an overpayment of pension, which arose on the death of a pensioner.

Decision

To not pursue the recovery of an overpayment of pension amounting to £6,033.45.

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

14. 2014-2017 Service Plan Update

An update was provided on the progress against performance indicators and key actions required to enable the Fund to meet its key objectives.

Decision

To note the progress of the Fund against the 2014-2017 Service Plan.

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

15. Risk Management

A summary was provided on the Lothian Pensions Fund's risk management procedures, including details on the operational risk register and quarterly risk overview.

Decision

To note the Quarterly Risk Overview.

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

Pensions Committee

2.30 p.m., Wednesday, 24 June 2015

Agenda Planning

Item number	5.3
Report number	
Executive/routine	
Wards	All

Executive summary

This document provides Committee with an induction 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 the 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](#)

Single Outcome Agreement

Agenda Planning

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 That the Committee notes the agenda planning document.

Background

- 2.1 In order for the Committee and Pension Board to gain an overview of the content of future meetings it was agreed that an agenda planning document be submitted each quarter.

Main report

- 3.1 Based on the Committee cycle and the current position, the proposed agendas for the next two meetings are set out below.
- 3.2 Changes to the planned agendas are:
 - the inclusion of 'Considerations and matters to be raised by the Pension Board regarding any items on the agenda'. This has been added to the agendas for all meetings of the Pensions Committee and the Pensions Audit Sub-Committee.
 - the appointments of the members of the Pensions Audit Sub-Committee annually in March.

September 2015

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

Pensions Committee	Pensions Audit Sub Committee
<ul style="list-style-type: none">• Referrals recommendations from Pensions Audit Sub Committee• Considerations and matters to be raised by the Pension Board regarding any items on the agenda'• LPF Annual Report (& Accounts) Audited• ISA 260 Audit Report	<ul style="list-style-type: none">• Considerations and matters to be raised by the Pension Board regarding any items on the agenda• LPR Annual Report (& Accounts) Audited• ISA 260 Audit Report• Internal Audit Reports• Pensions Data Quality

- Funding Strategy – Employer Appeals
- Employers Participating in Lothian Pension Fund
- Service Plan Update
- Risk management summary

- Fraud Prevention
- Delegated authorities – Write offs
- Audit of Foreign Exchange Transaction Costs
- Risk management summary

December 2014

Pensions Committee

- Referrals / recommendations from Pensions Audit-Sub Committee
- Annual Report by External Auditor [1]
- Benchmarking Report
- Environmental Social and Governance Activity Update (including Class Actions)
- Service Plan Update
- Risk management summary

Pensions Audit Sub Committee

- Annual Report by External Auditor [1]
- EU Tax Claims & Income Recovery
- Investment Income Review- Cross Border Withholding Tax
- Investment Controls & Compliance
- Risk management summary

[1] Paper may be brought forward to September if available.

Measures of success

- 4.1 The Committee and Pension Board 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 Pension Board, comprising member and employer representatives, is integral to governance of the Funds.

Background reading/external references

None

Alastair D 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

Single Outcome Agreement

Appendices Appendix 1 – Schedule of Committee papers

Frequency	Title	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	✓	-	March
	Policies/Strategies/Training	✓	-	March
	Governance Update (as from March 2016)	✓	-	March
	Audit Sub-Committee Appointments	✓	-	March
	LPF Annual Report & Accounts (Unaudited)	✓	✓	June
	Statement of Investment Principles	✓	-	June
	Investment Strategy Panel Activity	✓	-	June
	Annual Investment and funding – LPF/LBPF/SHPF	✓	-	June
	LPF Annual Report & Accounts (Audited)	✓	✓	September
	ISA 260 Audit Report	✓	✓	September
	Pensions Data Quality	-	✓	September
	Delegated authorities: Write offs	-	✓	September
	Fraud Prevention	-	✓	September
	Audit of Foreign Exchange Transaction Costs	-	✓	September
	Annual Report by External Auditor	✓	✓	December
	Benchmarking Report	✓	-	December
	EU Tax Claims & Income Recovery	-	✓	December
	Investment Income Review-Cross-Border withholding tax	-	✓	December
	Environmental Social and Governance Activity (including Class Actions)	✓	-	December
Investment Controls & Compliance	-	✓	December	

Frequency	Title	Pensions Committee	Audit Sub Committee	Month
Semi Annually	Employers Participating in Lothian Pension Fund	✓	-	March & September
3 Times per year	Service Plan Update	✓	-	March, September & December
	Referrals / recommendations from Pensions Audit-Sub	✓	-	June, September & December
Quarterly	Risk management summary	✓	✓	March, June, September & December
	Considerations and matters to be raised by the Pension Board regarding any items on the agenda	✓	-	March, June, September & December
Every 3 years	Actuarial Valuation: LPF/LBPF/SHPF Funding Strategy Statement	✓	-	December or March
As required	Delegated authorities (provider appointments)	✓	-	
	Discretions (death grants etc.)	✓	-	
	Internal Audit Reports	-	✓	
	Regulatory Update	✓	-	
	Investment Strategy Reviews (at least every 3 years)	✓	-	
	Risk management (in depth review)	-	✓	

Pensions Committee

2.30pm, Wednesday, 24 June 2015

Appointments - Pensions Audit Sub-Committee

Item number	
Report number	5.4
Executive/routine	
Wards	all

Executive summary

Committee is invited to appoint the membership of the Pensions Audit Sub-Committee from the membership of the Pensions Committee.

Links

Coalition pledges	
Council outcomes	CO25
Single Outcome Agreement	

Appointments – Pensions Audit Sub-Committee

Recommendations

- 1.1 To appoint three of the members of the Pensions Committee as members of the Pensions Audit Sub-Committee.
- 1.2 To appoint the Convener of the Pensions Audit Sub-Committee.
- 1.3 To request that the Pensions Board appoints two of its members (one employee, one employer) as observers to the Sub-Committee,

Background

- 2.1 The Committee is required to appoint the membership of the Pensions Audit Sub-Committee from its membership annually.

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. The sub-committee is tasked with helping to ensure that the highest standards of probity and public accountability are maintained and it thus is an essential component of the pension scheme's governance structure.
- 3.2 The membership is made up of members of the Pensions Committee and must contain at least two councillors. The previous year's membership consisted of three councillors who were Councillors Rose, Bill Cook and Orr.
- 3.3 The Convener of the Sub-Committee was Councillor Rose. The convener must be a member of the Pensions Committee but the Convener of the Pensions Committee is excluded from being the Convener of the sub-committee.
- 3.4 The Pensions Board will be asked to nominate two representatives (one employee, one employer) as observers to the Sub-Committee.

Measures of success

- 4.1 Not applicable.

Financial impact

5.1 Not applicable.

Risk, policy, compliance and governance impact

6.1 The Sub-Committee will be unable to take decisions unless a membership is appointed by the Committee in line with the Committee Terms of Reference and Delegated Functions.

Equalities impact

7.1 Not applicable.

Sustainability impact

8.1 Not applicable.

Consultation and engagement

9.1 Not applicable.

Background reading/external references

[Committee Terms of Reference and Delegated Functions](#)

Alastair D Maclean

Director of Corporate Governance

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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

Pensions Committee

2.30 p.m., Wednesday, 24 June 2015

Funding Strategy – Employer Appeals and Cessations

Item number	5.5
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to provide an update on employer engagement regarding the decision of the Pensions Committee of 25 March 2015 to allow certain employers the right of appeal against the funding strategy. As a reminder, this specifically refers to those employers (Community Admission Bodies) who are closed to new members and have less than 5 active members, or are expected to leave the Fund within two valuation periods (6 years). For these employers, the revised Funding Strategy Statement assumes investment in lower-risk assets i.e. index-linked government bonds.

To-date 14 of the 27 employers affected have notified Lothian Pension Fund of their intention to appeal. Of these, only one employer has provided its appeal submission in the initial phase. An oral update will be provided to Pensions Committee on the progress of the appeals. Committee is also advised of the cessation of membership by two employers as at 31 March 2015.

In England and Wales, cessation valuations are expected to be considered by the Scheme Advisory Board for the Local Government Pension Scheme (LGPS). Similarly it is expected that the Scheme Advisory Board for the LGPS in Scotland will also reflect upon this issue.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Funding Strategy Appeals – Employer Appeals and Cessations

Recommendations

The Committee is recommended to:

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 Note the update on funding appeals including the communication to, and engagement with, employers, the update on the progress of appeal(s); and the cessation of membership of Lothian Pension Fund of two other employers with effect from 31 March 2015.
- 1.3 Note that the basis for cessation valuation is being debated across the UK Local Government Pension Scheme.

Background

- 2.1 Committee is reminded that when the last active member of an employer leaves the Fund, as required by the Scheme regulations (and the Fund's policy on employers leaving Fund), a cessation valuation must be carried out to value the employer's liabilities and identify any payment required to cover such liabilities.
- 2.2 The Fund's policy has been for the cessation valuation to be undertaken using government bond discount rate with a prudent allowance for mortality improvements (subject to the covenant strength of any successor body and / or guarantor which may be in place after the cessation date). As a result, cessation valuations can often result in large deficits. This approach is unchanged over recent years, is consistent with the approach to cessations in other Funds across the LGPS and is in line with the Actuary's advice.
- 2.3 In order to improve employers' understanding of pension liabilities and cessation valuations, during the 2014 actuarial valuation the Actuary provided each employer with the value of their pension liabilities on the cessation basis as at 31 March 2014. In addition, the funding and contribution strategy was amended for those employers with:
 - less than 5 active members, and/or
 - a future working lifetime of active members of less than 6 years.in order to address the previous inconsistency between the actuarial valuation and cessation valuation.

2.4 As well as raising awareness of the cessation valuation, this strategy smoothes employer contributions in the period leading up to the employer's exit from the Fund. It also reduces the risk of employers being unable to pay large deficits when the last active member leaves. A change in investment strategy is also being adopted for these employers. Assets will be invested in lower-risk investments which will help reduce the degree of short-term change in employer contribution rates in the period prior to the employer leaving the Fund

2.5 The Pensions Committee, at its meeting on 25 March 2015, considered a report on the revised Funding Strategy Statement (FSS). This included coverage of the investment strategy, at reference 8.2, as follows:

“Overall the Fund adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer.

However employers (with the exception of Transferee Admitted Bodies) who are closed to new members and have less than 5 active members, or are expected to leave the Fund within two valuation periods (6 years), will be assumed to be invested in lower-risk investments i.e. index-linked government bonds. This aims to reduce the degree of short-term change in employer contribution rates in the period prior to the employer leaving the Fund and hence manage risks for both the individual employer and for the Fund as a whole.”

2.6 A deputation from the Centre for Moving Image (CMI) and Festival City Theatres Trust (FCTT) representing 12 other employers was present. The deputation asked the Committee to postpone the implementation of the revised FSS in order to allow time to reconsider the strategy, particularly for those employers impacted by a change to a lower risk, gilts valuation basis. The Committee then asked questions of the deputation and then discussed the FSS.

2.7 Committee noted the responses to the consultation on the revised FSS and, whilst endorsing the proposed revised strategy, it recognised the potentially significant cashflow implications the proposal could have for certain employers.

2.8 The Convenor tabled a motion to amend the revised FSS which was subsequently agreed by Committee. The amendment adds an additional section to reference 8.2 of the FSS as follows: ‘If there are specific circumstances where an employer may assert that the lower-risk funding strategy would place its future existence in jeopardy and therefore a less prudent funding strategy should prove advantageous to Lothian Pension Fund and the employer, then an appeal may be submitted to Lothian Pension Fund no later than 15 months after the date of the actuarial valuation. An appeal should include an alternative funding proposal recognising the need for the employer to meet their pension liabilities. Any such appeal would be considered by the Director of Corporate Governance in consultation with the Convenor of the Pensions Committee, Convenor of the Pensions Audit Sub-Committee and the Independent Professional Observer and

the decision reported subsequently to the Pensions Committee. In order for any appeal to be upheld, support from any respective 'aligned body' or guarantor would be required, together with approval of the Fund's Actuary. Should such appeal be successful, then a revised 'Rates and adjustment certificate' would be issued. Pending determination of any appeal, the actuarial valuation 'rates and adjustment certificate would remain applicable'.

Main report

Communication prior to submission of appeal

- 3.1 Lothian Pension Fund ('the Fund') has been engaged in ongoing dialogue with those employers who have the option to appeal against the funding strategy changes. Specifically, the Fund has been liaising with senior officials from the Centre for the Moving Image (CMI) and Festival City Theatres Trust (FCTT), the two employers who provided the deputation to Pensions Committee, about the appeal process.
- 3.2 Their comments as to the requested content and timing of any appeal were reflected by the Fund in the "Employers' Bulletin Special Edition – Funding Appeals" which was issued both to the affected employers and to the members of the Pensions Committee on 9 April 2015. For reference, this is included at Appendix 1.
- 3.3 The Fund also accepted an invitation to attend a meeting of a group of the affected employers, which was held on 20 April 2015. Representatives of thirteen employers were present. An actuarial consultant, commissioned by the employers, was also in attendance. Discussions on various specific points were held, with suitable clarification provided by the Fund as to the basis of any appeal.
- 3.4 A further meeting was held on 21 April 2015. CMI and FCTT represented the employer group, together with councillors and officials of the City of Edinburgh Council (as aligned body to a number of the employers) and the Fund. A pragmatic approach to consideration of any appeal was envisaged, with the twin objectives of ensuring that individual employers recognised and met their respective pension liabilities in full, whilst seeking not to place their future existence in jeopardy as a consequence.

Submission of Appeal(s)

- 3.5 Although the formal deadline for appealing is 30 June 2015, the Fund offered employers an option to lodge an appeal by 1 May 2015, with a commitment to concluding these early appeals around the end of June. The Fund did appreciate that not all employers would be able to meet this tighter timescale and appeals received after 1 May are expected to be concluded by the middle of September.
- 3.6 To-date, of the 27 employers affected by the change of funding approach, 14 have notified the Fund of their intention to appeal. Of these, only one employer

provided its appeal submission in the initial phase. To date, 6 employers have indicated that they will not appeal and 7 have not informed the Fund of their intention.

- 3.7 As agreed by Committee, the Director of Corporate Governance will consider the appeals in consultation with the Convenor of the Pensions Committee, Convenor of the Pensions Audit Sub-Committee and the Independent Professional Observer.
- 3.8 An oral update will be provided to Pensions Committee on the progress of the appeal(s).

Employer Cessations

- 3.9 Two employers, Mental Welfare Commission for Scotland and Pilton Community Health Project, ceased their membership of the Fund as at 31 March 2015.
- 3.10 Mental Welfare's last active member retired on 31 March 2015. A cessation valuation has been issued by the Actuary to the Fund and it is anticipated that the pension deficit will be settled in full in the near future. The Scottish Government is the body to which the Mental Welfare Commission is aligned.
- 3.11 Pilton Community Health Project is part of the pool of smaller employers which had previously closed to new entrants. It has decided to close to future accrual and is now engaged in dialogue with the Fund and the City of Edinburgh Council as to payment of the pension deficit.
- 3.12 Pensions Committee is reminded that "The Fund's general policy is for any deficit on cessation to be recovered through a single lump sum payment to the Fund. In exceptional circumstances, the Fund may consider permitting an employer to spread the payment over an agreed period where it considers that this does not pose a material risk to the solvency of the Fund. The Fund may take into account the covenant strength of any successor body and / or guarantor which may be in place after the cessation date. In this instance, interest at a rate advised by the actuary will be applied to determine the appropriate payments to be made."
- 3.13 It is likely that Pensions Committee's approval of the cessation valuation payment terms for Pilton Community Health Project will be sought in due course.
- 3.14 It is also considered likely that some other employers, for example, those with the option to appeal against the recent funding strategy changes, may seek similar recourse. It will be important for the Fund and the Pensions Committee to ensure consistency, whilst recognising specific individual employer circumstances.

The Principles and Basis of Cessation Valuations

- 3.15 The principles of cessation valuations (i.e. the crystallisation of pension liabilities when there are no more active members) are receiving attention nationally across the LGPS.
- 3.16 In England and Wales, cessation valuations are expected to be considered by the Scheme Advisory Board for the Local Government Pension Scheme (LGPS). Similarly it is expected that the Scheme Advisory Board for the LGPS in Scotland will also reflect upon this issue.
- 3.17 Both the basis for the calculation of the pension liabilities at cessation and repayment terms of any debt are being debated.
- 3.18 The Fund will continue to monitor and engage in the debate over cessation valuations and will advise Committee of developments.

Measures of success

- 4.1 None directly arising from this progress report.

Financial impact

- 5.1 None directly arising from this progress report, although the determination of any employer appeal against the funding strategy will obviously have financial implications for Lothian Pension Fund. Similarly, any spreading of a deficit payment on cessation of an employer will also be of consequence.

Risk, policy, compliance and governance impact

- 6.1 None directly arising from this progress report, although the determination of any employer appeal against the funding strategy shall comply with the decision of the Pensions Committee, at its meeting on 25 March 2015. The risk that any individual employer is unable to fulfil its financial obligations to meet pension liabilities is addressed by the Fund's Funding Strategy Statement.

Equalities impact

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

Sustainability impact

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

Consultation and engagement

- 9.1 The Fund has engaged in extensive consultation and dialogue with its employers over the changes to its funding strategy and the appeals process. Similarly, there has been full engagement with employers regarding the implications of cessation of LGPS membership.
- 9.2 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

None

Alastair D Maclean

Director of Corporate Governance

Contact: John Burns, Pensions & Accounting Manager

E-mail: john.burns@edinburgh.gov.uk | Tel: 0131 469 3711

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: Special Employer Bulletin

From: George Kirk on behalf of LPF Employers
Sent: 09 April 2015 11:25
Subject: Employers Bulletin: Special Edition - Funding Appeals



Employers' Bulletin

Special Edition – Funding Appeals

UPDATE

The Special Edition of the Employer Bulletin sent on 31 March outlined the results of the [2014 Actuarial Valuation](#) of Lothian Pension Fund. It also explained an option for the employers with a lower-risk funding strategy, to appeal and propose an alternative funding approach if their future existence is being put in jeopardy due to the change in funding. This bulletin provides details of the appeals process.

Appeals Process

Stage 1

Employer lodges intent to appeal.

Stage 2

Employer lodges appeal with Lothian Pension Fund. An indication of the information which would be helpful for the appeal to be considered is outlined below:

- Most recent financial statements, both audited and unaudited, highlighting any qualification or reservation expressed by the auditor.
- Financial forecasts (Profit & Loss,

IN THIS EDITION

UPDATE:

[Appeals Process](#)

[Timetable](#)

[Employer Contributions during Appeal Process](#)

[Employer Contributions after Appeal Process](#)

[Next steps](#)

Contact details for employers

George Kirk: 0131 529 4660

e-mail: erin.savage@edinburgh.gov.uk

Contact details for employees

Members pension helpline: 0131

Balance Sheet and Cashflow) reflecting the pension contribution as certified by the Actuary for the 2014 actuarial valuation, together with evidence to support the view that such payments would place the employer's future existence in jeopardy. The forecasts should cover, as a minimum, the period April 2015 to March 2018, the period which is relevant for the actuarial valuation.

- Financial forecasts (Profit & Loss, Balance Sheet and Cashflow) reflecting the contributions being proposed by the employer. These should include explicit coverage of the size and duration of proposed payments in relation to the future working lifetime of active members, as stated by the actuary, and the estimated gilts deficit as at 31 March 2014. (This information is included in the employer results schedule). Please explain how contributions to the pension fund are proposed to be used to make the employer more sustainable.
- Details of future funding sources, i.e. assumptions re grant and other income and the extent to which such funding is assured and by whom.
- Details of any security held on the organisation's assets, if relevant.
- Any potential options for security of assets available to the Fund or guarantor.
- Details of any contingent liabilities.
- Basis of admission to LGPS e.g. voluntary request, staff transfer from any local authority.
- Any other information the employer feels is appropriate.

Please note that not all of this information may be essential in every instance. If you are unable to supply such information, please let us know why.

Employers should also note that the Fund is not expecting that the proposed alternative funding strategy is based on precise actuarial calculations and therefore we do not envisage you having to take actuarial advice. It is recognised that appeals are for employers whose future existence may be in jeopardy hence it is expected that affordability will be the sole driver.

529 4638

e-mail

pensions@edinburgh.gov.uk

DATES FOR YOUR DIARY:

Finance Briefing : Thursday 25
June at 9am

For the purposes of consideration by any aligned body or guarantor, please explain:

- The impact of the change in the funding strategy will have on your service;
- The impact of your service which would result under your proposed funding approach;
- Your commitment to managing discretionary pension liabilities in the future.

Stage 3

Consideration of appeals by Director of Corporate Governance including consideration and views of aligned bodies/guarantors and the Actuary. Consultation with convenors of the Pensions Committee and Pensions Audit Sub-Committee and independent observer will follow.

Stage 4

Communicate results of the appeals to employers and Pensions Committee.

Timetable

The Funding Strategy Statement says that 'an appeal may be submitted to Lothian Pension Fund no later than 15 months after the date of the actuarial valuation'. The deadline for submitting an appeal on the results of the 2014 Actuarial Valuation is therefore **30 June 2015**.

Although the formal deadline for appealing is 30 June, we would like to offer employers an option to lodge an appeal by 1 May 2015. We will commit to concluding these early appeals around the end of June.

We appreciate that not all employers will be able to meet this tighter timescale and appeals received after 1 May are expected to conclude around the middle of September.

Employer Contributions During the Appeals Process

Contribution rates in the rates and adjustments certificate on pages 39 and 40 of the 2014 Actuarial Valuation report have been certified by the Actuary and they apply from **1 April 2015**. Employers were previously

advised of these rates in their individual results schedules.

Employer contributions expressed as a percentage of payroll (Future Service Rate) are payable every month. The monetary contributions in respect of Past Service Deficits (£000s) are payable at any time during the relevant financial year.

In accordance with regulations, any employer who pays less than the certified rates will be charged interest on late payments. With effect from 1 April 2015, the Fund is also applying penalties for late payments to cover the costs of recovering late payments.

We can confirm that payment of the rates certified in the 2014 Actuarial Valuation prior to an appeal will **NOT** jeopardise the outcome of the appeal.

Employer Contributions After the Appeals Process

Should an appeal be successful, the Actuary will revise the rates and adjustment certificate and the amounts paid from 1 April 2015 to the date of the outcome of the appeal will be taken into consideration as a prepayment.

Next steps

If you intend to appeal, please let us know as soon as possible. Also, please let us know when you expect to appeal by. This will help us plan the appeals process and deal with them more efficiently and respond to you quicker.

Pension Fund representatives have been invited to attend a meeting of employers at 11am on Monday 20 April at the Festival Theatre and we have agreed to attend to answer any questions around the appeals process. If any employer is interested in attending that meeting, please contact Ian Dickson at Centre of Moving Images on lpf@cmi-scotland.co.uk.

We received a number of letters from individual employers regarding the funding strategy after the deadline for the consultation. Apologies for the delay in replying to these letters – our focus has been on communicating with all employers at this

stage. We intend to reply to these individual letters over the coming weeks.

If you have any questions about the funding strategy, or the appeals process, please do not hesitate to call Erin Savage on 0131 529 4660 or e-mail erin.savage@edinburgh.gov.uk.

George Kirk | Employer Relations Officer | Lothian Pension Fund | Atria One | 144 Morrison Street | Edinburgh | EH3 8EX | Tel 0131 529 4652 | Fax 0131 529 6229 | george.kirk@edinburgh.gov.uk | www.lpf.org.uk



WINNER 2014
Best Alternatives



WINNER 2014
Fund of the Year (Under £750 m)
Lothian Buses Pension Fund
Winner in 2014, 2013, 2012, 2011, 2010



Pensions Committee

2.30 p.m, Wednesday, 24 June 2015

Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund Annual Report 2015 (& Accounts) Unaudited

Item number	5.6
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to present the unaudited Annual Report for the year ended 31 March 2015 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 2015 is attached as Appendix 1. The Accounts show that the Lothian Pension Fund valuation increased from £4,378 to £5,106m and Lothian Buses Pension Fund increased from £337m to £386m. The Scottish Homes Pension Fund increased from £136m to £155m.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund Annual Report 2015 (& Accounts) Unaudited

Recommendations

The Committee is recommended to:

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 Note the unaudited Annual Report for the year ended 31 March 2015 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. From 2010/11 onwards, the LGPS Annual Report should be published separately from the Authority's own financial statements and there should be a separate audit report.
- 2.2 On 11 May 2015, "Local Government Finance Circular No.6/2015" was issued to provide non statutory guidance on the requirements of The Local Authority Accounts (Scotland) Regulations 2014. These introduce a new statutory requirement for the Annual Accounts to include a Management Commentary and an Annual Governance Statement. Similar requirements are contained in The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008.
- 2.3 In July 2014, CIPFA published guidance "Accounting for Local Government Pension Scheme Management Costs", which promotes greater transparency of investment management fees. These principles have been adopted as best practice in the presentation of the unaudited Annual Report 2015. Committee is reminded that the accounts for 2012/13 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund were restated to include the investment management fees charged within comingled investment vehicles, in anticipation of the issuing of such guidance from CIPFA.

- 2.4 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 consider the unaudited Annual Report for the pension funds. As per Audit Scotland guidance, the Annual Report will be submitted to Council on 25 June 2015 for the purpose 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 2015 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund is attached as Appendix 1.
- 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, however, this Section 95 responsibility has been delegates to the Pensions and Accounting Manager.
- 3.2.2 The Accounts show that the Lothian Pension Fund valuation increased from £4,378m to £5,106m and the Lothian Buses Pension Fund increased from £337m to £386m. The Scottish Homes Pension Fund increased from £136m to £155m.
- 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 2014 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 FRS 17 / 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 of the liabilities of each of the three Funds and a suitable note has been added to the accounts of each fund (Lothian Pension Fund £6,663m from the previous year's £5,483m, Lothian Buses Pension Fund £400m from £358m and Scottish Homes £141m from £138m). The increased in the value of the liabilities is largely due to the reduction in bonds yields (discount rate) from 4.3% to 3.2% as at 31 March 2015.
- 3.3 Following the consideration of the unaudited Annual Report by Pensions Committee, the next steps will be:
- a. City of Edinburgh Council will be asked to note the unaudited accounts on 25 June 2015.
 - b. In order to meet the statutory timetable, the Pensions Audit Sub-Committee of 29 September 2015 and thereafter the Pensions Committee, at its meeting on 30 September 2015, will consider the following reports:
 - i. International Standard on Auditing (ISA) 260 Audit Report, which covers all significant issues arising from the audit of the accounts;
 - ii. the Annual Report by the External Auditor which summarises all significant matters arising from the audit and overall conclusions about the management of key risks; and
 - iii. the Audited Annual Report 2015.

Measures of success

- 4.1 The prime objective of the Council, as administering authority of the Lothian Pension Fund, Lothian Buses Pensions Fund and Scottish Homes Pension Fund, is to ensure an unqualified audit opinion of the Annual Report 2015. 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 from this report.

Consultation and engagement

- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.
- 9.2 This report is also being considered by the Pensions Audit Sub-Committee at its meeting on 23 June 2015 and its recommendation(s) will be reported orally.

Background reading/external references

None

Alastair D Maclean

Director of Corporate Governance

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E-mail: john.burns@edinburgh.gov.uk | Tel: 0131 469 3711

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: Unaudited Annual Report 2015 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund;

Appendix 2: Internal Audit Annual Report and Opinion for the Year Ended 31 March 2015 by Chief Internal Auditor;

Appendix 3: City of Edinburgh Council – Statement on the System of Internal Financial Control by Head of Finance;

Appendix 4: Lothian Pension Funds – Statement on the System of Internal Financial Control by Pensions & Accounting Manager



Unaudited Annual Report and Accounts 2014/15

Lothian Pension Fund
Lothian Buses Pension Fund
Scottish Homes Pension Fund



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Foreword and management commentary



Report from the Convener of the Pensions Committee

As Convener of the Pensions Committee with responsibility for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, I am pleased to introduce the 2014/15 Annual Report and Accounts.

The Local Government Pension Scheme (LGPS) in Scotland changed from a 'Final Salary' scheme to a 'Career Average' scheme on 1 April 2015. I would like to express my appreciation to the staff of the pension fund and our scheme employers who have worked so hard to support the successful implementation of the new scheme on behalf of our members. If you are paying into the scheme now the pension you build up from April 2015 is based on your average earnings until you take your pension. Pension you built up in the scheme before April 2015 will still be based on your final salary. Very importantly, particularly within the LGPS where we have a high proportion of relatively low paid and part time workers, the scheme remains a defined benefit scheme. This guarantees members a stable income in retirement, linked to inflation rates. The LGPS is still a great pensions scheme and ensuring members appreciate the value of their pension continues to be very important for us.

Preparations for governance changes on 1 April 2015 have also been made during the year. The Fund wound up the Consultative Panel, which has made a significant contribution over 2014/15 and in previous years, its members bringing valuable insight to the decision making of the Pensions Committee. A new Pension Board has replaced the Consultative Panel. I and my fellow members of the Pensions Committee look forward to working with the new Pension Board in a similarly constructive manner.

I would like to take this opportunity to record my thanks to my colleagues on the Pension Committee, the Consultative Panel and our advisors for their commitment and support over the last year.

Councillor Alasdair Rankin
Pensions Committee Convener
The City of Edinburgh Council
24 June 2015



Report by the Convener of the Pensions Audit Sub-Committee

The role of the Pensions Audit Sub-Committee 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. It consists of three members of the Pensions Committee and it draws on appropriate specialist knowledge, understanding and expertise to scrutinise the operation of the pension funds.

Two members of the Consultative Panel, one member representative and one employer representative and the independent professional observer also attend.

Over the 2014/15 year, the Sub-Committee met three times and considered the 2013/14 accounts which for the first time included details of investment fees which had previously been netted off against capital appreciation. It also reviewed findings from internal and external audits, fraud prevention, recovery of income tax on investment income and the service from the Funds' investment custodian.

The Audit Sub-Committee continues to provide added benefit to the pension funds and ultimately to members and employers.

Councillor Cameron Rose
Audit Sub Committee Convener
The City of Edinburgh Council
24 June 2015



Report by the Independent Professional Observer

My role as an Independent Professional Observer for the pension funds is to assist the Pensions Committee in exercising their governance responsibilities as effectively and as efficiently as possible. My experience as a pension trustee and knowledge of institutional investment help me to undertake the role.

2014-5 was a busy year for the Pensions Committee and the Consultative Panel. As well as overseeing preparations for the introduction of the new scheme in April 2015, they contributed actively to the consultations on the new governance arrangements for the LGPS in Scotland and acted swiftly to amend the governance processes for the Lothian fund once the regulations were finalised. The activities of the Pensions Committee and the Pension Board are now overseen by The Pensions Regulator, and all members have received training on the new governance and regulatory regime. In addition, the Committee has overseen the establishment of two special purpose vehicles to enhance the investment and administration efficiency of the schemes, and ensured that appropriate governance and oversight is in place for this new structure.

The level of debate during Committee meetings is of a consistently high quality. Members of both the Pensions Committee and the Consultative Panel have been very engaged with ensuring that the governance arrangements for the next stage of the funds' lifecycle continue to ensure that the interests of members, employers and taxpayers is paramount in how the funds are run.

Sarah Smart
Independent Professional Observer
24 June 2015

Management commentary



ALASTAIR MACLEAN
Director of Corporate Governance



CLARE SCOTT
Investment and Pensions Service Manager

Scheme Changes

During the year preparations have been made for the significant changes to the Local Government Pension Scheme and the introduction of a career average pension scheme taking effect on 1 April 2015.

We participated in working groups set up by the Scottish Local Government Pensions Advisory Group to develop communications material for the new Scheme, including the new Scheme-wide website www.scotLGPS2015.org and videos. Newsletters were also issued to members and we have delivered face-to-face presentations. A communications toolkit was also developed for employers to use for their employees which reinforce the message that the scheme remains a valuable part of remuneration.

As well as reviewing and adapting our internal processes we have also been working with our software providers to develop the new systems required to administer the new scheme.

Customers

Efforts to speed up the transfer of membership data from employers to the Fund have continued over the year and approximately two-thirds of employers are now submitting membership data to us every month. This enables us to provide a quicker service to members. As a result, the satisfaction of new members improved significantly in 2014/15 with 89% of those surveyed agreeing that our service was excellent. We have continued to warn members of the risk of pension liberation fraud and to try to prevent such fraud. During the year, the Funds, once again, retained the Customer Service Excellence award and achieved specific recognition for our efforts to improve the timeliness of data transferred from employers and our handling of complaints.

2014 Actuarial Valuations

The financial position of all three pension funds, and the employer contributions for the coming years, were assessed at the 2014 actuarial valuation.

Lothian Pension Fund's funding level fell from 96.1% at 31 March 2011 to 91.3% at 31 March 2014 valuation and the deficit increased from £142 million to £417 million. Despite strong investment performance over the three years between the valuations, falls in bond yields as well as the improvements in longevity caused the funding level to fall. The Funding Strategy Statement was reviewed during the actuarial valuation. A review of the employer covenant highlighted the fact that a number of employers have very few active members and are therefore close to exit. When the last active member leaves the Fund, a cessation valuation must be carried out to value the employer's liabilities and identify any payment required to cover such liabilities. Cessation valuations can often reveal large pension deficits. In order to improve employers' understanding of cessation valuations, the Actuary provided each employer with the value of their pension liabilities during the valuation. In addition, to address the previous inconsistency between the actuarial and cessation valuations, a new funding approach was adopted for employers close to exiting the Fund to spread the deficit payment over the future working lifetime of the active members. As well as raising awareness of pension deficits, it also reduces the risk of employers being unable to pay deficits when the last active member leaves.

For Lothian Buses Pension Fund, the funding level (on the ongoing basis) rose from 112.4% at 31 March 2011 to 116.7% at 31 March 2014 and the surplus increased from £28 million to £48 million. As the Fund has been closed to new entrants since 1 January 2008, inevitably the liabilities will gradually mature. In this context, the funding level was also measured on a more prudent basis, discounting the liabilities using government bond (gilts) yields. This increased the liabilities by £93 million and reduces the funding level to 88.2%.

The funding level for Scottish Homes Pension Fund at 31 March 2014 was 88.8%, increased from 86.3% from the 2011 actuarial valuation. The funding level remained below the target funding level (91.5% at March 2014) as prescribed in the funding agreement with Scottish Government.

Funding and Investments over 2014/15

Investment markets performed strongly over the year with most markets delivering returns over 10% as markets continued to respond positively to low interest rates. Lothian Pension Fund produced a return of 16.5% over the year and at 31 March 2015 was valued at over £5 billion. Lothian Buses Pension Fund and Scottish Homes Pension Fund returned 15.1% and 19.7% respectively.

Despite very strong investment markets over the 2014/15 year, the decline in market yields has led to a deterioration of the funding levels for Lothian Pension Fund and Lothian Buses Pension Fund. The implementation of the investment strategies for the Funds for 2012-17 proceeded at a measured pace as investment opportunities become available and as opportunities were researched.

For the Scottish Homes Pension Fund, the funding level rose over the financial year 2014/15 and as a result the Fund's equity allocation was reduced in favour of bonds in order to reduce risk. The funding level at 31 March 2015 was estimated to be 92.8%. During April 2015, with equity markets having continued to rally, the funding level rose again and the equity allocation was reduced further.

In order to further develop the internal investment capabilities of the Fund, two special purpose vehicles were created to employ certain key internal investment staff and to seek Financial Conduct Authority (FCA) registration.

Future Challenges

We set out the the future challenges and priorities for the pension funds in our Service Plan each year. The most recent Service Plan, which was agreed by the Pensions Committee in March 2015, is available on our website.

The change to a career average pension scheme means that administration and communication will be more complex. There are also more wide reaching and radical reforms for pensions taking place in the UK, with changes to the State Pension and flexible access to pensions savings under the 'Freedom and Choice' initiative. 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.

Looking ahead, investors are wondering how long the current positive environment for investment markets can last. Given that the low interest rates and unconventional monetary policy (so-called quantitative easing) are inextricably linked with prices in asset markets, the fear is that this element of support will be withdrawn and interest rates will rise. It appears unlikely that the high returns of 2014/15 will be sustained over the long term. Uncertainty is a constant in the investment market, which creates the opportunities for investors to earn returns higher than those available from risk-free assets. With the benefit of economic growth and advancement over the coming years and decades, the investment strategies of the Funds should deliver the required returns over the long term. The Fund will also seek Financial Conduct Authority (FCA) registration in order to further develop its investment capabilities.

The results of the 2014 actuarial valuation and employer covenant analysis have highlighted the need for different funding and investment options for certain employers. Employers in the Lothian Pension Fund continue to face organisational changes and with increased pressure on employer contributions, increasing numbers of admitted bodies are investigating options to exit the Fund. We are committed to ensuring commitments to the Fund are honoured whilst adopting as flexible an approach as possible to funding.

From April 2015, the Funds will be under greater scrutiny. As well as the increased oversight by the Pensions Regulator, the Funds have a new Pension Board, made up of employers and members and a new (national) Scheme Advisory Board which has been established which will provide advice to Scottish Ministers on desirability of changes to the scheme in the future.

By continuing to use the principles of the Customer Service Excellence award, we will strive to meet our customers' needs.

ALASTAIR MACLEAN
Director of Corporate Governance
The City of Edinburgh Council
25 June 2015

CLARE SCOTT
Investment and Pensions Service Manager
The City of Edinburgh Council
25 June 2015

How the Funds work

The City of Edinburgh Council acts as administering authority for the Local Government Pension Scheme in the Lothian area. There are three funds, Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

Pensions Committee and Audit Sub-Committee

The City of Edinburgh Council in its role as administering authority delegates pension matters to the Pensions Committee and Pension Audit Sub-Committee whose members act as 'quasi trustees'.

The Pensions Committee held four meetings during the year and the Audit Sub-Committee met three times. Membership of both Committees is shown below.

Membership 1 April 2014 to 31 March 2015

Pensions Committee

Councillor Alasdair Rankin (Convener)
Councillor Maureen Child
Councillor Jim Orr
Councillor Bill Cook
Councillor Cameron Rose
John Anzani (nominated by the Consultative Panel)
Darren May (nominated by the Consultative Panel)

Pensions Audit Sub-Committee

Councillor Cameron Rose (Convener)
Councillor Jim Orr
Councillor Bill Cook

Consultative Panel

Membership of the Consultative Panel to 31 March 2015 was made up of six employer and six member representatives who act as a sounding board for, and meet with, the Pensions Committee. The Panel members are shown below.

Consultative Panel membership 1 April 2014 to 31 March 2015		
	Employer	Representing
Employer representatives		
Alan Williamson	Edinburgh College	Colleges/universities
Darren May*	Scottish Water	Other employers
Helen Carter	Scottish Government	Scottish Homes
Eric Adair	EDI	Other employers
Guy Hughes (Resigned 1/2/15)	Lothian Buses	Lothian Buses
Sharon Dalli	Police Scotland	Other employers

Consultative Panel membership 1 April 2014 to 31 March 2015		
	Employer	Representing
Member representatives		
Charlie Boyd	The City of Edinburgh Council	Active members
Eric MacLennan	The City of Edinburgh Council	Unison
Owen Murdoch	Retired member	Unison
John Rodgers	Lothian Buses	Unite
John Anzani*	Midlothian Council	Active members
Vacancy		

* Members of the Pensions Committee at 31 March 2015

Pensions Committee and Consultative Panel training

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

All Committee members undertook training covering key elements of pension legislation and investments. Committee members collectively attended 167.5 hours of training over the year. Panel members undertook 60.5 training hours.

The Committee and Consultative Panel also participated in additional meetings to discuss and agree the governance changes required by new legislation.

Governance changes

On 25 March 2015, the Pensions Committee approved governance changes arising from the requirements of the Public Services Pensions Act 2013 and the Local Government Pension Scheme (Governance) (Scotland) Regulations 2014 which were required to be implemented by 1 April 2015.

The Consultative Panel was disbanded with effect from 31 March 2015 and was replaced on the 1 April 2015 with a new Pension Board. The role of the Pension Board is to help ensure that the operation of the pension funds is in accordance with the applicable law and regulation. Its membership will comprise ten members; five appointed from the employer bodies and five appointed from the trade unions representing the membership in the Fund. The application process to appoint Pension Board members ran from December 2014 to February 2015. The new Pension Board is as follows:

Pension Board from 1 April 2015	
	Appointed by
Employer representatives	
Simon Belfer	Napier University
Darren May	Scottish Water
Rucelle Souter	The Edinburgh Military Tattoo
Eric Adair	EDI
Linda Mcdonald	Handicabs
Member representatives	
Jim Anderson	Unison
Catrina Warren	Unison
Graham Turnbull	UCATT
John Rodgers	Unite
Thomas Carr-Pollock	GMB

There is no change to the Pensions Committee and Audit Sub-Committee which continue in their current form although the two non-councillor members are now drawn from the employers and members. The Councillor membership from 1 April 2015 remains unchanged and John Anzani also continues as a member representative. Darren May was replaced by Richard Lamont on 20 April 2015.

Investment and Pensions Division

The Investment and Pensions Division of the Corporate Governance Directorate is part of 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 advisers are Gordon Bagot, Scott Jamieson and KPMG, represented by David O'Hara.

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.

The statement below discusses arrangements at 31 March 2015, prior to the introduction of new governance arrangements on 1 April 2015. Please also see the How the Fund works section for an overview of the changes implemented.

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	<p>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:</p> <ul style="list-style-type: none"> - Five City of Edinburgh elected members - Two external members from the 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	<p>The Pensions Committee includes two external places for pension fund stakeholders i.e. one each from the employer and member representatives taken from the Consultative Panel. Two members of the Consultative Panel also attend the Pensions Audit Sub-Committee.</p> <p>Fund members and employers are also represented by the Funds' Consultative Panel. Membership includes six employer representatives and six member representatives.</p> <p>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.</p>

Principle		Full Compliance	Comments
Structure (cont'd)	That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes	<p>The Pensions Audit Sub-Committee consisting of three members of the Pensions Committee, report to the Pensions Committee on their findings and recommendations.</p> <p>The 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.</p> <p>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.</p>
Representation	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	<p>The Funds' Consultative Panel consists of a mix of representatives:</p> <ul style="list-style-type: none"> - 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	<p>An Independent Professional Observer was appointed in March 2013 to help Committee scrutinise advice.</p> <p>Three independent investment advisers sit on the Investment Strategy Panel.</p> <p>A separate specialist Pensions 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. The Independent Professional Observer also attends the meetings of the Pensions Audit Sub-Committee.</p>

Principle		Full Compliance	Comments
Representation	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 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 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 of training each year and Consultative Panel members one day of training each year. The members confirm that they have read and will abide by a Code of Conduct (specifically tailored for the Committee and Panel) prior to their appointment to the Funds' Pensions Committee and Consultative Panel.
	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 Pensions Committee and to the 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 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 Pensions Committee and to the Lothian Pension Funds' Consultative Panel which addresses these matters. This Code is under continual review in order that it remains up to date and that it contains an appropriate level of detail.

Principle		Full Compliance	Comments
Training / Facility Time / Expenses cont'd	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	The Funds' training policy requires that each member of the Pensions Committee 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.
	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 Consultative Panel attends all the Pensions Committee meetings. Further meetings are held if necessary. The Pensions Audit 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	<p>The City of Edinburgh Council is responsible for the appointment of members to the Pensions Committee.</p> <p>However on an annual basis:</p> <ul style="list-style-type: none"> - 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. <p>Membership of the Consultative Panel is rotated every three years.</p> <p>The Funds publish governance documents and communicate regularly with employers and scheme members. Two members of the Consultative Panel are recruited by self nomination.</p>



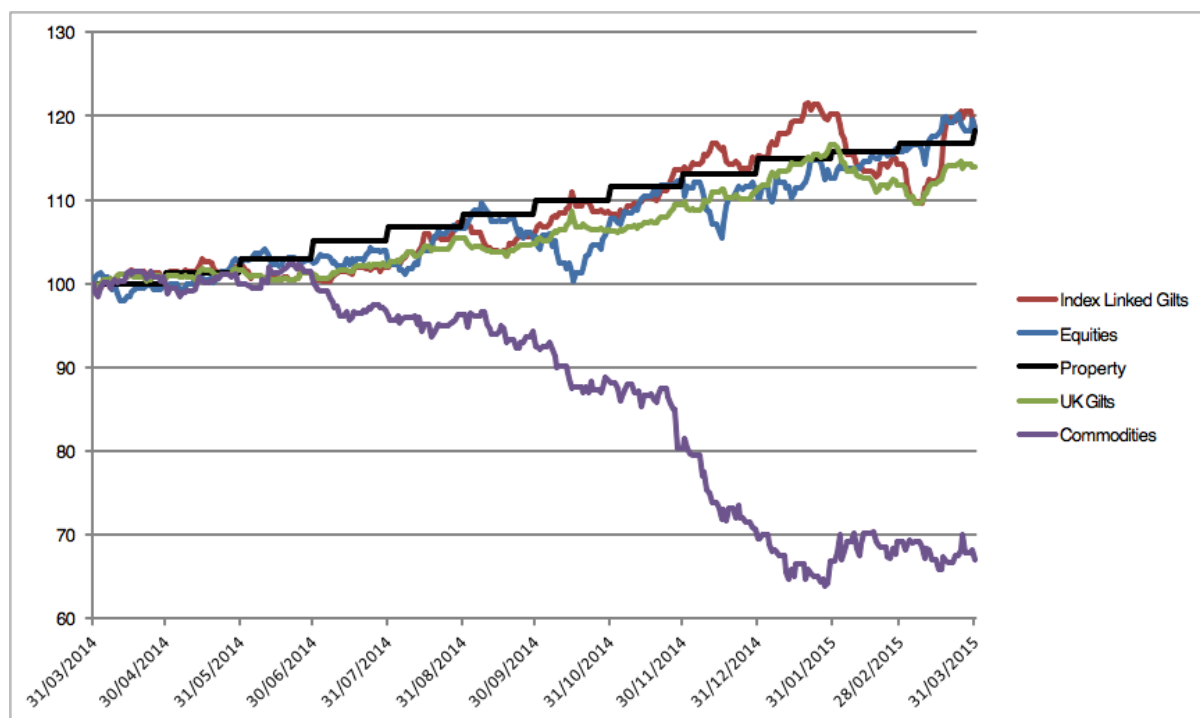
Investments

Investment markets

The UK economy has made a solid recovery since the dark days of the global financial crisis in 2008/09. Unemployment has shrunk to 6% from a peak of 8% in 2009, and the employment rate of 73.3% is the highest since records began in 1971. The public sector deficit has halved since 2010. In 2014, the UK economy expanded by 2.8%, although it slowed in the first quarter of 2015. US economic growth has been robust for the last few years, and even laggard countries and regions such as Japan and Europe are now displaying some springtime green shoots of recovery.

Asset markets continue to respond positively to low interest rates and unconventional monetary policies (bond buying by central banks) aimed at stimulating economic growth. Perhaps unsurprisingly, government and corporate bond markets made handsome gains as investors anticipated strong central bank buying support for these assets. Equity markets benefited too. The US equity market is now comfortably in excess of its two previous peaks, Japanese equities continued to perform well and the UK stock market is once again hovering around its historical high point. Even the continental European stock markets have shown signs of reviving, but after a long period in the doldrums, the outstanding equity market performer over 2014/15 was the Shanghai Stock Exchange in China, which soared 56%. Other asset classes, such as property, also made attractive returns. The key feature in currency markets was US dollar strength. The only real disappointment was commodities, where oil and iron ore prices in particular fell sharply.

One Year Asset Class Returns – Major Markets (rebased to 100)



Looking ahead, investors are wondering how long the current positive environment for asset markets can last. Given that the low interest rates and unconventional monetary policy (so-called quantitative easing) are inextricably linked with prices in asset markets, the fear is that this element of support will be withdrawn and interest rates will rise. This is front and centre of mind in one of the two largest economies in the world, the USA, where wage inflationary pressure could cause the economy to overheat. This is not the case across the globe. The European Central Bank has only recently resorted to stimulating the economy with quantitative easing and the other giant economy in the world, China, seems quite out of sync with the USA, having recently embarked on a policy of cutting interest rates in the face of a slowing economy and low inflationary pressure.

So, the timing of less supportive central bank policies is far from clear (further market gains are quite possible), but that tightening monetary policy will cause increased volatility and declines in bond and equity markets with high valuations is crystal clear. The high returns of 2014/15 cannot be sustained over the long term.

Other than monetary policy, there are a number of issues that will affect asset market returns in an unpredictable way going forward. There are numerous high profile geopolitical risks preying on investors' minds. These include Greek debt, Chinese expansion, the Ukraine conflict, war in Syria and fallout from the lower oil price in producing countries such as Norway, Russia, Venezuela and Saudi Arabia. These geopolitical risks are manageable to the extent that it is in nobody's interests to let them get out of control. Uncertainty is a constant in the investment backdrop and it is the uncertainty which creates the opportunities for investors to earn returns higher than those available from risk-free assets. With the benefit of economic growth and advancement over the coming years and decades, a diversified portfolio of assets should provide that risk premium over the long term.

Investment strategies

The review of investment strategies for all three Funds during 2012 concluded that there was scope to reduce investment risk. Given valuations of fixed income markets, the Funds' current focus has been 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 or negative 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.

Over 2014/15, both Lothian Pension Fund and Lothian Buses Pension Fund reduced their equity allocations and increased their index-linked allocations modestly and continued to make new commitments to alternative assets, including timber assets and infrastructure investments in Scotland and overseas. Scottish Homes Pension Fund reduced its equity allocation and increased the allocation to index-linked gilts over 2014/15 as result of improvements in the funding level.

Responsible investment

We strive to be active shareholders in order to enhance the long-term value of our investments. The Funds consider environmental social and governance issues in the investment process in a manner which is consistent with the fiduciary duty to provide the highest standard of stewardship on behalf of the beneficiaries.

Robust arrangements are in place to ensure that the Funds' shareholdings are monitored and appropriate voting and engagement activity is undertaken with the aim of bringing about positive long term change at companies through a focused and value oriented approach.

We are a signatory to the Principles for Responsible Investment and publish how the Financial Reporting Council UK Stewardship Code requirements, which promote public disclosure of stewardship activities, are met. The Funds undertake voting and engagement activities through Hermes Equity Ownership Service for the majority of the investments. Baillie Gifford, UBS and State Street take direct responsibility for stewardship issues in the investments they manage on the Funds' behalf.

Over the year, we voted at shareholder meetings for the more than 800 companies in which the Funds were invested, voting on over 10,000 resolutions and opposing over 600 of them. Hermes EOS engaged on our behalf with over 130 companies across the world on topics such as board structure, executive compensation, climate change and retail supply chains.

As part of the Funds' responsible investing activities, we undertake class action activity, which typically involves a group of shareholders collectively suing a company in order to recover a loss in share value. During 2014-15, all the cases where the Funds were acting as co-lead plaintiff in class action lawsuits concluded. The potential benefits and risks of active participation in class actions will continue to be assessed on a case by case basis.

Councillor Cameron Rose, a member of the Pensions Committee, is Vice Chair of the Local Authority Pension Fund Forum (LAPFF), which promotes the investment interests of local authority pension funds and seeks to maximise their influence as shareholders. LAPFF has continued its work on accounting standards for the banking industry and has made significant progress. Other recent activity includes engagement on corporate governance, carbon risk and executive pay. Members of the LAPFF executive committee attended a number of company AGMs over the last year, where the boards were challenged on executive pay arrangements and questions were posed to chairmen on corporate carbon management risk, employment standards, customer service, dividends and buybacks.



Funding and Financial Performance

Funding Strategy Statement

The Funding Strategy Statement sets out how we balance the potentially conflicting aims of affordability and stability of employers' pension contributions whilst taking a prudent long-term view of funding pension liabilities. The Funding Strategy Statement was revised at the 2014 Actuarial Valuation and can be viewed on our website at www.lpf.org.uk/publications. The Statement covers the funding strategies of each of the three Funds.

Administrative expenses

A summary of the Division's administrative expenditure for 2014/15 is shown against the budget approved by Pensions Committee.

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

The key variances against budget were:

Investment management fees - £1,601k underspend. This saving arose from greater use of in-house investment management expertise, with external fund mandates to Rogge, Baillie Gifford and Invesco being terminated over the year.

Income - £1,499k additional receipts. Securities lending revenue exceeded budget by £1,407k. This resulted primarily from favourable changes in securities lending activity in investment markets, particularly in the United States, and also reflected changes to the underlying asset holdings.

Employees - £261k underspend. This arose from savings from unfilled posts and also the timings of recruitment.

Administrative expenses (comparison with approved budget)

	Approved budget	Actual outturn	Actual variance
	£000	£000	£000
Employees	2,253	1,992	(261)
Property	77	158	81
Plant and Transport	27	27	-
Supplies and Services	952	805	(147)
Investment Managers Fees - Invoiced	9,453	7,852	(1,601)
Other Third Party Payments	522	654	132
Capital funding - Depreciation	80	87	7
Direct Expenditure	13,364	11,575	(1,789)
Support Costs	281	322	41
Income	(772)	(2,271)	(1,499)
Total net controllable cost to the Funds	12,873	9,626	(3,247)

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".

Such costs, together with a reconciliation of the gross costs for 2014/15, are shown below. This is intended to accord with CIPFA guidance "Accounting for Local Government Pension Scheme Management Costs", dated July 2014, which promotes greater transparency of investment management fees.

	Actual outturn
	£000
Actual outturn on budgeted items above	9,626
Add back securities lending revenue included in income above	2,207
Investment property administration costs	648
Investment transaction costs	2,002
Investment management fees deducted from capital	15,923
Total cost to the Funds (inclusive of full investment management fees)	30,406
Per Fund Accounts	
Lothian Pension Fund	28,721
Lothian Buses Pension Fund	1,432
Scottish Homes Pension Fund	253
Total	30,406

Actuarial Valuations 2014

We carry out an actuarial valuation for the pension Funds every three years and the latest was held at 31 March 2014. Below are summaries of the valuation reports which are available on our website: www.lpf.org.uk/publications

Lothian Pension Fund

The financial position of the Fund at 31 March 2014 saw the value of assets of £4,379 million while the liabilities (estimate of pension benefits to be paid in the future) was £4,796 million. The deficit rose from £142 million as at 31 March 2011 to £417 million which resulted in the funding level falling from 96% in 2011 to 91% in 2014. Overall the Fund's investments performed well and employer contributions have been greater than the cost of new benefits being built up. However, the overall funding level has reduced due to falls in bond yields (used to estimate the current value of future liabilities) as well as improvements in longevity which leads to pensions being paid longer.

Lothian Buses Pension Fund

Lothian Buses Pension Fund saw an improved funding level, rising from 112% in 2011 to 117% at 31 March 2014. The value of assets rose from £257 million to £337 million. The liabilities at March 2014 were £289 million so the Fund showed a surplus of £48 million on the ongoing valuation basis. Investment returns for the three years to 31 March 2014 were higher than anticipated.

Historically, the funding position of Lothian Buses Pension Fund has been assessed on an ongoing basis. That allows for investment returns in excess of those expected from Government bonds. However, the Fund has been closed to new entrants since 1 January 2008 and the liabilities will therefore gradually mature as members currently paying into the Scheme retire and take their benefits. Therefore, the funding level was also measured on a more prudent basis using government bond (gilts) yields. This increases the liabilities by £93 million and reduces the funding level to 88.2% resulting in a deficit of £45 million on the gilts basis valuation.

Scottish Homes Pension Fund

The funding strategy for the Scottish Homes Pension Fund is determined by the guarantee agreement with the Scottish Government. The funding level stood at 89% at 31 March 2014 (86% at 2011) which is below the target funding level of 91.5%. As guarantor, the Scottish Government will pay a contribution of £675,000, including administration costs, each year from April 2015 to March 2018.

Risk Management Statement

The Funds are committed to a strong control environment to ensure that risks are identified, understood, managed and monitored appropriately. The risks (not taking account of our controls) faced by the Funds 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.

As at 31 March 2015, the most significant risks (taking account of controls), as assessed by the Investment and Pensions Service Management Team, were as follows:

Description	After controls			
	Impact	Likelihood	Risk score	Risk target
Recruitment and retention of appropriate key staff	5	7	35	16
The collapse of an employer body member, leading to pressure on other employers	4	8	32	21
Adverse movement against non-investment assumptions leading to pressure on employer contributions	5	6	30	20
Receiving services without adequate contractual protection	6	5	30	10
Over reliance on single service provider for core functions	7	4	28	18



Performance against our service plan objectives

The Fund is committed to continuously developing to provide the best possible service to our customers. We set our vision, objectives, key actions and how we will measure success in the our annual service plan. We regularly report our progress to the Pensions Committee and Consultative Panel.

The Fund objectives are:

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

In 2014/15, we have delivered the following achievements:

- introduced LGPS2015 and participated in Scotland-wide communications and Regulation changes
- successfully completed Actuarial Valuations for the three pension funds and work continued work on employer covenants
- participated in the debate on governance changes leading to new governance arrangements for Scotland and put in place a new Pension Board with effect from 1 April 2015
- introduced a new internal global equity portfolio after extensive research and transferred approximately £300 million to internal management
- implemented new Customer First team - leading to improved call handling
- reduced our backlog of work - during the year carrying out 25,448 procedures (8,914 key and 23,697 non key)
- introduced investment cost transparency in our Annual Report and Accounts
- created two companies in order to separate some service functions and obtain FCA authorisation
- automated the process for one off benefit payments, creating efficiency and reducing risk.

Performance against key objectives

Our key performance indicators are split into three main categories in line with our objectives - customers, staff and performance. Our performance targets and actual performance for the year are set out below. The investment performance can be found later in this report under each individual Fund accounts section.

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%	89%
Proportion of active members receiving a benefit statement by 30 August 2014	95%	96%
Retain Customer Service Excellence Standard accreditation	Retain	Retained



Service Excellence

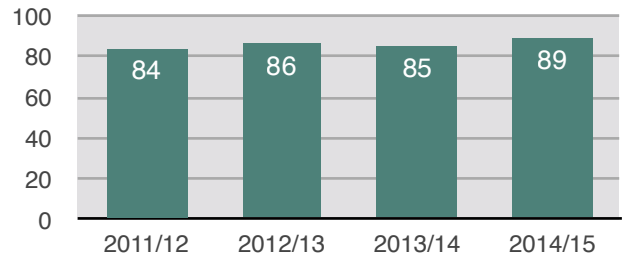
We use the Customer Service Excellence (CSE) framework to maintain our commitment to customer service and ensure we continuously make improvements to our customer services. Our annual external CSE assessment ensures we improve and develop our services on an ongoing basis.

Our assessment in February 2015 saw us retain CSE for another year adding two more Compliance Plus awards for our complaint handling and also working with employers to improve the provision of data in a timely manner. We now hold four Compliance Plus awards. In 2015, the assessor commented in his report that the "service demonstrated that it has continued to provide a very high quality of service to its customers."

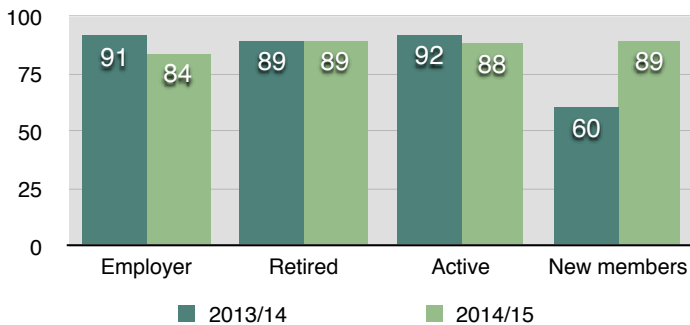
Surveys

Our overall customer satisfaction was 89%, above the target of 86%. The satisfaction of our different customer groups (employers, retired, active and new members) is shown.

Overall satisfaction with services - %



Overall satisfaction by survey



The work carried out by the Fund to introduce improvements to the way employers provide their data to us via our employer online system has significantly improved the service for new scheme members. Satisfaction has improved significantly from 60% in 2013/14 to 89% in 2014/15.

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.

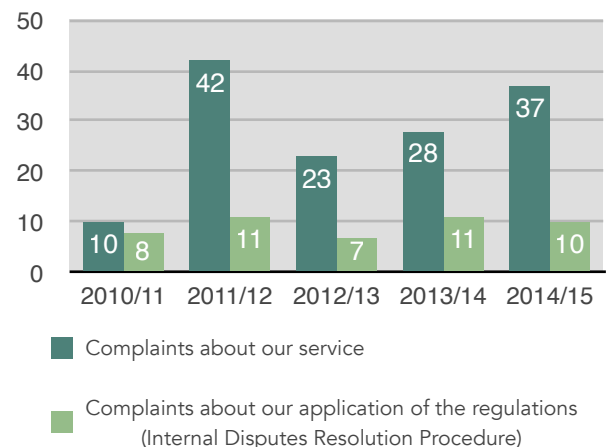
We categorise our complaints in two ways:

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 0.1% percentage of the procedures (over 25,000) we carried out in 2014/15.

Complaints

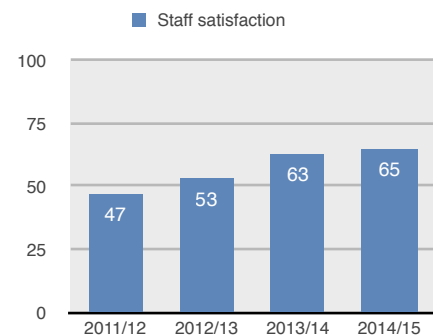


Service plan objective 2 – Support and develop staff

	Target	Actual
Level of sickness absence	4%	2.1%
Staff satisfaction with present job	65%	65%
Minimum number of days training per year for each member of staff	2 days	2 days

Our staff are at the heart of our business and are key to delivering our objectives. Key indicators for staff in 2014/15 were overall staff satisfaction, sickness absence levels and training hours completed. All targets were achieved. The sickness absence rate was low at 2.1% and overall job satisfaction has increased steadily over recent years and was 65% in 2014/15.

Over the last financial year, all our staff have had regular training to ensure they meet the target of at least two days training. As well as attendance at external seminars, we held in-house sessions covering topics such as the new Scheme, annual report, risk, the actuarial valuation and data protection.



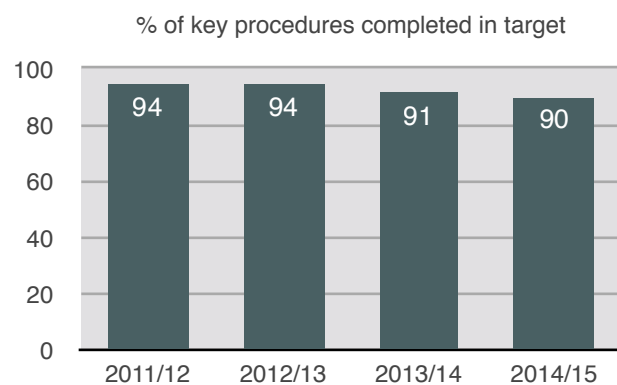
Service plan objective 3 – To continue to be a top performing Fund

	Target	Actual
Percentage of critical pensions administration work completed within standards	90%	90%
Audit of annual financial statements	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%	98%

Pensions Administration

The dedicated in-house team provides pension administration services for the three pension 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 2014/15 showed 90% of the work completed was within target.

In 2014/15, the overall volume of work continued to increase and we focused on reducing a backlog of non-key work, whilst also continuing the drive to enhance data quality.



Data quality

High quality data is essential for us to provide an excellent service to our members. During the year more than 60 employers started submitting contribution data to us on a monthly basis - leading to cleaner membership data. Along with our employer web portal, 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.

We also carry out quarterly checks with the General Register Office and participate in the National Fraud Initiative. In 2014, we carried out a matching exercise for deferred members where we have lost touch with them. The project is currently being followed up with contact being made where a possible match has been found.

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%	97%
Conditional and Numerical Data		
Fund specific measurement including date of joining; pensionable remuneration; date of leaving and reasons for leaving etc.	98%	98%

The Pensions Administration Strategy

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

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 2014/15, we continued to meet with our largest employers to discuss performance and worked with them to help us deliver a better service to members. We have also provided training and support to employers to provide monthly contribution information. This process helps identify any missing or incorrect membership data more quickly, improving data quality and hence helping us to deliver a better service to members. This was recognised as part of the assessment for Customer Service Excellence where the assessor noted that 'work undertaken with partners to resolve data quality issues has led to improved pension information for customers'.

Employer performance for 2014/15 and 2013/14 for comparison is shown below:

Case type	Target (working days)	2013/14			2014/15		
		Number received	Number within target	% within target	Number received	Number within target	% within target
New member	20	4,069	2,812	69%	4,741	3,631	77%
Leaver	20	1,006	384	38%	2,430	1,189	49%
Retirement	20	778	374	48%	931	373	40%
Death in service	10	42	23	55%	29	7	24%

In 2014/15, there have been significant increases in the number of leavers and new members and performance has improved in both categories during the year. We have continued to work with employers to deal with outstanding queries regarding leavers from previous years. As more employers supply monthly contribution data for each member, we anticipate that performance will further improve in this area.

In contrast the proportion of cases when we receive information on retirement and death in service from employers within target timescales has worsened over the year. We dealt with nearly 20% more retirement cases during the year, and more than a third of all retirements required some additional consent (for instance ill-health or redundancy retirement). These cases can often be difficult to process in their target timescales.

Efforts to ensure employers send details of membership changes promptly to the Fund will continue, including education of employer contacts at all steps of the retirement process to ensure that employers are aware of the need to provide information promptly.

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 2014/15 of 98% of pension contributions paid in time was achieved.

Of the 1,161 payments made to the Fund in 2014/15, 62 payments were later than the target of the 19th of the month. The number of late payments by employer is provided below.

Employer	Number of late payments
Broomhouse Centre Representative Council	1
Centre for Moving Image	1
Children's Hearing Scotland	3
Dawn Construction	3
Dean Orphanage	1
Donaldson Trust	2
Edinburgh Cyrenians Trust	1
Edinburgh Festival Society	1
Edinburgh World Heritage	1
Edinburgh College	1
ELCAP	1
Enjoy East Lothian	2
Festival City Theatres Trust	2
First Step	1
Forth & Oban	1
Four Square	4

Employer	Number of late payments
Granton Information Centre	6
Homeless Action Scotland	1
Scottish Fire & Rescue Service (Training College)	1
Police Scotland	1
Midlothian Council	1
North Edinburgh Dementia Care	1
Penumbra	3
Pilton Community Health Project	5
Royal Edinburgh Military Tattoo	2
Scotland's Learning Partnership	2
Skanska	2
St Columba's Hospice	1
Stepping Our Project	1
Victim Support Scotland	5
Wester Hailes Land & Property Trust	4

Lothian Pension Fund

Membership records

Status	Membership at 31 March 2012	Membership at 31 March 2013	Membership at 31 March 2014	Membership at 31 March 2015
Active	28,337	28,869	30,622	32,273
Deferred	15,392	16,600	16,482	15,916
Pensioners	18,905	20,484	19,972	20,636
Dependants	3,720	4,064	3,770	3,810
Total	66,354	70,017	70,846	72,635

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 2015 the contribution rates were as follows:

Full time equivalent pensionable pay (rate of pay on 31/3/2015)	Rate
Less than £20,382	5.50%
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 2015 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 2014/15 at the end of this section.

The Fund has recently completed its triennial valuation as at 31 March 2014. The Fund's actuary has calculated the funding level as 91%.

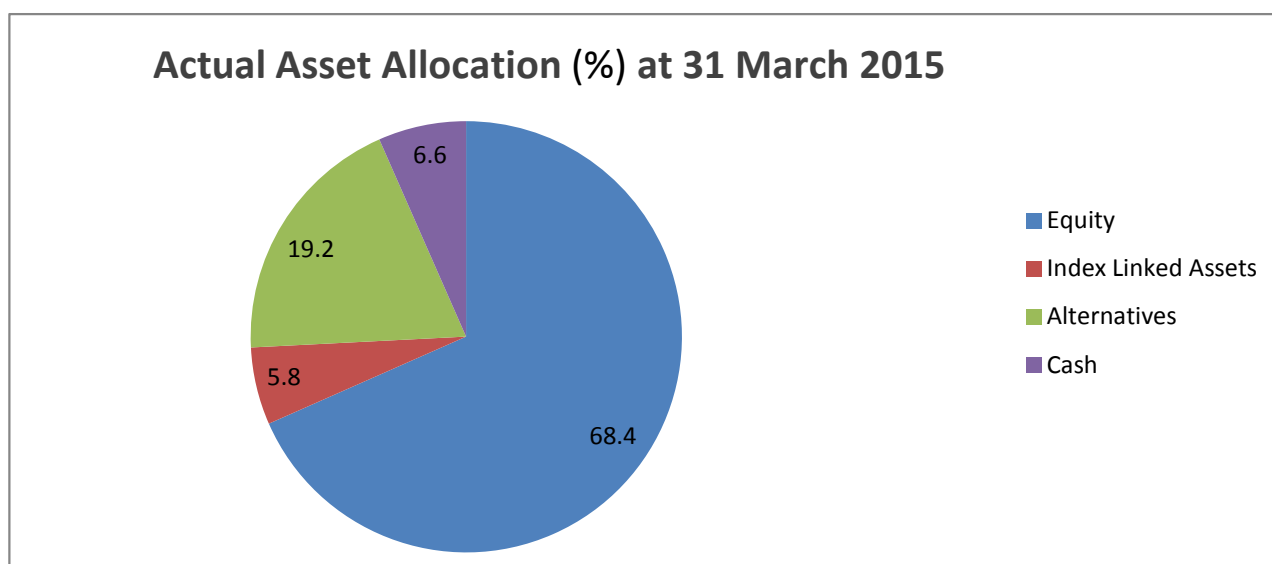
Investment Strategy

The Pensions Committee approved the Investment Strategy 2012-17 for Lothian Pension Fund in October 2012. The strategy reduces the allocation to equities (including private equity) from 71.5% at the end of 2012 to 65% by the end of 2017 and increases the allocation to index-linked gilts and alternatives. It recognises a gradually changing risk profile for the Fund, but retains significant exposure to investments, such as Index-Linked Gilts and Equities, which have a history of protecting or enhancing purchasing power after the effects of inflation have been taken into account.

The investment strategy is set at the broad asset class level of Equities, Index-Linked Assets 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 and other debt investments.

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.

	Strategic Allocation 31/03/2015	Long term Strategy 2012 - 2017	Permitted ranges
	%	%	%
Equities	68	65	50 - 75
Index Linked Assets	7	7	0 - 20
Alternatives	24	28	20 - 35
Cash	1	0	0 - 10
Total	100	100	n/a



The implementation of the Investment Strategy 2012-17 continued to proceed at a measured pace over 2014/15 as investment opportunities became available and as research on opportunities was completed. Progress towards the long term strategy allocation involves the interim strategy allocation and the actual asset allocation changing gradually over time. The pace of change can be accelerated or slowed depending on asset prices, the availability of alternative investments and research conclusions on new strategies.

The most significant change to the Fund over 2014/15 was a further shift from regional to lower risk global equity mandates. Approximately three quarters 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 Fund continues to outsource investment management services for specialist mandates, which complement the portfolio strategies employed internally.

Investment performance

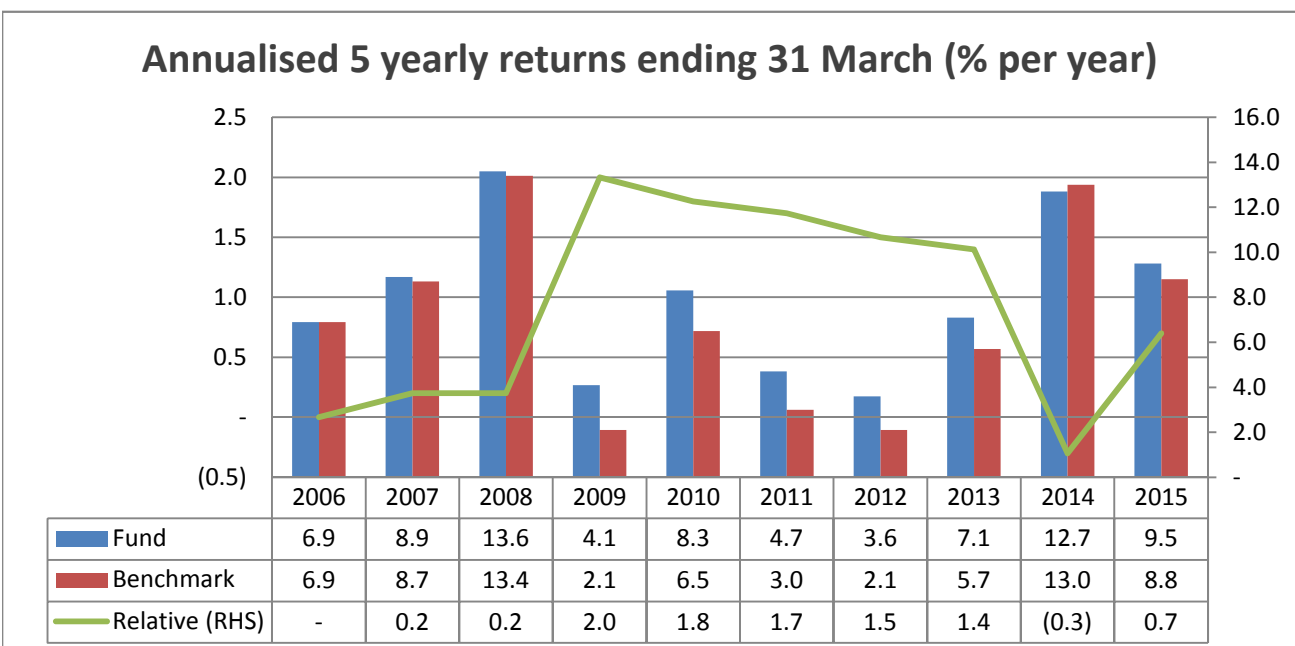
The objectives of the Fund were redefined in December 2012 and are:

- 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 has achieved returns in excess of the strategic allocation over the last year and over the longer term timeframes shown in the table. The benchmark return shown in the table is the strategic allocation and comprises equity, index-linked gilt and cash indices as well as an inflation-linked index for the alternatives allocation. Returns relative to the benchmark over a one year period need to be placed in the context that there are no ideal benchmarks for many of the assets held in the Fund, especially the Alternatives. The Fund's benchmark for Alternatives is inflation plus 3.5% per annum, which makes sense over the long term as the Fund's liabilities are linked to inflation. However, over shorter periods, there is less information content in the relative returns of the Fund because the development of asset prices is much more volatile than that of UK retail or consumer prices. The Investment Strategy Panel assesses the underlying risks of the portfolios that make up the asset allocation to ensure that these are consistent with the long term objectives of the Fund.

Annualised returns to 31 March 2015 (% per year)

	1 year	5 year	10 years
Lothian Pension Fund	16.5	9.5	8.9
Benchmark	14.5	8.8	7.6
Retail Price Index (RPI)	0.9	3.1	3.0
Consumer Price Index (CPI)	(0.1)	2.4	2.5
National Average Earnings	3.3	1.7	2.6



Lothian Pension Fund

Fund Account for year ended 31 March 2015

2013/14 £000	Note	2014/15 £000
Income		
140,721	2	142,437
41,363	3	42,343
4,280	4	6,452
186,364		191,232
Less: expenditure		
120,434	5	128,701
34,942	6	31,456
5,331	7	3,593
235		423
186		407
10,392	8	5,580
1,943	9a	1,780
173,463		171,940
12,901	Net additions from dealing with members	19,292
Returns on investments		
124,526	10	122,404
171,440	12a, 13b	613,941
(25,990)	9b	(26,941)
269,976	Net returns on investments	709,404
282,877	Net increase in the Fund during the year	728,696
4,094,659	Net assets of the Fund at 1 April 2014	4,377,536
4,377,536	Net assets of the Fund at 31 March 2015	5,106,232

Lothian Pension Fund

Net Assets Statement as at 31 March 2015

31 March 2014			31 March 2015
£000		Note	£000
Investments			
4,349,645	Assets		5,077,632
(6,335)	Liabilities		(5,048)
4,343,310		11, 14	5,072,584
Fixed assets			
397	Computer systems		365
397			365
Current assets			
7,819	The City of Edinburgh Council	20	6,352
31,734	Cash balances	14, 20	36,350
11,286	Debtors	17, 23	9,769
50,839			52,471
Current liabilities			
(17,010)	Creditors	18	(19,188)
(17,010)			(19,188)
33,829	Net current assets		33,283
4,377,536	Net assets of the Fund at 31 March 2015	13a	5,106,232

JOHN BURNS FCMA CGMA

Pensions and Accounting Manager

24 June 2015

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 2015, 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:-

	2013/14	2014/15
	£000	£000
By category		
Percentage of pay	107,927	111,692
Fixed deficit contribution	24,756	24,698
Strain costs	7,870	5,131
Cessation contribution	168	916
	140,721	142,437
By employer type		
Administering Authority	56,472	55,795
Other Scheduled Bodies	67,659	67,980
Community Admission Bodies	16,292	18,411
Transferee Admission Bodies	298	251
	140,721	142,437

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

	2013/14	2014/15
	£000	£000
By employer type		
Administering Authority	16,172	16,544
Other Scheduled Bodies	19,433	19,751
Community Admission Bodies	5,686	5,988
Transferee Admission Bodies	72	60
	41,363	42,343

4 Transfers in from other pension schemes

	2013/14	2014/15
	£000	£000
Group transfers	-	703
Individual transfers	4,280	5,749
	4,280	6,452

Notes to the Accounts

5 Pensions payable	2013/14	2014/15
By employer type	£000	£000
Administering Authority	62,517	60,636
Other Scheduled Bodies	47,937	56,688
Community Admission Bodies	9,883	11,234
Transferee Admission Bodies	97	143
	120,434	128,701

For 2013/14, the above split was based on an estimated allocation due to limitations of the old pension payroll system. The new payroll system now allows the Fund to identify all expenditure directly to each employer which in turn improves the accuracy of this analysis.

6 Lump sum retirement benefits payable	2013/14	2014/15
By employer type	£000	£000
Administering Authority	15,131	12,330
Other Scheduled Bodies	17,289	15,783
Community Admission Bodies	2,477	3,301
Transferee Admission Bodies	45	42
	34,942	31,456

7 Lump sum death benefits payable	2013/14	2014/15
By employer type	£000	£000
Administering Authority	2,453	1,191
Other Scheduled Bodies	2,340	2,020
Community Admission Bodies	489	382
Transferee Admission Bodies	49	-
	5,331	3,593

8 Transfers out to other schemes	2013/14	2014/15
	£000	£000
Group transfers	5,287	-
Individual transfers	5,105	5,580
	10,392	5,580

9a Administrative expenses	2013/14	2014/15
	£000	£000
Employee costs	1,042	985
The City of Edinburgh Council - pension payroll costs	111	-
The City of Edinburgh Council - other support costs	262	134
System costs	197	208
Actuarial fees	75	89
External audit fees	43	44
Legal fees	64	3
Printing and postage	38	94
Depreciation	63	67
Office costs	40	88
Sundry costs less sundry income	8	68
	1,943	1,780

Notes to the Accounts

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.

9b Investment management expenses	2013/14	2014/15
	£000	£000
External management fees - invoiced	7,542	7,113
External management fees - deducted from capital	13,318	15,274
Transaction costs	2,805	1,971
Property operational costs	781	648
Employee costs	772	841
Custody fees	206	375
Engagement and voting fees	68	71
Performance measurement fees	56	50
Consultancy fees	40	70
System costs	141	141
Legal fees	109	107
The City of Edinburgh Council - other support costs	104	161
Office costs	16	57
Sundry costs	32	62
	25,990	26,941

Investment 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.

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 £5.258m in respect of performance-related fees (2013/14 £3.056m).

9c Management expenses	2013/14	2014/15
	£000	£000
Administrative costs	1,744	1,550
Investment management expenses	24,022	25,479
Oversight and governance costs	2,167	1,692
	27,933	28,721

This analysis of costs for the Lothian Pension Fund has been prepared in accordance with CIPFA guidance. The analysis looks at the combined Administration and Investment expenses in note 9a and b and splits out the costs to include a third heading covering governance expenditure.

Notes to the Accounts

10 Investment income

	2013/14	2014/15
	£000	£000
Income from fixed interest securities	10,911	4,857
Dividends from equities	84,814	88,527
Unquoted private equity and infrastructure	9,472	7,924
Income from pooled investment vehicles	960	861
Gross rents from properties	19,022	18,754
Interest on cash deposits	617	1,130
Stock lending and sundries	1,345	2,461
	127,141	124,514
Irrecoverable withholding tax	(2,615)	(2,110)
	124,526	122,404

11 Net investment assets

	31 March	31 March
	2014	2015
	£000	£000
Fixed interest securities	318,215	414,330
Equities	2,866,444	3,267,975
Pooled investment vehicles	598,687	633,040
Properties	270,753	316,169
Derivatives		
Futures	304	-
Forward foreign exchange	9,977	29,879
	10,281	29,879
Cash deposits		
Margin balances	894	-
Deposits	257,749	400,497
	258,643	400,497
Other investment assets		
Due from broker	12,553	4,585
Dividends and other income due	14,067	11,157
	26,620	15,742
Total investment assets	4,349,643	5,077,632
Investment liabilities		
Derivatives		
Futures	(91)	-
Forward foreign exchange	(268)	(79)
	(359)	(79)
Other financial liabilities - due to broker	(5,974)	(4,969)
Total investment liabilities	(6,333)	(5,048)
Net investment assets	4,343,310	5,072,584

Notes to the Accounts

12a Reconciliation of movement in investments and derivatives

	Market value at 31 March 2014 £000	Purchases at cost and derivative payments £000	Sale and derivative receipts £000	Change in market value £000	Market value at 31 March 2015 £000
Fixed interest	318,215	325,346	(313,907)	84,676	414,330
Equities	2,866,444	878,347	(860,763)	383,947	3,267,975
Pooled investment vehicles	598,687	76,731	(103,020)	60,642	633,040
Property	270,753	11,375	(2,143)	36,184	316,169
Derivatives - futures	213	(99)	(521)	407	-
Derivatives - fwd foreign exchange	9,709	3,281	(28,068)	44,878	29,800
	4,064,021	1,294,981	(1,308,422)	610,734	4,661,314
Other financial assets / liabilities					
Margin balances	894			-	-
Cash deposits	257,749			3,190	400,497
Broker balances	6,579			17	(384)
Dividends due etc	14,067			-	11,157
	279,289			3,207	411,270
Net financial assets	4,343,310			613,941	5,072,584

	Market value at 31 March 2013 £000	Purchases at cost and derivative payments £000	Sale 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

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.

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.

Notes to the Accounts

12b Analysis of investments (at market value)

	Region	31 March 2014 £000	31 March 2015 £000
Fixed interest securities			
Public sector fixed interest quoted	UK	2,560	-
Public sector index linked gilts quoted	UK	144,621	288,651
Corporate quoted	UK	65,908	-
Public sector quoted	Overseas	9,542	125,679
Commercial quoted	Overseas	95,584	-
		318,215	414,330
Equities			
Quoted	UK	583,053	609,702
Quoted	Overseas	2,283,391	2,658,273
		2,866,444	3,267,975
Pooled investment vehicles			
Private equity, infrastructure and timber funds	UK	137,191	127,587
Private equity, infrastructure and timber funds	Overseas	389,990	436,583
Property funds	UK	55,319	55,035
Other funds	UK	16,187	13,835
		598,687	633,040
Properties			
Direct property	UK	270,753	316,169

Derivatives - futures

Contract type	Contract expires	Economic exposure £000	Market value at			
			31 March 2014 £000	31 March 2015 £000		
Assets						
	UK Fixed Income	< 1 year	14,458	111	-	-
	Overseas Fixed Income	< 1 year	(28,605)	193	-	-
				304		-
Liabilities						
	UK Fixed Income	< 1 year	-	-	-	-
	Overseas Fixed Income	< 1 year	23,247	(91)	-	-
				(91)		-
Net asset				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. The Fund's bond manager had its contract cancelled during the year and were the only manager to transact futures.

Notes to the Accounts

Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2015

Contract settlement within	Currency bought	Currency sold	Local	Local	Asset value	Liability value
			currency bought	currency sold		
			£000	£000	£000	£000
Up to one month	GBP	AUD	87,717	(161,873)	4,465	-
Up to one month	GBP	CAD	75,153	(134,989)	3,359	-
Up to one month	GBP	EUR	262,607	(333,283)	21,427	-
Up to one month	MXN	USD	599	(39)	-	-
One to six months	AUD	USD	1,327	(1,096)	-	(59)
One to six months	USD	AUD	3,296	(3,687)	331	-
One to six months	USD	CHF	18,487	(17,431)	297	(20)
Open forward currency contracts at 31 March 2015					29,879	(79)
Net forward currency contracts at 31 March 2015						29,800

Prior year comparative

Open forward currency contracts at 31 March 2014					9,977	(268)
Net forward currency contracts at 31 March 2014						9,709

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 certain currency movements.

12c Investment managers and mandates

Manager	Mandate	Market	% of total	Market	% of total
		value at 31 March 2014	31 March 2014	value at 31 March 2015	31 March 2015
		£000	%	£000	%
In-house	UK all cap equities	100,415	2.3	101,918	2.0
In-house	UK mid cap equities	100,553	2.3	103,346	2.0
Total UK equities		200,968	4.6	205,264	4.0
In-house	European ex UK equities	98,404	2.3	102,665	2.0
In-house	US equities	98,265	2.3	118,528	2.3
Baillie Gifford	Pacific equities	152,847	3.5	-	-
Invesco	Pacific equities	140,806	3.2	-	-
Mondrian	Emerging markets	92,455	2.1	104,048	2.1
UBS	Emerging markets	91,186	2.1	121,954	2.4
Total regional overseas equities		673,963	15.5	447,195	8.8

Notes to the Accounts

12c Investment managers and mandates (cont)

Manager	Mandate	Market value at	% of total	Market value at	% of total
		31 March 2014	31 March 2014	31 March 2015	31 March 2015
		£000	%	£000	%
In-house	Global high dividend	642,862	14.8	675,666	13.3
In-house	Global low volatility	744,406	17.1	886,891	17.5
In-house	Global value	-	-	333,310	6.6
Cantillon	Global equities	238,423	5.5	265,575	5.2
Harris	Global equities	175,955	4.1	205,125	4.0
Nordea	Global equities	163,920	3.8	203,667	4.0
Total global equities		1,965,566	45.3	2,570,234	50.7
In-house	Currency hedge	8,771	0.2	29,251	0.6
Total currency overlay		8,771	0.2	29,251	0.6
Total listed equities		2,849,268	65.6	3,251,944	64.1
In-house	Private equity unquoted	190,787	4.4	186,536	3.7
In-house	Private equity quoted	51,480	1.2	57,866	1.1
Total private equity		242,267	5.6	244,402	4.8
Total equities		3,091,535	71.2	3,496,346	68.9
In-house	Index linked gilts	152,699	3.5	296,300	5.8
In-house	Gold	15,412	0.4	15,897	0.3
Total inflation linked bonds and gold		168,111	3.9	312,197	6.2
In-house	Property	59,218	1.4	47,241	0.9
Standard Life	Property	322,037	7.4	382,694	7.5
Total property		381,255	8.8	429,935	8.5
In-house	Infrastructure unquoted	251,116	5.8	251,099	5.0
In-house	Infrastructure quoted	25,531	0.6	29,932	0.6
In-house	Timber	51,666	1.2	101,826	2.0
Total other real assets		328,313	7.6	382,857	7.5
In-house	Secured loans	17,520	0.4	13,927	0.3
In-house	Treasury bills	-	-	129,614	2.6
Rogge	Corporate bonds	184,569	4.2	-	-
Total other bonds		202,089	4.6	143,541	2.8
In-house	Cash	171,892	3.9	294,537	5.8
In-house	Transition	115	-	13,171	0.3
Total cash and sundries		172,007	3.9	307,708	6.1
Net financial assets		4,343,310	100.0	5,072,584	100.0

Notes to the Accounts

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

	Market value at 31 March 2014 £000	% of class 31 March 2014 %	Market value at 31 March 2015 £000	% of class 31 March 2015 %
Fixed interest				
US Treasury Bill 1.25% 31/10/19	-	-	68,626	16.6
US Treasury Bill 1% 30/11/19	-	-	57,054	13.8
UK Gov 1.125% Index Linked 22/11/37	19,450	6.1	23,300	5.6
UK Gov 0.5% Index Linked 22/03/50	-	-	21,458	5.2
Pooled funds				
Stafford Elm Inc	35,169	5.9	42,650	6.5
RREEF Pan European Infrastructure Fund	30,638	5.1	31,345	4.8
Macquarie European Infrastructure Fund	33,204	5.5	28,003	4.3
Property				
London, 119-125 Wardour St	20,800	7.7	24,750	7.8
Martlesham Heath, Retail Park	20,500	7.6	24,375	7.7
Sheffield, Bochum Parkway	18,250	6.7	19,600	6.2
London, 100 St John Street	16,450	6.1	20,600	6.5
Exeter, David Lloyd Leisure	14,850	5.5	17,575	5.6
Exeter, Bishops Court	14,675	5.4	15,650	4.9

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 2015, £92.1m (2014 £120.9m) of securities were released to third parties. Collateral valued at 107.1% (2014 107.4%) of the market value of the securities on loan was held at that date.

12f Property holdings

	2013/14 £000	2014/15 £000
Opening balance	251,480	270,753
Additions	9,160	11,375
Disposals	(15,822)	(2,143)
Net change in market value	25,935	36,184
Closing balance	270,753	316,169

As at 31 March 2015, 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.

The future minimum lease payments receivable by the Fund are as follows

	2013/14 £000	2014/15 £000
Within one year	18,660	19,140
Between one and five years	68,431	65,238
Later than five years	116,384	103,665
	203,475	188,043

Notes to the Accounts

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 2014			31 March 2015		
	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost
	£000	£000	£000	£000	£000	£000
Financial assets						
Investment assets						
Fixed interest	318,215	-	-	414,330	-	-
Equities	2,866,444	-	-	3,267,975	-	-
Pooled investments	598,687	-	-	633,040	-	-
Property leases	10,706	-	-	9,497	-	-
Derivative contracts	10,281	-	-	29,879	-	-
Margin balances	-	894	-	-	-	-
Cash	-	257,749	-	-	400,497	-
Other balances	-	26,620	-	-	15,742	-
	3,804,333	285,263	-	4,354,721	416,239	-
Other assets						
City of Edinburgh Council	-	4,950	-	-	6,352	-
Cash	-	31,734	-	-	36,350	-
Debtors	-	14,155	-	-	9,769	-
	-	50,839	-	-	52,471	-
Assets total	3,804,333	336,102	-	4,354,721	468,710	-
Financial liabilities						
Investment liabilities						
Derivative contracts	(359)	-	-	(78)	-	-
Other investment balances	(5,974)	-	-	(4,970)	-	-
	(6,333)	-	-	(5,048)	-	-
Other liabilities						
Creditors	-	-	(17,010)	-	-	(19,188)
Liabilities total	(6,333)	-	(17,010)	(5,048)	-	(19,188)
Net assets total	3,798,000	336,102	(17,010)	4,349,673	468,710	(19,188)
Total net financial instruments			4,117,092			4,799,195
Amounts not classified as financial instruments			260,444			307,037
Total net assets			4,377,536			5,106,232

Notes to the Accounts

13b Net gains and losses on financial instruments

	2013/14 £000	2014/15 £000
Designated as fair value through fund account	153,378	571,760
Loans and receivables	(7,707)	3,207
Financial liabilities at amortised cost	-	-
Total	145,671	574,967
Gains and losses on directly held freehold property	25,769	38,974
Change in market value of investments per fund account	171,440	613,941

13c 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.

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 typically 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.

Notes to the Accounts

	31 March 2015			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
Financial assets				
Designated as fair value through fund account	3,344,192	414,330	596,199	4,354,721
Loans and receivables	468,710	-	-	468,710
Total financial assets	3,812,902	414,330	596,199	4,823,431
Financial liabilities				
Designated as fair value through fund account	(5,048)	-	-	(5,048)
Financial liabilities at amortised cost	(19,188)	-	-	(19,188)
Total financial liabilities	(24,236)	-	-	(24,236)
Net financial assets	3,788,666	414,330	596,199	4,799,195

	31 March 2014			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£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

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.

Notes to the Accounts

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.

Notes to the Accounts

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		Potential	Value on	Value on
	31 March		Change	increase	decrease
	2015	% of fund	+ / -		
	£m	%	%	£m	£m
Equities - Developed Markets	2,997	59.1	20.0	3,596	2,398
Equities - Emerging Markets	226	4.5	30.0	294	158
Private Equity	244	4.8	30.0	317	171
Timber and Gold	118	2.3	30.0	153	83
Secured Loans	14	0.3	10.0	15	13
Fixed Interest Gilts	130	2.6	10.5	144	116
Index-Linked Gilts	296	5.8	8.5	321	271
Infrastructure	281	5.5	8.0	303	259
Property	430	8.5	13.0	486	374
Cash and forward foreign exchange	337	6.6	1.5	342	332
Total [1]	5,073	100.0	17.7	5,971	4,175
Total [2]			15.0	5,834	4,312
Total [3]			14.5	5,809	4,337

[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 illustrate 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.

Notes to the Accounts

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 2015, cash deposits represented £436.8m, 8.6% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2015	Balances at 31 March 2014 £000	Balances at 31 March 2015 £000
Held for investment purposes			
Northern Trust Global Investment Limited - liquidity funds	Aaa	45,480	100,507
Northern Trust Company - cash deposits	A1	80,765	76,374
The City of Edinburgh Council - treasury management	See below	131,504	223,616
Total investment cash		257,749	400,497
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	31,734	36,350
Total cash		289,483	436,847

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.

	Moody's Credit Rating at 31 March 2015	Balances at 31 March 2014 £000	Balances at 31 March 2015 £000
Money market funds			
Deutsche Bank AG, London	Aaa	21,502	38,167
Goldman Sachs	Aaa	12,037	38,123
Bank call accounts			
Bank of Scotland	A1	14,852	24,567
Royal Bank of Scotland	Baa1	5,600	3,448
Santander UK	A2	15,363	23,840
Barclays Bank	A2	14,983	24,894
Svenska Handelsbanken	Aa3	23,089	38,765
HSBC Bank	Aa3	22,274	37,927
Commonwealth Bank of Australia	Aa2	-	10,079
Floating rate note			
Rabobank	Aa2	-	6,720
Building society fixed term deposits			
Nationwide Building Society	A2	7,431	6,719
UK Pseudo-Sovereign risk instruments			
Other Local Authorities	n/a	18,679	-
UK Government Treasury Bills	Aa1	7,428	6,717
		163,238	259,966

Notes to the Accounts

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 2015, the Fund was due £29.9m and owed £0.1m on over-the-counter foreign currency derivatives.

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 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.

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 £6,663m (2014 £5,483m). 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	31 March
	2014	2015
	% p.a.	% p.a.
Inflation / pensions increase rate	2.8	2.4
Salary increase rate*	5.1	4.3
Discount rate	4.3	3.2

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

Notes to the Accounts

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements in line with the CMI 2012 model, assuming that the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	Males	Females
Current pensioners	22.1 years	23.7 years
Future pensioners (assumed to be currently 45)	24.2 years	26.3 years

These assumptions have changed since the previous IAS26 disclosure of the Fund.

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 2014 £000	31 March 2015 £000
Contributions due - employers	8,773	7,373
Contributions due - members	1,900	1,995
Benefits paid in advance or recoverable	16	-
Sundry debtors	325	160
VAT	-	-
Prepayments	272	241
	11,286	9,769

Analysis of debtors

Administering Authority	1,993	305
Other Scheduled Bodies	6,794	6,671
Community Admission Bodies	1,964	2,624
Transferee Admission Bodies	99	27
Other Local Authorities	9	7
Central Government Bodies	-	-
Other entities and individuals	427	135
	11,286	9,769

18 Creditors

	31 March 2014 £000	31 March 2015 £000
Benefits payable	4,662	3,793
VAT and State Scheme premiums	1,331	1,210
Contributions in advance	8,275	11,899
Miscellaneous creditors and accrued expenses	2,698	2,137
Office - operating lease	44	149
	17,010	19,188

Notes to the Accounts

Analysis of creditors

	2014 £000	2015 £000
Administering Authority	-	63
Other Scheduled Bodies	8,237	11,890
Community Admission Bodies	38	-
Central Government Bodies	1,331	1,247
Other entities and individuals	7,404	5,988
	17,010	19,188

19 Additional Voluntary Contributions

Active members of the Lothian 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.

Total contributions during year for Lothian Pension fund

	2013/14 £000	2014/15 £000
Standard Life	441	404
Prudential	1,163	1,369
	1,604	1,773

Total value at year end for both Lothian Pension Fund

	31 March 2014 £000	31 March 2015 £000
Standard Life	6,105	6,342
Prudential	2,051	3,158
	8,156	9,500

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. 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 £55.8m to the Fund during the year (2014 £56.5m).

Notes to the Accounts

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	31 March
	2014	2015
	£000	£000
	7,819	6,352

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 2015, the fund had an average investment balance of £204.1m (2014 £115.2m). Interest earned was £950.3k (2014 £603.7k).

Year end balance on treasury management account	31 March	31 March
	2014	2015
	£000	£000
Held for investment purposes	131,504	223,616
Held for other purposes	31,734	36,350
	163,238	259,966

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	31 March
	2014	2015
	£000	£000
Within one year	-	-
Between one and five years	157	272
After five years	1,222	1,107
	1,379	1,379
Recognised as an expense during the year	33	91

The above expense has been allocated across the three Funds, Lothian Pension Fund's share is £83.8k.

Governance

As at 31 March 2015, 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.

Notes to the Accounts

Key management personnel

During the period from 1 April 2014 to the date of issuing of these accounts, a number of employees of the City of Edinburgh Council and its wholly owned subsidiary, LPFE Limited, held key positions in the financial management of the Lothian Pension Fund. With effect from 1 May 2015, all the employees listed below, with the exception of the Director of Corporate Governance, were employed by LPFE Limited. 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	Accrued CETV
		as at 31 March 2014 £000	as at 31 March 2015 £000
Alastair Maclean*	Director of Corporate Governance	115	141
Clare Scott	Investment and Pensions Service Manager	126	147
Struan Fairbairn	Legal and Risk Manager	9	19
John Burns	Pensions and Accounting Manager	386	426
Esmond Hamilton	Financial Controller	119	138
Bruce Miller	Investment Manager	112	139

* 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 2014 £000	31 March 2015 £000
Outstanding investment commitments	109,692	146,403

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.

22 Contingent assets

There were no contingent assets at the year end.

23 Impairment losses

During the year the Fund recognised a decrease in impairment losses in respect of specific benefit over payments for which reimbursement has been requested of £8k. This decreased the impairment to £31.9k at the year end.

Lothian Pension Fund (“the Fund”)

Actuarial Statement for 2014/15

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 2014/15. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

Description of Funding Policy

The funding policy is set out in the Administering Authority’s Funding Strategy Statement (FSS), dated March 2015. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the overall Fund
- to ensure the solvency of each individual employers’ share of the Fund based on their expected term of participation in the 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; and
- 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 2014. This valuation revealed that the Fund’s assets, which at 31 March 2014 were valued at £4,379 million, were sufficient to meet 91% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £417 million.

Individual employers’ contributions for the period 1 April 2015 to 31 March 2018 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 the valuation report dated 31 March 2015.

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 2014 valuation were as follows:

Financial Assumption	31 March 2014	
	% p.a. Nominal	% p.a. Nominal
Discount rate	5.00%	2.30%
Pay increases*	5.00%	2.30%
Price inflation/Pension increases	2.70%	-

*2% p.a. for 2014/15 and 2015/16, reverting to 5.0% p.a. thereafter.

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI_2012 model, assuming the current rate of improvements has reached a peak and will converge to long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	22.1 years	23.7 years
Future Pensioners*	24.2 years	26.3 years

*Future pensioners are assumed to be aged 45 at the 2014 valuation

Copies of the 2014 valuation report and Funding Strategy Statement are available on request from The City of Edinburgh Council, the Administering Authority to the Fund.

Experience over the period since April 2014

The administering authority monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update as at 31 March 2015 revealed that the Fund's assets were sufficient to meet 84% of the past service liabilities. The decrease in the funding level was largely as a result of a decrease in real bond yields and the subsequent reduction in the net discount rate, which places a higher value on the Fund's liabilities. The resulting deficit as at 31 March 2015 was £973 million.

The next actuarial valuation will be carried out as at 31 March 2017. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden FFA

Fellow of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

1 June 2015

List of active employers at 31 March 2015

Employer	Type
Almond Housing Association Ltd	CAB
Barony Housing Association Ltd	CAB
Baxter Storey	TAB
Broomhouse Centre Representative Council	CAB
Convention of Scottish Local Authorities	CAB
Canongate Youth Project	CAB
Capital City Partnership	CAB
Children's Hearing Scotland	CAB
Children's Hospice Association Scotland	CAB
Citadel Youth Centre	CAB
City of Edinburgh Council (The)	SB
Audit Scotland	CAB
Compass Chartwell	TAB
Link In	CAB
Dawn Group Ltd	TAB
Dean Orphanage and Cauvin's Trust	CAB
Donaldson's Trust	CAB
Scottish Water	SB
East Lothian Council	SB
Four Square (Scotland)	CAB
Edinburgh Business School	CAB
University of Edinburgh (Edin College of Art)	CAB
Edinburgh Cyrenians Trust	CAB
EDI Group Ltd	CAB
Edinburgh International Festival Society	CAB
Festival City Theatres Trust	CAB
Edinburgh Woman's Rape & Sexual Abuse Centre	CAB
Streetwork UK Ltd	CAB
Edinburgh World Heritage Trust	CAB
Edinburgh College	SB
Edinburgh Leisure	CAB
ELCAP	CAB
Enjoy East Lothian	CAB
Family Advice and Information Resource	CAB
Family & Community Development West Lothian	CAB
Scottish Fire and Rescue Service	SB
First Step	CAB
Forth and Oban Ltd	TAB
Forth Estuary Transport Authority	SB
Freespace Housing Association	CAB
Pilton Community Health Project	CAB
Granton Information Centre	CAB
HWU Students Association	CAB
Handicabs (Lothian) Ltd	CAB
Hanover (Scotland) Housing Association	CAB
BAM Construction Ltd	TAB
Health in Mind	CAB
Heriot-Watt University	SB
Homes for Life Housing Partnership	CAB
Into Work	CAB

Employer	Type
ISS UK Ltd	TAB
Keymoves	CAB
Lothian Valuation Joint Board	SB
Melville Housing Association	CAB
Midlothian Council	SB
Mitie PFI	TAB
Morrison Facilities Services Ltd	TAB
Edinburgh Napier University	CAB
NSL Ltd	TAB
Newbattle Abbey College	CAB
North Edinburgh Dementia Care	CAB
Scotland's Rural College (SRUC)	SB
Open Door Accommodation Project	CAB
Penumbra	CAB
Pilton Equalities Project	CAB
Pilton Youth and Children's Project	CAB
Police Scotland	SB
Queensferry Churches Care in the Community Project	CAB
Queen Margaret University	CAB
Royal Society of Edinburgh	CAB
Scotland's Learning Partnership	CAB
Homeless Action Scotland	CAB
Scottish Mining Museum	CAB
Scottish Adoption Agency	CAB
Scottish Futures Trust	CAB
Scottish Legal Complaints Commission	CAB
Museums Galleries Scotland	CAB
Scottish Police Authority	SB
SESTRAN	SB
Skanska UK	TAB
Scottish Schools Education Research Centre (SSERC)	CAB
St Columba's Hospice	CAB
St Andrew's Children's Society Limited	CAB
Stepping Out Project	CAB
Royal Edinburgh Military Tattoo	CAB
Centre for Moving Image (The)	CAB
Improvement Service (The)	CAB
Victim Support Scotland	CAB
Visit Scotland	SB
Edinburgh Development Group	CAB
West Granton Community Trust	CAB
Waverley Care	CAB
Weslo Housing Management	CAB
West Lothian College	SB
West Lothian Council	SB
West Lothian Leisure	CAB
Wester Hailes Land and Property Trust	CAB
Young Scot Enterprise	CAB
Youthlink Scotland	CAB

SB - Scheduled bodies

CAB - Community Admitted Bodies

TAB - Transferee Admitted Bodies

Lothian Buses Pension Fund

Membership records

Status	Membership at 31 March 2012	Membership at 31 March 2013	Membership at 31 March 2014	Membership at 31 March 2015
Active	1,407	1,335	1,268	1,196
Deferred	1,179	1,163	1,146	1,131
Pensioners	1,122	1,163	1,191	1,222
Dependants	303	310	320	332
Total	4,011	3,971	3,925	3,881

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 2015 the contribution rates were as follows:

Full time equivalent pensionable pay (rate of pay on 31/3/2015)	Rate
Less than £20,382	5.50%
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 2015 were based on the actuarial valuation at 31 March 2011. For the 2014/15 financial year the rate was 20.5% of pensionable pay for service currently being accrued.

During the financial year, the actuarial valuation at 31 March 2014 has been undertaken. The funding level on an ongoing basis was calculated by the Fund's actuary to be 117%. At 31 March 2015, the actuary provided an updated estimate of 106%.

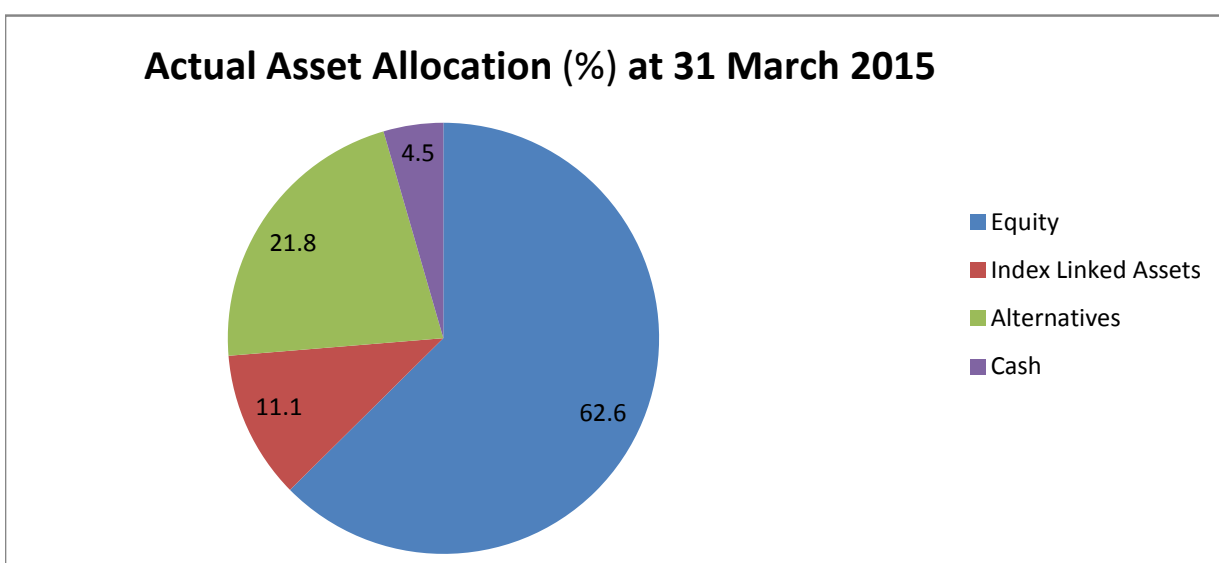
On the more prudent 'gilts basis', the funding levels were 88% and 81% at 31 March 2014 and 31 March 2015 respectively. More information on funding can be found in the Actuarial Statement for 2014/15.

Investment Strategy

The Pensions Committee approved the Investment Strategy 2012-17 for Lothian Buses Pension Fund in October 2012. The strategy reduces the allocation to equities (including private equity) from 63.5% at the end of 2012 to 55% by the end of 2017 and increases the allocation to index-linked gilts and alternatives. It recognises a gradually changing risk profile for the Fund, but retains significant exposure to investments, such as Index-Linked Gilts and Equities, which have a history of protecting or enhancing purchasing power after the effects of inflation have been taken into account.

The investment strategy is set at the broad asset class level of Equities, Index-Linked Assets 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; Alternatives include property, infrastructure, timber and fixed income assets, such as corporate bonds and other debt investments. 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.

	Strategic Allocation	Long term Strategy	Permitted ranges
	31/03/2015	2012 - 2017	
	%	%	%
Equities	60.5	55.0	45 - 65
Index Linked Assets	12.0	15.0	10 - 30
Alternatives	27.5	30.0	10 - 35
Cash	-	-	0 - 10
Total	100	100	n/a



The implementation of the Investment Strategy 2012-17 has continued to proceed at a measured pace as investment opportunities became available and as research on opportunities was completed. Progress towards the long term strategy allocation involves the interim strategy allocation and the actual asset allocation changing gradually over time. The pace of change can be accelerated or slowed depending on asset prices, the availability of alternative investments and research conclusions on new strategies.

Changes to the underlying structure of the Fund were more modest in 2014/15 following the significant changes implemented in the prior year, notably the move to have approximately half of the Fund's equity exposure managed by the internal team in a low cost, low turnover, high dividend yield strategy.

Investment performance

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

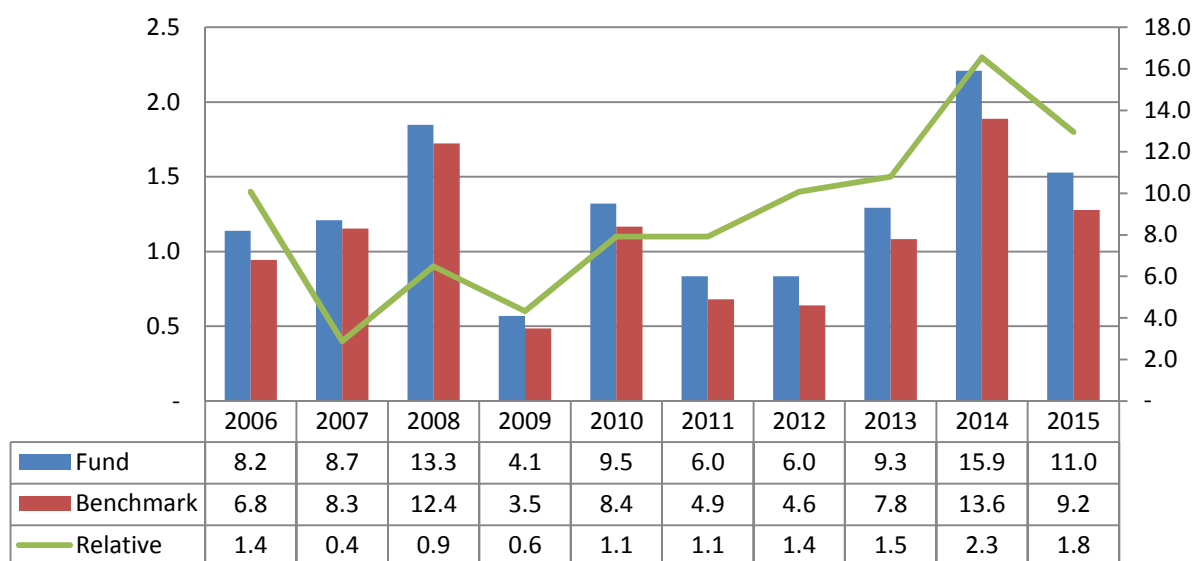
- over long-term economic cycles (typically 5 years or more) the achievement of the same return as that generated by the strategic allocation
- over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

The Fund has achieved returns in excess of the strategic allocation over the last year and over the longer term timeframes shown in the table. The benchmark return shown in the table is the strategic allocation and comprises equity, index-linked gilt and cash indices as well as an inflation-linked index for the alternatives allocation. Returns relative to the benchmark over a one year period need to be placed in the context that there are no ideal benchmarks for many of the assets held in the Fund, especially the Alternatives. The Fund's benchmark for Alternatives is inflation plus 3.5% per annum, which makes sense over the long term as the Fund's liabilities are linked to inflation. However, over shorter periods, there is less information content in the relative returns of the Fund because the development of asset prices is much more volatile than that of UK retail or consumer prices. The Investment Strategy Panel assesses the underlying risks of the portfolios that make up the asset allocation to ensure that these are consistent with the long term objectives of the Fund.

Annualised returns to 31 March 2015 (% per year)

	1 year	5 year	10 years
Lothian Pension Fund	15.1	11.0	10.3
Benchmark	14.9	9.2	8.8
Retail Price Index (RPI)	0.9	3.1	3.0
Consumer Price Index (CPI)	(0.1)	2.4	2.5
National Average Earnings	3.3	1.7	2.6

Annualised 5 yearly returns ending 31 March (% per year)



Lothian Buses Pension Fund

Fund Account for year ended 31 March 2015

2013/14 £000		<i>Note</i>	2014/15 £000
	Income		
7,126	Contributions from employer	2	7,094
2,222	Contributions from members		2,162
-	Transfers from other schemes		-
9,348			9,256
	Less: expenditure		
7,358	Pension payments including increases		7,790
1,819	Lump sum retirement payments		2,864
213	Lump sum death benefits		262
218	Transfers to other schemes	3	17
110	Administrative expenses	4a	112
9,718			11,045
(370)	Net withdrawals from dealing with members		(1,789)
	Returns on investments		
6,156	Investment income	5	8,346
22,411	Change in market value of investments	6a, 7b	43,422
(2,982)	Investment management expenses	4b	(1,320)
25,585	Net returns on investments		50,448
25,215	Net increase in the Fund during the year		48,659
311,910	Net assets of the Fund at 1 April 2014		337,125
337,125	Net assets of the Fund at 31 March 2015	7a, 7c	385,784

Lothian Buses Pension Fund

Net Assets Statement as at 31 March 2015

31 March 2014		31 March 2015
£000	Note	£000
	Investments	
337,279	Assets	382,261
(1,934)	Liabilities	(98)
335,345	6, 8	382,163
	Current assets	
422	The City of Edinburgh Council	1,113
1,523	Cash balances	2,026
912	Debtors	726
2,857		3,865
	Current liabilities	
(1,077)	Creditors	(244)
(1,077)		(244)
1,780	Net current assets	3,621
337,125	Net assets of the Fund at 31 March 2015	385,784
	7a, 7c	

JOHN BURNS FCMA CGMA

Pensions and Accounting Manager

24 June 2015

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 2015, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

2 Contributions from employer

	2013/14	2014/15
	£000	£000
Lothian Buses Plc		
Normal (ongoing contributions)	7,126	7,094
Deficit funding	-	-
Pension strain	-	-
Total	7,126	7,094

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 2014/15 the employer contribution rate was 20.5% of pensionable pay 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 2014/15.

3 Transfers out to other pension schemes

	2013/14	2014/15
	£000	£000
Group transfers	-	-
Individual transfers	218	17
	218	17

4a Administrative expenses

	2013/14	2014/15
	£000	£000
Employee costs	59	53
The City of Edinburgh Council - pension payroll costs	7	-
The City of Edinburgh Council - other support costs	15	7
System costs	11	12
Actuarial fees	9	21
External Audit fees	2	2
Legal fees	-	-
Printing and postage	2	5
Depreciation	3	4
Office costs	2	5
Sundry costs less sundry income	-	3
	110	112

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.

Notes to the Accounts

4b Investment management expenses	2013/14	2014/15
	£000	£000
External management fees - invoiced	2,021	539
External management fees - deducted from capital	568	589
Transaction costs	268	31
Employee costs	59	63
Custody fees	21	36
Engagement and voting fees	5	5
Performance measurement fees	11	17
Investment consultancy fees	3	-
System costs	11	11
Legal fees	3	8
The City of Edinburgh Council - other support costs	8	12
Office costs	1	4
Sundry costs	3	5
	2,982	1,320

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 6a - Reconciliation of movements in investments).

The external investment management fees for 2014/15 include a performance-related element of £0.1m (2013/14 £1.4m).

4c Management expenses	2013/14	2014/15
	£000	£000
Administrative costs	99	84
Investment management expenses	2,763	1,259
Oversight and governance costs	230	89
	3,092	1,432

This analysis of costs for the Lothian Buses Pension Fund has been prepared in accordance with CIPFA guidance. The analysis looks at the combined Administration and Investment expenses in note 4a and b and splits out the costs to include a third heading covering oversight and governance.

5 Investment income	2013/14	2014/15
	£000	£000
Fixed income	7	84
Dividends from equities	4,610	6,230
Income from pooled investment vehicles	1,451	1,747
Interest on cash deposits	46	50
Securities lending and sundries	140	320
	6,254	8,431
Irrecoverable withholding tax	(98)	(85)
	6,156	8,346

Notes to the Accounts

	31 March 2014 £000	31 March 2015 £000
6 Net investment assets		
Investment assets		
Fixed interest	6,511	13,209
Equities	221,274	242,863
Pooled investment vehicles	87,978	105,943
Deposits	19,521	19,174
Other investment assets		
Due from broker	1,084	81
Dividends and other income due	911	991
	1,995	1,072
Total investment assets	337,279	382,261
Investment liabilities		
Other financial liabilities - due to broker	(1,934)	(98)
Total investment liabilities	(1,934)	(98)
Net investment assets	335,345	382,163

6a Reconciliation of movement in investments

	Market value at 31 March 2014 £000	Purchases at cost £000	Sales proceeds £000	Change in market value £000	Market value at 31 March 2015 £000
Fixed interest	6,511	5,185	(391)	1,904	13,209
Equities	221,274	20,545	(27,165)	28,209	242,863
Pooled investment vehicles	87,978	5,319	(779)	13,425	105,943
	315,763	31,049	(28,335)	43,538	362,015
Other financial assets / (liabilities)					
Cash deposits	19,521			(113)	19,174
Broker balances	(850)			(3)	(17)
Dividends due	911			-	991
	19,582			(116)	20,148
Net financial assets	335,345			43,422	382,163

Notes to the Accounts

	Market value at 31 March 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

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.

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.

6b Analysis of investments (at market value)

	Market value at 31 March 2014 £000	Market value at 31 March 2015 £000
Fixed income		
UK index linked	6,511	13,209
Equities		
UK quoted	42,178	39,225
Overseas quoted	179,096	203,638
	221,274	242,863
Pooled investment vehicles		
UK		
Managed funds - property	29,327	34,201
Managed funds - index linked	23,338	28,449
Managed funds - other bonds	24,039	27,380
Infrastructure and timber	1,703	2,053
Overseas		
Infrastructure and timber	9,571	13,860
	87,978	105,943

Notes to the Accounts

6c Investment managers and mandates

		Market value at 31 March 2014 £000	% of total funds %	Market value at 31 March 2015 £000	% of total funds %
Manager	Mandate				
Baillie Gifford	Global equities	107,901	32.2	120,728	31.7
In-house	Global high dividend	107,435	32	113,824	29.8
In-house	Private equity quoted	3,761	1.1	4,753	1.2
Total equities		219,097	65.3	239,305	62.7
Baillie Gifford	Index linked gilts	23,338	7.0	28,449	7.5
In-house	Index linked gilts	14,106	4.2	13,915	3.6
Total index linked gilts		37,444	11.2	42,364	11.1
Baillie Gifford	Corporate bonds	24,039	7.2	27,380	7.2
In-house	Secured loans	1,421	0.4	530	0.1
Total other bonds		25,460	7.6	27,910	7.3
Standard Life	Property managed fund	29,327	8.7	34,201	8.9
In-house	Infrastructure unquoted	8,627	2.6	7,915	2.1
In-house	Infrastructure quoted	5,739	1.7	7,026	1.8
In-house	Timber	2,647	0.8	6,341	1.7
In-house	Alternatives cash	-	-	1,657	0.4
Total alternative investment		17,013	5.1	22,939	6.0
In-house	Cash	6,886	2.1	11,986	3.1
In-house	Transition	118	-	3,458	0.9
		7,004	2.1	15,444	4.0
Net financial assets		335,345	100.0	382,163	100.0

6d Investments representing more than 5% of the net assets of the Fund

	Market value at 31 March 2014 £000	% of total funds %	Market value at 31 March 2015 £000	% of total funds %
Standard Life Property Fund	29,327	8.7	34,201	8.9
Baillie Gifford Inv Grade Bond Fund	24,039	7.1	27,380	7.1
Baillie Gifford Index Linked Gilt Fund	23,338	6.9	28,449	7.4

Notes to the Accounts

6e Investments representing more than 5% of any investment class

		Market value at 31 March 2014 £000	Percent of class 31 March 2014 %	Market value at 31 March 2015 £000	Percent of class 31 March 2015 %
UK Gov 1.125% Index Linked 22/11/37	Fixed interest	1,226	18.8	1,472	11.1
UK Gov 2% Index Linked 26/01/35	Fixed interest	1,179	18.1	1,368	10.4
UK Gov 0.625% Index Linked 22/03/40	Fixed interest	987	15.2	1,215	9.2
UK Gov 0.75% Index Linked 22/03/34	Fixed interest	988	15.2	1,161	8.8
UK Gov 0.125% Index Linked 22/03/44	Fixed interest	-	-	1,151	8.7
UK Gov 1.25% Index Linked 22/11/32	Fixed interest	1,170	18.0	1,125	8.5
UK Gov 0.75% Index Linked 22/11/47	Fixed interest	-	-	880	6.7
UK Gov 4.125% Index Linked 22/07/30	Fixed interest	961	14.8	878	6.6
UK Gov 0.375% Index Linked 22/03/62	Fixed interest	-	-	866	6.6
UK Gov 1.25% Index Linked 2055	Fixed interest	-	-	758	5.7
Standard Life Property Fund	Pooled fund	29,327	33.3	34,201	32.3
Baillie Gifford Inv Grade Bond Fund	Pooled fund	24,039	27.3	27,380	25.8
Baillie Gifford Index Linked Gilt Fund	Pooled fund	23,338	26.5	28,449	26.9

6f Securities lending

During the year Lothian Buses Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2015, £10.5m (2014 £14.1m) of securities were released to third parties. Collateral valued at 106.1% (2014 105.2%) of the market value of the securities on loan was held at that date.

7 Financial instruments

7a 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.

Notes to the Accounts

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 2014			31 March 2015		
	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	-	-	13,209	-	-
Equities	221,274	-	-	242,863	-	-
Pooled investments	87,978	-	-	105,943	-	-
Cash	-	19,521	-	-	19,174	-
Other investment balances	-	1,995	-	-	1,071	-
	315,763	21,516	-	362,015	20,245	-
Other assets						
City of Edinburgh Council	-	422	-	-	1,113	-
Cash	-	1,523	-	-	2,027	-
Debtors	-	912	-	-	726	-
	-	2,857	-	-	3,866	-
Assets total	315,763	24,373	-	362,015	24,111	-
Financial liabilities						
Investment liabilities						
Other investment balances	(1,934)	-	-	(98)	-	-
	(1,934)	-	-	(98)	-	-
Other liabilities						
Creditors	-	-	(1,077)	-	-	(244)
	-	-	(1,077)	-	-	(244)
Liabilities total	(1,934)	-	(1,077)	(98)	-	(244)
Net asset total	313,829	24,373	(1,077)	361,917	24,111	(244)
Total net financial instruments			337,125			385,784

7b Net gains and losses on financial instruments

	2013/14 £000	2014/15 £000
Designated as fair value through fund account	22,814	43,538
Loans and receivables	(403)	(116)
Financial liabilities at amortised cost	-	-
Total	22,411	43,422

Notes to the Accounts

7c 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 unlisted 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 typically 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 2015			Total £000
	Level 1 £000	Level 2 £000	Level 3 £000	
Financial assets				-
Designated as fair value through fund account	332,875	13,209	15,931	362,015
Loans and receivables	24,111	-	-	24,111
Total financial assets	356,986	13,209	15,931	386,126
Financial liabilities				
Designated as fair value through fund account	(98)	-	-	(98)
Financial liabilities at amortised cost	(244)	-	-	(244)
Total financial liabilities	(342)	-	-	(342)
Net financial assets	356,644	13,209	15,931	385,784

Notes to the Accounts

	31 March 2014			Total £000
	Level 1 £000	Level 2 £000	Level 3 £000	
Financial assets				
Designated as fair value through fund account	297,978	6,511	11,274	315,763
Loans and receivables	24,373	-	-	24,373
Total financial assets	322,351	6,511	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	319,340	6,511	11,274	337,125

8 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.

Notes to the Accounts

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	12.0%
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 2015		Potential Change	Value on increase	Value on decrease
	£000	% of fund	+ / -	£000	£000
Equities - developed markets	234,550	61.4	20.0	281,460	187,640
Private equity	4,753	1.2	30.0	6,179	3,327
Timber	6,341	1.7	30.0	8,243	4,439
Secured loans	530	0.1	10.0	583	477
Corporate bonds	27,380	7.2	12.0	30,666	24,094
Index-linked gilts	42,364	11.1	8.5	45,965	38,763
Infrastructure	14,941	3.9	8.0	16,136	13,746
Property	34,201	8.9	13.0	38,647	29,755
Cash	17,103	4.5	1.5	17,360	16,846
Total [1]	382,163	100.0	16.5	445,239	319,087
Total [2]			14.4	437,194	327,132
Total [3]			13.6	434,137	330,189

[1] No allowance for correlations between assets

[2] Including allowance correlations for between assets

[3] Including allowance for correlation between assets and liabilities.

Notes to the Accounts

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 2015, cash deposits represented £21.7m, 6.1% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2015	Balances at 31 March 2014 £000	Balances at 31 March 2015 £000
Held for investment purposes			
Northern Trust Global Investment Limited - liquidity funds	Aaa	11,452	3,285
Northern Trust Company - cash deposits	A1	5,591	3,903
The City of Edinburgh Council - treasury management	See below	2,478	11,986
Total investment cash		19,521	19,174
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	1,523	2,026
Total cash		21,044	21,200

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.

Notes to the Accounts

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 2015	Balances at 31 March 2014 £000	Balances at 31 March 2015 £000
Money market funds			
Deutsche Bank AG, London	<i>Aaa</i>	527	2,057
Goldman Sachs	<i>Aaa</i>	295	2,055
Bank call accounts			
Bank of Scotland	<i>A1</i>	364	1,324
Royal Bank of Scotland	<i>Baa1</i>	137	186
Santander UK	<i>A2</i>	377	1,285
Barclays Bank	<i>A2</i>	367	1,341
Svenska Handelsbanken	<i>Aa3</i>	566	2,090
HSBC Bank	<i>Aa3</i>	-	2,045
Commonwealth Bank of Australia	<i>Aa2</i>	546	543
Floating Rate Note			
Rabobank	<i>Aa2</i>	-	362
Building society fixed term deposits			
Nationwide Building Society	<i>A2</i>	182	362
UK pseudo-sovereign risk instruments			
Other Local Authorities	<i>n/a</i>	458	
UK Government Treasury Bills	<i>Aa1</i>	182	362
		4,001	14,012

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.

Notes to the Accounts

9 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.

10 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 £400m (2014 £358m).

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

Inflation / pensions increase rate

Salary increase rate

Discount rate

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

31 March 2014	31 March 2015
% p.a.	% p.a.

2.8

2.4

5.1

4.3

4.5

3.2

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements in line with the CMI 2012 model, assuming that the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

Current pensioners

Future pensioners (assumed to be currently 45)

Males	Females
-------	---------

20.4 years

22.6 years

23.5 years

25.9 years

These assumptions have changed since the previous IAS26 disclosure of the Fund.

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.

Notes to the Accounts

11 Debtors

	31 March 2014 £000	31 March 2015 £000
Contributions due - employers	654	528
Contributions due - employees	199	161
Pensions paid on behalf of employer	38	-
Sundry debtors	21	37
	912	726
Analysis of debtors		
Administering Authority	1	1
Lothian Buses plc	890	689
Other entities and individuals	21	36
	912	726

12 Creditors

	31 March 2014 £000	31 March 2015 £000
Benefits payable	91	73
Miscellaneous creditors and accrued expenses	986	171
	1,077	244
Analysis of creditors		
Other entities and Individuals	1,077	244
	1,077	244

13 Additional Voluntary Contributions

Active members of 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.

	2013/14 £000	2014/15 £000
Total contributions during year for Lothian Buses Pension Fund		
Standard Life	9	9
Prudential	108	73
	117	82
	31 March 2014 £000	31 March 2015 £000
Total value at year end for Lothian Buses Pension Fund		
Standard Life	148	167
Prudential	186	251
	334	418

Notes to the Accounts

14 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. 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 2014 £000	31 March 2015 £000
422	1,113

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 2015, the Fund had an average investment balance of £6.8m (2014 £6.6m), interest earned was £31k (2014 £34.9k).

Year end balance on treasury management account

Held for investment purposes
Held for other purposes

31 March 2014 £000	31 March 2015 £000
2,478	11,986
1,523	2,026
4,001	14,012

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.

Notes to the Accounts

	31 March 2014 £000	31 March 2015 £000
Within one year	-	-
Between one and five years	157	272
After five years	1,222	1,107
	1,379	1,379
Recognised as an expense during the year	33	91

The above expense has been allocated across the three Pension Funds, Lothian Buses Pension Fund's share is £5.2k.

Key management personnel

During the period from 1 April 2014 to the date of issuing of these accounts, a number of employees of the City of Edinburgh Council and its wholly owned subsidiary, LPFE Limited, held key positions in the financial management of the Lothian Pension Fund. With effect from 1 May 2015, all the employees listed below, with the exception of the Director of Corporate Governance, were employed by LPFE Limited. 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 2014 £000	Accrued CETV as at 31 March 2015 £000
Alastair Maclean*	Director of Corporate Governance	115	141
Clare Scott	Investment and Pensions Service Manager	126	147
Struan Fairbairn	Legal and Risk Manager	9	19
John Burns	Pensions and Accounting Manager	386	426
Esmond Hamilton	Financial Controller	119	138
Bruce Miller	Investment Manager	112	139

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

15 Contingent liabilities and contractual commitments

The Fund has commitments relating to outstanding call payments due on unquoted funds 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 2014 £000	31 March 2015 £000
Outstanding investment commitments	466	5,387

Notes to the Accounts

16 Contingent assets

There were no contingent assets at the year end.

17 Impairment losses

No impairment losses have been identified during the year.

Lothian Buses Pension Fund

Actuarial Statement for 2014/15

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 2014/15. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

Description of Funding Policy

The funding policy is set out in the Administering Authority's Funding Strategy Statement (FSS), dated March 2015. In summary, the key funding principles are as follows:

- To ensure solvency of the Fund;
- To minimise the degree of short-term change in employer contribution rates;
- Reduce risk of the investment strategy over time;
- To ensure that sufficient cash is available to meet all liabilities as they fall due for payment

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 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £337 million, were sufficient to meet 117% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2014 valuation was £48 million.

On the more prudent gilts basis, the Fund's assets at 31 March 2014 were sufficient to meet 88% of the liabilities accrued to that date. The resulting deficit at the 2014 valuation, on the gilts basis, was £45million.

The employer contributions for the period 1 April 2015 to 31 March 2018 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 the valuation report dated 31 March 2014.

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.

Actuarial Statement for 2014/15

The key financial assumptions adopted for the 2014 valuation were as follows:

Financial Assumption	31 March 2014	
	% p.a. Nominal	% p.a. Nominal
Discount rate	5.00%	2.30%
Pay increases*	5.00%	2.30%
Price inflation/Pension increases	2.70%	-

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI_2012 model, assuming the current rate of improvements has reached a peak and will converge to long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	20.4 years	22.6 years
Future Pensioners*	23.5 years	25.9 years

*Future pensioners are assumed to be aged 45 at the 2014 valuation

Copies of the 2014 valuation report and Funding Strategy Statement are available on request from The City of Edinburgh Council, the Administering Authority to the Fund.

Experience over the period since April 2014

The administering authority monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update as at 31 March 2015 revealed that the Fund's assets were sufficient to meet 106% of the past service liabilities. The decrease in the funding level was largely as a result of a decrease in real bond yields, and the subsequent reduction in the net discount rate, which places a higher value on the Fund's liabilities. The resulting surplus was £22 million.

On the more prudent gilts basis, the Fund's assets at 31 March 2015 were sufficient to meet 81% of the liabilities accrued to that date, with a resulting deficit of £91 million.

The next actuarial valuation will be carried out as at 31 March 2017. The Funding Strategy Statement will also be reviewed at that time

Richard Warden FFA

Fellow of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

1 June 2015

Scottish Homes Pension Fund

Membership records

Status	Membership at 31/03/2012	Membership at 31/03/2013	Membership at 31/03/2014	Membership at 31/03/2015
Active	-	-	-	-
Deferred	650	626	595	562
Pensioners	999	978	956	928
Dependants	303	308	298	293
Total	1,952	1,912	1,849	1,783

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 2015, of £771,000, was based on the actuarial valuation as at 31 March 2011. As a result of the 31 March 2014 valuation, the Scottish Government will pay £675,00 each year from 1 April 2015 to 31 March 2018.

The Fund's actuary has estimated the funding level to be 92% at 31 March 2015.

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 2014 Actuarial Valuation showed that the actual funding level (88.8%) was below the target funding level (91.5%).

Following the results of the 2014 Actuarial Valuation, the Pensions Committee approved a revised investment strategy for Scottish Homes Pension Fund in December 2014, which confirms that the equity allocation will be reduced with corresponding increases in the bond allocation dependent on the funding level. The target funding levels from 2011 to 2026 are shown in the table below along with the corresponding target equity allocations.

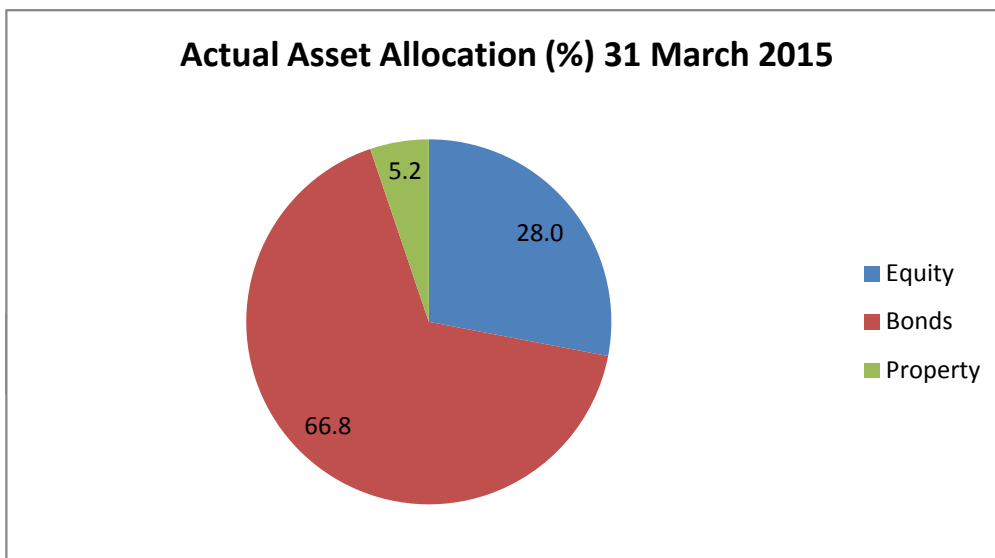
Year [1]	Target Funding Level %	Equity Allocation %
2011	89.5	35
2014	91.5	30
2017	93.0	25
2020	94.5	20
2023	95.5	15
2026	96.5	10

[1] The Scottish Government guarantee agreement sets out the target funding levels every 3 years until 2044.

Over 2014/15, the actual funding level did improve to the target funding level and action was taken to reduce the equity allocation from 30.0% to 27.5% during the first quarter of 2015, consistent with the funding approach. The estimated actual funding level was 92% at 31 March 2015, which is broadly in-line with the target funding level of 93.0% for 2017. The strategic asset allocation at 31 March 2015 is shown below.

	Strategic Allocation 31 March 2014	Strategic Allocation 31 March 2015
	%	%
Equities	30.0	27.5
Bonds	65.0	67.5
Property	5.0	5.0
Cash	-	-
Total	100.0	100.0

The actual asset allocation at 31 March 2015 is shown in the pie chart below.



During 2014/15, an analysis of the Fund's liability cash flow projections was undertaken, which highlighted the differences between the term/duration of the Fund's investments compared to the liabilities. This was partly due to the fact that the investments have tracked a standard market index of gilts and issuance of new government bonds over recent years has tended to be of longer duration. During September 2014, the duration of the Fund's investments was reduced accordingly and part of the Fund's holdings is now being managed internally. Approximately half of the bond portfolio was moved to in-house management. The equity and bond allocations did not change over this time. This change in duration should result in the investments providing a closer match to the liabilities in the future.

Investment performance

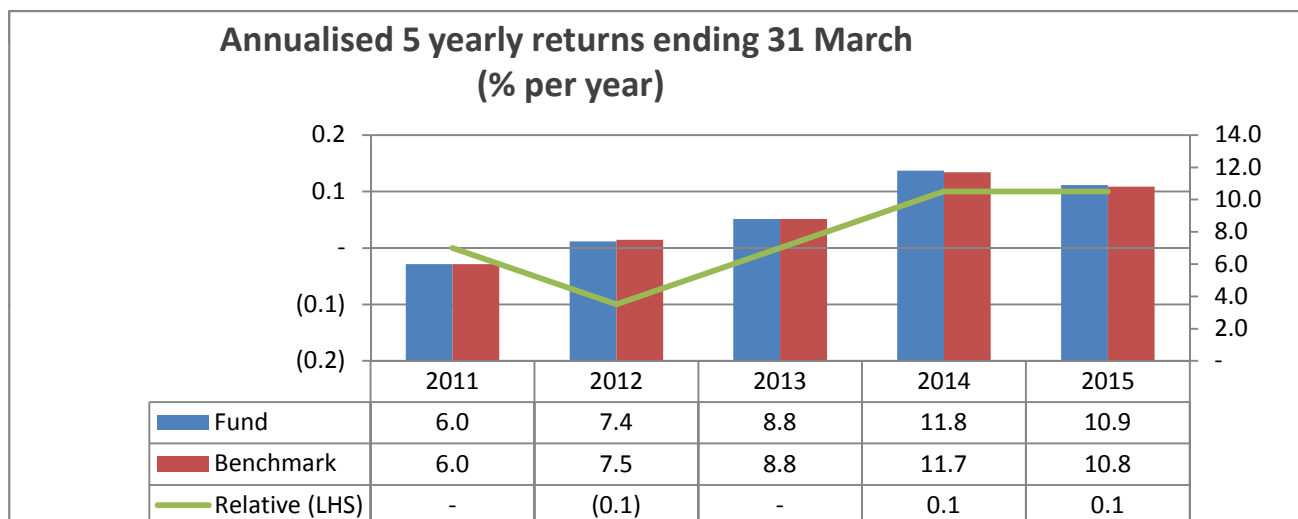
The objectives of the Fund were redefined in December 2012 and are:

- 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'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 since inception, and has outperformed its benchmark by a small margin over the 1- and 5-year timeframes. The Fund's equity and bond assets are currently managed passively and the Fund's risk has been similar to that of the benchmark.

Annualised returns to 31 March 2014 (% per year)	1 year	5 years	Since inception (July 2005)
Scottish Homes Pension Fund	19.7	10.9	9.2
Benchmark	19.4	10.8	9.2
Retail Price Index (RPI)	0.9	3.1	3.0
Consumer Price Index (CPI)	(0.1)	2.4	2.5
National Average Earnings	3.3	1.7	2.4

The absolute performance of Scottish Homes Pension Fund over the 12-month period was +19.7% and 5 year performance was +10.9% per annum. With a large allocation to bonds, the continuing bull market in the world's bond markets boosted the fund's performance over 2014/15. Since inception in July 2005, the Fund has returned +9.2% per annum, well ahead of measures of inflation, and national average earnings.



Scottish Homes Pension Fund

Fund Account for year ended 31 March 2015

2013/14 £000		Note	2014/15 £000
	Income		
791	Contributions from employer	2	771
-	Transfers from other schemes		-
791			771
	Less: expenditure		
7,083	Pension payments including increases		7,057
329	Lump sum retirement payments		372
15	Lump sum death benefits		11
9	Transfers to other schemes	3	93
57	Administrative expenses	4a	69
7,493			7,602
(6,702)	Net withdrawals from dealing with members		(6,831)
	Returns on investments		
339	Investment income	5	569
2,742	Change in market value of investments	6a, 7b	24,861
(191)	Investment management expenses	4b	(184)
2,890	Net returns on investments		25,246
(3,812)	Net (decrease) / increase in the Fund during the year		18,415
140,117	Net assets of the Fund at 1 April 2014		136,305
136,305	Net assets of the Fund at 31 March 2015	7a, 7c	154,720

Scottish Homes Pension Fund

Net Assets Statement as at 31 March 2015

31 March 2014			31 March 2015
£000		Note	£000
	Investments		
133,761	Assets		152,067
-	Liabilities		-
133,761		6, 8	152,067
	Current assets		
175	The City of Edinburgh Council	14	219
2,383	Cash balances	8, 14	2,433
48	Debtors	11	27
2,606			2,679
	Current liabilities		
(62)	Creditors	12	(26)
(62)			(26)
2,544	Net current assets		2,653
136,305	Net assets of the Fund at 31 March 2014	7a, 7c	154,720

JOHN BURNS FCMA CGMA

Pensions and Accounting Manager

24 June 2015

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 2015, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

2 Contributions

	2013/14 £000	2014/15 £000
Deficit funding	671	671
Administration expenses contribution	100	100
Strain costs	20	-
	791	771

The Scottish Homes Pension Fund is a single employer pension fund for former 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 was paid by the Scottish Government over the period April 2012 to March 2015. In addition, the Scottish Government agreed to pay £100,000 every year towards the cost of ongoing administration. The results of the 31 March 2014 actuarial valuation mean that the Scottish Government will pay £575,000 per year in deficit funding for the period April 2015 to March 2018 while the administration cost remains the same.

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

	2013/14 £000	2014/15 £000
Group transfers	-	-
Individual transfers	9	93
	9	93

4a Administrative expenses

	2013/14 £000	2014/15 £000
Employee costs	27	25
The City of Edinburgh Council - pension payroll costs	6	-
The City of Edinburgh Council - other support costs	7	3
System costs	5	7
Actuarial fees	7	25
External audit fees	1	1
Printing and postage	1	2
Depreciation	2	2
Office costs	1	2
Sundry costs less sundry income	-	2
	57	69

Notes to the Accounts

4a Administrative expenses - continued

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.

4b Investment management expenses

	2013/14	2014/15
	£000	£000
External management fees - invoiced	72	59
External management fees - deducted from capital	61	60
Transaction costs	2	-
Employee costs	24	25
Engagement and voting fees	2	2
Performance measurement fees	2	5
Investment consultancy fees	1	-
The City of Edinburgh Council - other support costs	3	5
Custodian fees	18	18
System costs	4	4
Legal fees	-	2
Office costs	1	2
Sundry costs	1	2
	191	184

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 2014/15 or 2013/14.

4c Management expenses

	2013/14	2014/15
	£000	£000
Administrative costs	52	40
Investment management expenses	171	159
Oversight and governance costs	25	54
	248	253

This analysis of costs for the Scottish Homes Pension Fund has been prepared in accordance with CIPFA guidance. The analysis looks at the combined Administration and Investment expenses in note 4a and b and splits out the costs to include a third heading covering Oversight and governance.

Notes to the Accounts

5 Investment income	2013/14 £000	2014/15 £000
Income from fixed interest securities	-	250
Property pooled investment income	326	308
Interest on cash deposits	13	11
	339	569
Irrecoverable withholding tax	-	-
	339	569

6 Net investment assets	31 March 2014 £000	31 March £000
Investment Assets		
Fixed Interest Securities	-	54,147
Pooled investment vehicles	133,761	97,503
Deposits	-	244
Other investment assets		
income due	-	173
Net investment assets	133,761	152,067

6a Reconciliation of movement in investments

	Value at 31 March 2014 £000	Purchases at cost £000	Sales proceeds £000	Change in market value £000	Value at 31 March 2015 £000
Fixed Interest	-	49,838		4,309	54,147
Pooled investment vehicles	133,761		(56,810)	20,552	97,503
	133,761	49,838	(56,810)	24,861	151,650
Other financial assets/(liabilities)					
Cash deposits	-			-	244
Dividends due	-			-	173
	-			-	417
Net investment assets	133,761			24,861	152,067

	Value at 31 March 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

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.

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.

Notes to the Accounts

6b Analysis of Investments (at market value)

Fixed income

Public sector index linked gilts quoted

2013/14	2014/15
£000	£000

-	54,147
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Pooled investment vehicles

UK managed funds - property

6,960	7,875
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UK managed funds - other

126,801	89,628
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133,761	151,650
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6c Investment managers and mandates

Manager	Mandate	Market value at	% of total	Market value at	% of total
		31 March 2014	funds	31 March 2015	funds
		£000	%	£000	%
State Street	UK equity	8,777	6.6	9,199	6.0
State Street	N American equities	12,596	9.4	12,575	8.3
State Street	European equities	8,171	6.1	8,580	5.6
State Street	Pacific (ex Jpn) equities	3,225	2.4	3,544	2.3
State Street	Japanese equities	4,149	3.1	5,264	3.5
State Street	Emerging mkts equities	3,048	2.3	3,449	2.3
Total overseas equities		31,189	23.3	33,412	22.0
In-house	UK index-linked gilts	-	-	54,564	35.9
State Street	UK fixed interest gilts	17,336	13	21,362	14.0
State Street	UK index-linked gilts	69,499	51.9	25,655	16.9
Total fixed interest		86,835	64.9	101,581	66.8
Schroders	Property	6,960	5.2	7,875	5.2
Total property		6,960	5.2	7,875	5.2
Net financial assets		133,761	100	152,067	100.0

Notes to the Accounts

6d Investments representing more than 5% of the net assets of the Fund or 5% of any investment class

	Market value at 31 March 2014 £000	% of total funds %	Market value at 31 March 2015 £000	% of total funds %
UK Gov 1.125% Index Linked 22/11/27	-	-	26,489	17.4
State Street UK Index Linked Gilts Over 15Y	69,498	52.0	25,655	16.9
State Street UK Conventional Gilts Over 15Y	17,336	13.0	21,362	14.0
UK Gov 1.25% Index Linked 22/11/32	-	-	16,401	10.8
State Street MPF North America Equity Index	12,596	9.4	12,575	8.3
UK Gov 1.125% Index Linked 22/11/37	-	-	11,257	7.4
State Street MPF UK Equity Index	8,777	6.6	9,199	6.0
State Street MPF Europe ex-UK Equity Index	8,171	6.1	8,580	5.6
Schroders UK Real Estate INC	6,690	5.2	7,874	5.2

6e Securities lending

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

Notes to the Accounts

7 Financial instruments

7a 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 2014			31 March 2015		
	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost
	£000	£000	£000	£000	£000	£000
Financial assets						
Investment assets						
Fixed Interest securities	-	-	-	54,147	-	-
Pooled investments	133,761	-	-	97,503	-	-
Cash	-	-	-	-	244	-
Other balances	-	-	-	-	173	-
	133,761	-	-	151,650	417	-
Other assets						
City of Edinburgh Council	-	175	-	-	219	-
Cash	-	2,383	-	-	2,433	-
Debtors	-	48	-	-	27	-
	-	2,606	-	-	2,679	-
Assets total	133,761	2,606	-	151,650	3,096	-
Financial liabilities						
Other liabilities						
Creditors	-	-	(62)	-	(26)	-
	-	-	(62)	-	(26)	-
Liabilities total	-	-	(62)	-	(26)	-
Net assets total	133,761	2,606	(62)	151,650	3,070	-
Total net financial instruments			136,305			154,720

Notes to the Accounts

7b Net gains and losses on financial instruments

	2013/14	2014/15
	£000	£000
Designated as fair value through fund account	2,742	24,681
Loans and receivables	-	-
Financial liabilities at amortised cost	-	-
Total	2,742	24,681

7c 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 2015			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
Financial assets				
Designated as fair value through fund	97,503	54,147	-	151,650
Loans and receivables	3,096	-	-	3,096
Total financial assets	100,599	54,147	-	154,746
Financial liabilities				
Designated as fair value through fund				
Financial liabilities at amortised cost	(26)	-	-	(26)
Total financial liabilities	(26)	-	-	(26)
Net financial assets	100,573	54,147	-	154,720

Notes to the Accounts

	31 March 2014			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£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

8 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
- 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.

Notes to the Accounts

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			Value on increase £000	Value on decrease £000
	at 31 March 2015 £000	% of fund %	Change + / - %		
Equities - Developed Markets	39,162	25.7	20.0	46,994	31,330
Equities - Emerging Markets	3,449	2.3	30.0	4,484	2,414
Fixed Interest Gilts	25,655	16.9	10.5	28,349	22,961
Index-Linked Gilts	75,926	49.9	8.5	82,380	69,472
Property	7,875	5.2	13.0	8,899	6,851
Total [1]	152,067	100.0	12.5	171,106	133,028
Total [2]			9.4	166,361	137,773
Total [3]			7.1	162,864	141,270

[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].

Notes to the Accounts

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 2015 cash deposits represented £2.7m, 1.7% of total net assets. This was held as follows:

	Moody's Credit Rating at 31 March 2015	Balances at 31 March 2014 £000	Balances at 32 March 2015 £000
Held for investment purposes			
Northern Trust Company - cash deposits	A1	-	244
Total investment cash		-	244
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	2,383	2,433
Total cash		2,383	2,677

The majority of 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.

Notes to the Accounts

The Fund's cash holding under its treasury management arrangements at 31 March 2015 was held with the following institutions:

	Moody's Credit Rating at 31 March 2015	Balances at 31 March 2014 £000	Balances at 31 March 2015 £000
Money market funds			
Deutsche Bank AG, London	Aaa	314	357
Goldman Sachs	Aaa	175	357
Bank call accounts			
Bank of Scotland	A1	217	230
Royal Bank of Scotland	Baa1	82	32
Santander UK	A2	225	223
Barclays Bank	A2	219	233
Svenska Handelsbanken	Aa3	337	363
HSBC Bank	Aa3	325	355
Commonwealth Bank of Australia	Aa2	-	94
Floating Rate Note			
Rabobank	Aa2	-	63
Building society fixed term deposits			
Nationwide Building Society	A2	108	63
UK pseudo-sovereign risk instruments			
Other Local Authorities [1]	n/a	273	-
UK Government Treasury Bills	Aa1	108	63
		2,383	2,433

[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 was 'Aa1'). Of the £273k above, £119k was with a local authority which had 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.

Notes to the Accounts

9 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.

10 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 £141m (2014 £138m). 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 2014	31 March 2015
	% p.a.	% p.a.
Inflation / pensions increase rate	2.6	2.1
Discount rate	4.1	3.1

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements from 2011 in line with Medium Cohort and a 1.25% p.a. underpin. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	Males	Females
Current pensioners	24.5 years	25.4 years
Future pensioners (assumed to be aged 45 as at 31 March 2014)	26.8 years	28.6 years

These assumptions have changed since the previous IAS26 disclosure of the Fund.

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.

11 Debtors

	31 March 2014	31 March 2015
	£000	£000
Sundry debtors	48	27
	48	27
Analysis of debtors		
Administering Authority	1	1
Scottish Government	20	-
Other entities and individuals	27	26
	48	27

Notes to the Accounts

12 Creditors

	31 March 2014 £000	31 March 2015 £000
Benefits payable	39	5
Miscellaneous creditors and accrued expenses	23	21
	62	26
Analysis of creditors		
Other entities and individuals	62	26
	62	26

Additional Voluntary

13 Contributions

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

14 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. 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 2014 £000	31 March 2015 £000
Year end balance on holding account	175	219

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 2015, the Fund had an average investment balance of £2.5m (2014 £2.3m). Interest earned was £11.5k (2014 £12.3k).

	31 March 2014 £000	31 March 2015 £000
Year end balance on treasury management account		
Held for investment purposes	-	-
Held for other purposes	2,383	2,433
	2,383	2,433

Notes to the Accounts

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 2014 £000	31 March 2015 £000
Within one year	-	-
Between one and five years	157	272
After five years	1,222	1,107
	1,379	1,379
Recognised as an expense during the year	33	91

The above expense has been allocated across the three pension funds. Scottish Homes Pension Fund's share is £2.2k.

Key management personnel

During the period from 1 April 2014 to the date of issuing of these accounts, a number of employees of the City of Edinburgh Council and its wholly owned subsidiary, LPFE Limited, held key positions in the financial management of the Lothian Pension Fund. With effect from 1 May 2015, all the employees listed below, with the exception of the Director of Corporate Governance, were employed by LPFE Limited. 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 2014 £000	Accrued CETV as at 31 March 2015 £000
Alastair Maclean*	Director of Corporate Governance	115	141
Clare Scott	Investment and Pensions Service Manager	126	147
Struan Fairbairn	Legal and Risk Manager	9	19
John Burns	Pensions and Accounting Manager	386	426
Esmond Hamilton	Financial Controller	119	138
Bruce Miller	Investment Manager	112	139

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

15 Contingent liabilities and contractual commitments

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

Notes to the Accounts

16 Contingent assets

There were no contingent assets at the year end.

17 Impairment losses

No impairment losses have been identified during the year.

Scottish Homes Pension Fund

Actuarial Statement for 2014/15

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 2014/15. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

Description of Funding Policy

The administering authorities Funding Strategy Statement, dated March 2015, states that a bespoke funding strategy has been adopted for the Fund.

The strategy aims for the Fund to be 100% solvent by 2044 using a discount rate based on government bonds. It includes target funding levels at each actuarial valuation. Contributions from the Scottish Government are determined by reference to the target funding levels. The deficit recovery period is 8 years.

The Funding strategy is designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over the time, with a reducing allocation to equities over time reflecting the requirements of the Scottish Government to lock away any surpluses that may occur over time by accelerating the transfer into bonds.

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 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £136 million, were sufficient to meet 89% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £17 million.

The Guarantor's contributions for the period 1 April 2015 to 31 March 2018 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 the valuation report dated 4 December 2014.

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 2014 valuation were as follows:

Assumption	Description
Price Inflation (CPI) (deferreds and pensioners)	Bank of England implied inflation (RPI) curve less 0.8% p.a
Discount rate (deferreds and pensioners)	Bank of England nominal yield curve

Actuarial Statement for 2014/15

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI_2012 model, assuming the current rate of improvements has reached a peak and will converge to long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	24.5 years	25.4 years
Future Pensioners*	26.8 years	28.6 years

*Future pensioners are assumed to be aged 45 at the 2014 valuation

Copies of the 2014 valuation report and Funding Strategy Statement are available on request from The City of Edinburgh Council, the Administering Authority to the Fund.

Experience over the period since April 2014

The administering authority monitors the funding position on a regular basis as part of its risk management programme. At the time of writing the funding level is estimated to be 92%, an increase of 3% since the formal funding valuation at 31 March 2014.

The next actuarial valuation will be carried out as at 31 March 2017. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden FFA

Fellow of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

1 June 2015

Statement of accounting policies and general notes

1 Basis of preparation

The Statement of Accounts summarises the transactions of the Funds for the 2014/15 financial year and their position at year-end as at 31 March 2015. The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 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.

Employer deficit funding contributions are accounted for on the due date on which they are payable under the scheme actuary.

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.

Statement of accounting policies and general notes

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.

Rental income is reported gross with the operational costs of the properties included in investment management expenses.

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.

Statement of accounting policies and general notes

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 to recognise investment management costs that are deducted from the value of an investment and recognised this 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 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.

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 section f) 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.

Statement of accounting policies and general notes

- 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 the 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.

Statement of accounting policies and general notes

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 an 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 Accounting Standards that have been issued but not yet adopted

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This applies to the adoption of the following new or amended standards within the 2014/15 Code:

- IFRS 7 Financial Instruments: Disclosure
- IFRS 9 Financial Instruments
- IFRS 13 Fair Value Measurement
- IAS 1 Presentation of Financial Statements
- IAS 19 Employee Benefits

The IFRS and IAS improvements are generally minor, principally providing clarification. Overall, these new or amended standards are not expected to have a significant impact on the financial statements.

4 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.

Statement of accounting policies and general notes

For the Lothian Pension Fund, the value of unquoted private equity, infrastructure and timber investments at 31 March 2015 was £564.2m (2014 £527.2m).

For the Lothian Buses Pension Fund, the value of unquoted private equity, infrastructure and timber investments at 31 March 2015 was £15.9m (2014 £11.3m).

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.

5 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 2015 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 2015	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in discount rate	11	706
1 year increase in member life expectancy	3	200
0.5% increase in salary increase rate	4	251
0.5% increase in pensions increase rate	7	436

Statement of accounting policies and general notes

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 2015	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in discount rate	11	42
1 year increase in member life expectancy	3	12
0.5% increase in salary increase rate	4	14
0.5% increase in pensions increase rate	7	27

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 2015	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in discount rate	6	8
1 year increase in member life expectancy	3	4
0.5% increase in pensions increase rate	6	8

b) Valuation of 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.

c) Quantifying the cost of investment fees deducted from capital Uncertainties

Section g) above describes the accounting policy for investment management expenses in relation to expenses deducted from the capital value of investments. Quantification of these costs involves asking the relevant managers for information and only some of this information can be independently verified. In cases where the charges relate to an investment as a whole, an estimate needs to be made of the costs applicable to the holding owned by the relevant Fund.

Effect if actual results differ from assumptions

There is a risk that the cost of investment fees deducted from capital may be under or overstated. However, as the costs are included in the fund account by adjusting the change in market value of investments, any inaccuracy in the cost estimate will not change the reported net change in the fund for the year.

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 2015).

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 2015, and their income and expenditure for the year ended 31 March 2015.

JOHN BURNS, FCMA CGMA

Pensions and Accounting Manager

24 June 2015

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 statutory duty under the Local Government in Scotland Act 2003, to make arrangements to secure best value, which is defined as 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 adopted a Local Code of Corporate Governance that is consistent with the principles of the Chartered Institute of Public Finance and Accountancy (CIPFA) and Society of Local Authority Chief Executives (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.

This statement explains how the Council has complied with the Local Code of Corporate Governance and how it meets the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom.

The Governance Framework

The governance framework comprises the systems, processes, cultures and values by which the Council is directed and controlled. It also describes the way it engages with, accounts to and leads its communities. It enables the Council and Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund (the "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 framework is intended to meet the principles of effective governance.

The Funds place reliance upon the internal financial controls within the Council's financial systems and the monitoring in place to ensure the effectiveness of these controls. The relevant key elements of the Council's corporate governance framework, with specific additional reference as appropriate to the arrangements for the Funds, are set out below:

- The Council's key corporate vision and priorities are set out and published in the City of Edinburgh Council Business Plan 2015-2018.
- The Council's revenue budget framework underpins the Council's long term financial plan and strategic planning framework, enabling it to manage expected future costs and service demands, aligning service delivery to the Council's Transformation and Improvement Plan to address these demands and deliver best value from available resources.
- The Corporate Programme Office provides a single and central structure with oversight of all significant Council projects over £5 million.
- A performance management framework, incorporating internal and public performance reporting, enables the Council to regularly report performance in achieving its key corporate objectives.

Annual Governance Statement

- The submission of reports, findings and recommendations from Audit Scotland, the external auditor, other inspectorates and internal audit, to the Corporate Leadership Group, Governance, Risk and Best Value Committee and Council, and to the Pensions Committee and Pensions Audit Sub-Committee for all matters affecting the Funds, where appropriate, supports effective scrutiny and service improvement activities.
- The roles and responsibilities of Elected Members and Officers are defined in Procedural Standing Orders, Committee Terms of Reference and Delegated Functions, Contract Standing Orders, Scheme of Delegation to Officers, the Member/officer protocol and Financial Regulations. These are subject to annual review.
- The Chief Executive has overall responsibility to Council, as head of paid service, for all aspects of operational management.
- The Director of Corporate Governance has overall responsibility for ensuring the continued development and improvement of systems and processes concerned with ensuring appropriate direction, accountability and control.
- The Head of Finance as section 95 Officer has overall responsibility for ensuring appropriate advice is given to the Council on all financial matters, keeping proper financial records of accounts and maintaining an effective system of internal financial control. For the Funds, the Section 95 officer has sub-delegated responsibility to the Pensions and Accounting Manager.
- The Chief Internal Auditor has overall responsibility to review, appraise and report to management and the Governance, Risk and Best Value Committee, and for pension fund matters to the Pensions Committee and Pensions Audit Sub-Committee, on the adequacy of the Council's internal control and corporate governance arrangements and on risks relating to approved policies, programmes and projects.
- The Director of Corporate Governance has responsibility for advising the Council on corporate governance arrangements.
- The Governance, Risk and Best Value Committee, and for pension fund matters, the Pensions Committee and Pensions Audit Sub-Committee, provides the Council with independent assurance of the adequacy of the governance and risk management frameworks and internal control environment. It also provides independent scrutiny of the Council's financial and non-financial performance, approves and monitors the progress of the Internal Audit risk based plan, and monitors performance of the internal audit service.
- The risk management policy and framework set out the responsibilities of elected members, Governance, Risk and Best Value Committee, and for pension fund matters, the Pensions Committee and Pensions Audit Sub-Committee, management and staff for the identification and management of risks to corporate and service related priorities;
- The Community Risk Register, Council Risk Register and Service area risk registers identify risks and proposed treatment or actions. These registers are regularly reviewed, updated and reported to the Corporate Leadership Group, which reviews Council-wide risk and reports to the Governance, Risk and Best Value Committee for scrutiny and challenge.
- Resilience and business continuity plans are in place for all essential Council services. These set out arrangements for continuing to deliver essential services in the event of an emergency or other disruption.
- Senior management and heads of service have formal objectives, with performance reviewed by the appropriate chief officer. Officers have personal work objectives, and receive feedback on their performance through the Council-wide performance review and development process.
- An Elected Members remuneration and expenses scheme is in place and is consistent with the Scottish Government's 'Councillors Remuneration: allowances and expenses – Guidance'. Information on the amounts and composition of elected members salaries, allowances and expenses is published on the Council's website.
- The Council's Director of Corporate Governance ensures that induction training on roles and responsibilities, and ongoing development opportunities, are provided for Elected Members.
- Codes of Conduct that set out the standards of behaviour expected from Elected Members and officers are in place.

Annual Governance Statement

- The Employee Code of Conduct, Anti Bribery Policy and Policy on Fraud Prevention set out the responsibilities of officers and Elected Members in relation to fraud and corruption, and are reinforced by the Councillors' Code of Conduct, the Code of Ethical Standards and the Financial Regulations.
- The Whistleblowing policy provides a process for disclosure in the public interest about the Council and its activities by officers, Elected Members and others.
- A Register of Members' Interests and Registers of Officers' interests are maintained and available for public inspection.
- Identifying the objectives of the Funds in the Funding Strategy Statement, Statement of Investment Principles and Service Plan;
- A systematic approach to monitoring service performance by the Pensions Committee, Pensions Audit Sub-Committee, senior officers and stakeholders, including the Consultative Panel and Independent Professional Observer;
- A structured programme to ensure that Pensions 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 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 pension funds.

A significant element 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 Council's objectives, including those relevant to the Funds. Following the establishment of the wholly-owned subsidiary company, LPFE Limited, the Council continues to have appropriate assurance processes and procedures in relation to the responsible officers involved in the administration of the Funds.

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 Director of Corporate Governance has reviewed the effectiveness of the Code and will report the result to the Governance, Risk and Best Value Committee in August 2015.

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 reported 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 review of the effectiveness of the governance framework is informed by:

- The work of the Corporate Leadership Group which develops and maintains the governance environment;
- The certified annual assurance statements provided by all directors;
- The certified assurance statements provided by the Chief Executives and Directors of Finance of the Council's Group companies, together with the work of each company's respective external (and where applicable, internal) auditors;
- Council officers' management activities;
- The Chief Internal Auditor's annual report and internal audit reports, risk based, across a range of Council services;

Annual Governance Statement

- Reports from the Council's external auditor; and
- Reports by external, statutory inspection agencies.

In compliance with standard accounting practice, the Head of Finance has provided the Chief Executive with a statement of the effectiveness of the Group's internal financial control system for the year ended 31st March 2015. It is the Head of Finance's opinion that reasonable assurance can be placed upon its effectiveness. The Pensions and Accounting Manager has provided the same in respect of the Funds.

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 that we need to continue to address:

- the mitigation of risks associated with the Council's transformation process, including structural and operating model changes;
- the Best Value audit actions: transformational change, corporate working, workforce, ICT, risk management and scrutiny, staff engagement and budget;
- the processes to ensure compliance with policies and procedures;

- the processes to ensure compliance with health and safety legislation, regulations and guidance;
- the implementation of actions identified in internal audit reviews;
- the implementation of all other actions identified by service directors in statements of assurance.

Accordingly, such matters relevant to the Funds will be also be progressed, including the implementation of actions identified in internal audit reviews and appropriate risk mitigation measures.

Certification

It is our opinion based on the foregoing that reasonable assurance can be placed upon the adequacy and effectiveness of the systems of governance operated by the City of Edinburgh Council that relate to the arrangements for the Funds. The annual review has shown that, with the exception of those matters listed above, the arrangements are in place and operating as planned.

SUE BRUCE
Chief Executive
24 June 2015

ALASTAIR MACLEAN
Director of Corporate Governance
24 June 2015

COUNCILLOR ALASDAIR RANKIN
Convener of Pensions Committee
24 June 2015

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
- Annual Report and Accounts
- Statement of Investment Principles
- Pension Admin strategy
- Communications strategy
- Funding Strategy Statement
- Service Plan
- Trustee training policy
- Pension Admin strategy

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 and 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 and Prudential
Property valuations:	CB Richard Ellis Ltd
Solicitors:	Dedicated in-house resource

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.

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Web: www.lpf.org.uk

Fax: 0131 529 6229

Lothian Pension Fund
Atria One
144 Morrison Street
Edinburgh
EH3 8EX



Internal Audit Annual Report and Opinion for the Year Ended 31 March 2015

Item number

Report number
Executive/routine
Wards

Executive summary

This report provides the Internal Audit Annual Report and Opinion based on Internal Audit activity undertaken for the financial year ended 31 March 2015.

This report details the scope of internal audit, the opinion for the year ended 31 March 2015 and a note on the role and limitations of internal audit. This report is prepared per the requirement set out in the Public Sector Internal Audit Standards (PSIAS).

Links

Coalition pledges	P30
Council outcomes	CO25
Single Outcome Agreement	All

Internal Audit Annual Report for the Year Ended 31 March 2015

Recommendations

- 1.1 It is recommended that the Committee note the internal audit opinion for the year ended 31 March 2015.

Background

- 2.1 The Public Sector Internal Audit Standards (PSIAS) requires that the Chief Internal Auditor delivers an annual opinion to the Pension Committee that can be used to inform the organisation's Annual Governance Statement. The purpose of this report is to present Internal Audit's opinion on the overall adequacy and effectiveness of the Lothian Pension Fund's framework of governance, risk management and controls, as relevant to our internal audit work performed for the financial year 1 April 2014 to 31 March 2015.
- 2.2 Whilst this report is a key element of the framework designed to inform the Annual Governance Statement, there are also a number of other important sources to which the Pension Committee should look to gain assurance. This report does not supplant the Pension's Committee's responsibility for forming their own view on governance, risk management and control.

Main report

Opinion

- 3.1 Internal Audit have not identified any fundamental weaknesses in the framework of governance, risk management and control at the Lothian Pension Fund which would put the achievement of organisational objectives at risk, nor significant non-compliance with controls that would put the achievement of organisational objectives at risk.

However, based on our work performed in the year (set out below), the management recommendations that remain outstanding at the date of this report, and the work performed during the year over governance, risk management and controls at the City of Edinburgh Council, Internal Audit considers that there are some weaknesses in the framework of governance, risk management and control which could potentially put the achievement of organisational objectives at risk if not addressed and there are some instances of non-compliance with controls that may put the achievement of organisational objectives at risk if not addressed.

We consider that addressing the matters identified will further enhance the

adequacy and effectiveness of governance, risk management and control.

- 3.2 This opinion is subject to the inherent limitations of internal audit (covering both the controls environment and the assurance over controls) as set out in Appendix 1.

Basis of opinion

- 3.3 Our opinion is based solely on our assessment of whether the governance, risk management and controls in place support the achievement of the Fund's objectives.
- 3.4 We have conducted two specific Pension Fund Reviews during the year;
- 'Scheme of Delegation'
 - 'Pension Administration'
- 3.5 The 'Scheme of Delegation' review identified one finding, graded medium, in connection with the authorisation of batch transactions (where an individual transaction is implemented in smaller tranches). The Custodian's Portal (Trade Capture) did not enforce authorisation of funds transfers in batch transactions. This recommendation is now closed after Trade Capture was upgraded to ensure that all batch transactions require authorisation in line with the Scheme of Delegation.
- 3.6 The 'Pension Administration' review identified two findings, both graded medium. The first was in connection with superuser access to the Fund's IT Operating system Altair and the second related to the performance of monthly reconciliations from scheme employers. The former recommendation was closed following the implementation of process to monitor superuser activity. The latter recommendation remains open although Management have had some success in moving Fund members towards providing the information that the Fund requires to allow monthly reconciliations
- 3.7 We have considered the effect of any changes in the Funds's systems & objectives as well as the level of resources available to Internal Audit. Given the Fund's dependence on the Council for a number of support services, we have also considered the results of the work that we performed on the governance, risk management and controls in place at the City of Edinburgh Council and the weaknesses in the framework of governance, risk management and control which that work identified.

Conformance with Public Sector Internal Audit Standards

- 3.8 From 1st April 2013, new Public Sector Internal Audit Standards (PSIAS) came into effect. These were jointly developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Chartered Institute of Internal Auditors (CIIA). These standards require as to report annually on conformance. The PSIAS replaced the 2006 CIPFA Code of Practice for Internal Audit in Local

Government in the UK as the mandatory guidance and provide a coherent and consistent internal audit framework for the whole of the public sector.

3.9 CIPFA has prepared a Local Government Application Note and a Checklist for Assessing Conformance with the PSIAS in order to allow internal audit teams to evaluate the effectiveness of Internal Audit's performance. The Checklist, which contains 334 best practice questions was completed in Q3/Q4 2014 as part of the Internal Audit team's quality programme.

3.10 The completion of the check list identified 192 questions where the Internal Audit team could not demonstrate conformance with the CIPFA Guidance. In the majority of these cases the Internal Audit team was substantially complying with the requirements but did not have documented evidence immediately available to demonstrate compliance. Internal Audit identified the areas of significant actual non-compliance with the PSISAs set out below

- The Internal Audit Charter was obsolete and required a number of amendments to incorporate specific PSIAS requirements;
- The Internal Audit manual was obsolete and required a number of amendments to incorporate specific PSIAS requirements;
- The 2013/14 Internal Audit annual planning process considered risk when determining areas for review however this was informal and did not demonstrate clear linkage to organisational objectives and priorities;
- No formal Quality Assurance and Improvement Programme had been put in place subsequent to the expiry of the ISO 9001/2008 accreditation;
- The Internal Audit team had not evaluated the Risk function and Risk Management processes within the Fund.

3.11 A remediation exercise was undertaken in Q4 2014 & Q1 2015 to remediate (where possible) the areas of non-compliance and address the deficiencies in documentary evidence. For 2015/16 we expect to be compliant with the PSISAs with the exception of evaluating the Risk function and Risk Management processes within the Fund, as under the current structure, the Internal Audit function is not sufficiently independent to evaluate the Risk function. As the Internal Audit team matures, we expect to move towards a position of greater independence.

3.12 As part of our Quality Assurance and Improvement Programme, we are scheduled to reassess our conformance with the CIPFA Local Government Application Note and Checklist in Q3 2015.

Quality Assurance and Improvement Programme

3.13 The PSIAS require that a quality assurance and improvement programme (QAIP) is developed that covers all aspects of the internal audit activity, and that the results of this programme are included in the Internal Audit annual report. The QAIP must include both annual internal assessments and external assessments at least every 5 years.

3.14 As noted at 3.10 above, subsequent to the expiry of the ISO 9001/2008 accreditation no formal quality assurance programme had been put in place. A QAIP was developed in Q4 2015/Q1 2015 and will be effective for the 2015/16

audit year. The QAIP, as required by the PSIAS has been developed to include both periodic internal and external assessments.

- 3.15 Internal Assessments must include ongoing monitoring of the performance of the internal audit activity and periodic self-assessments. Ongoing monitoring is an integral part of the day-to-day supervision, review and measurement of the internal audit activity, and is incorporated in the routine policies and practices used to manage the internal audit activity. All work is reviewed by qualified staff prior to being issued to ensure it is of sufficient quality and complies with the methodology set out in the Internal Audit Manual.
- 3.16 The requirement for the periodic self-assessment will be met by;
- The completion of quality reviews checklists on a sample of reviews to ensure that they comply with the Audit Manual. These reviews will be undertaken by a team member independent of the reviews;
 - Bi-annual compilation of feedback received from clients on completed reviews to identify any trends emerging;
 - Analysis of Internal Audit KPI trends; and
 - An annual self review of compliance with the PISA via reviewing our conformance with the CIPFA Local Government Application Note and Checklist in Q3 2015.
- 3.17 External assessments must be performed every 5 years with the current longstop date being 31 March 2018. It is currently envisaged that we will join the External Quality Assessment (EQA) process of peer reviews that has been proposed by the Scottish Local Authorities Chief Internal Auditors Group. The scope of external assessments will be agreed with the Convenor Governance, Risk & Best Value Committee and the external assessor prior to work commencing.

Measures of success

- 4.1 Effective governance, risk management and internal control within the Lothian Pension Fund.

Financial impact

- 5.1 No direct financial impact.

Risk, policy, compliance and governance impact

- 6.1 No direct impact.

Equalities impact

7.1 No direct impact.

Sustainability impact

8.1 No direct impact.

Consultation and engagement

9.1 None.

Background reading/external references

10.1 .Public Sector Internal Audit Standards – Applying the IIA International Standards to the UK Public Sector.

Magnus Aitken

Chief Internal Auditor

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Links

Coalition pledges	P30
Council outcomes	CO25
Single Outcome Agreement	All

Appendix 1 – Limitations and responsibilities of internal audit and management responsibilities

Limitations and responsibilities of internal audit

The opinion is based solely on the internal audit work performed for the financial year 1 April 2014 to 31 March 2015. The work addressed the Terms of Reference agreed for each individual internal audit assignment as set out in the individual assignment reports. However, where other matters have come to the attention of Internal Audit which is considered relevant, they have been taken into account when forming the opinion.

There might be additional weaknesses in the system of internal control that were not identified because they did not form part of the programme of work, were excluded from the scope of individual internal audit assignments or were not brought to Internal Audit's attention. As a consequence Management and the Committee should be aware that the opinion may have differed if the programme of work or scope for individual reviews was extended or other relevant matters were brought to Internal Audit's attention.

Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

Future periods

The assessment of controls relating to the Fund is for the year ended 31 March 2015. Historic evaluation of effectiveness may not be relevant to future periods due to the risk that:

- the design of controls may become inadequate because of changes in operating environment, law, regulation or other; or
- the degree of compliance with policies and procedures may deteriorate.

Responsibilities of Management and Internal Audit

It is Management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal audit work should not be seen as a substitute for Management's responsibilities for the design and operation of these systems.

Internal Audit endeavour to plan its work so that it has a reasonable expectation of detecting significant control weaknesses and, if detected, it carries out additional work directed towards identification of consequent fraud or other irregularities. However, internal audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected, and examinations by internal auditors should not be relied upon to disclose all fraud, defalcations or other irregularities which may exist.

The City of Edinburgh Council

Statement on the system of internal financial control

1. This statement is given in respect of the internal financial controls operated by The City of Edinburgh Council. As the Council's designated section 95 officer as defined under the provisions of the Local Government (Scotland) Act 1973, I acknowledge my responsibility for ensuring that an effective system of internal financial control is put in place and its effectiveness regularly reviewed.
2. The system of control can provide reasonable, but not absolute, assurance that material control weaknesses or irregularities do not exist, and that there is no unacceptable risk of material error, loss, fraud or breach of legislation. Consequently, the Council continually seeks to improve the effectiveness of its systems of internal control so that irregularities are either prevented or detected within an acceptable period of time.
3. The system of internal financial control is based on a framework of regular management information, financial rules and regulations, administrative procedures (including segregation of duties), management supervision and a scheme of delegation and accountability. The system is maintained and developed by Council management and includes:
 - comprehensive budgeting systems;
 - preparation and regular review of periodic financial reports that measure actual financial performance against forecasts. For 2015/16, the effectiveness and regularity of this review is being enhanced through more systematic monitoring and scrutiny of the delivery of approved savings and management of budget pressures by the Corporate Leadership Group (CLG) and elected members;
 - agreement of targets against which financial and operational performance can be assessed;
 - clearly-defined capital expenditure guidelines communicated to services and set out in the Finance Rules;
 - an approved long-term financial strategy and plan, updates in respect of which are regularly discussed at the CLG and reported to the Finance and Resources Committee;
 - formal project management disciplines as supported and promoted by the Corporate Programmes Office, including senior Finance representation on all major project boards and assurance review panels; and
 - formal governance arrangements operated within both subsidiary and associated companies.
4. The Internal Audit section operates in accordance with the Chartered Institute of Public Finance and Accountancy's United Kingdom Public Sector Internal Audit Standards. The Section undertakes an annual programme based on an agreed audit strategy. The plan is based on formal assessments of risk and audit needs which are reviewed regularly to reflect evolving risks and changes within the Council. During 2014/15, the section reported to the Head of Legal, Risk and Compliance. However, it also has free access to the Chief Executive, Directors, Heads of Service (including the Head of Finance) and elected members of the Council when required. The Chief Risk Officer has provided an assurance statement that includes his opinion on the adequacy and effectiveness of the system of internal financial control.

5. My review of the effectiveness of the internal financial control system is informed by:
- assurance certificates on internal control received from all Directors of Council service areas;
 - governance arrangements in place for subsidiary and associated companies and an ongoing assessment of the effectiveness of these arrangements;
 - the work of managers within the Council;
 - the work of internal audit; and
 - external audit reports, in particular the independent annual reports on the Council's financial statements and internal control framework.
6. The Council's financial management arrangements conform with the governance requirements of the CIPFA Statement on the Role of the Chief Financial Officer (2010) as set out in the Application Note to Delivering Good Governance in Local Government Framework. Having reviewed the framework, it is my opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Group's systems of internal control.
7. I have overseen the programme of work undertaken in response to an independent review of the effectiveness of internal controls in May 2012, resulting in a number of specific measures being put in place to improve the overall robustness of the financial control framework. Implementation of these improvements has been regularly reported to the Governance, Risk and Best Value Committee and the extent of progress independently verified in January 2014. These improvements will be further strengthened and embedded through implementation of the steps contained within the resulting action plan. I have also overseen the improvements put in place in response to other recommendations made by internal and external audit work during the year.
8. I have furthermore overseen work consolidating the Council's long-term financial planning arrangements and mitigating the effects of the economic downturn across the Group, recognising the need to keep these matters under review. While a balanced overall position against the Council's budget was again delivered in 2014/15, a significant overspend was nonetheless apparent in Health and Social Care. I have therefore already prioritised in 2015/16 the strengthening and enforcement of existing financial controls, as well as re-instilling necessary wider financial discipline within the service to re-establish the basis of financial sustainability going forward.


Hugh Dunn

Head of Finance

3 June 2015

Lothian Pension Funds Annual Report 2015

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 2015.

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 3 June 2015, refers.

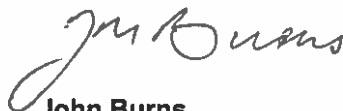
Within this overall control framework, specific arrangements for the Lothian Pension Funds also include:

- 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 Chief Internal Auditor has provided an assurance statement on the effectiveness of the system of internal control. 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.



John Burns
Pensions & Accounting Manager

Date: 09 June 2015

Pensions Committee

2.30 p.m., Wednesday, 24 June 2015

Statement of Investment Principles

Item number	5.7
Report number	
Executive/routine	
Wards	All

Executive summary

The City of Edinburgh Council agreed on 12 March 2015 to ask the Convener of the Pensions Committee to request a report on the potential impact to the Funds of divesting in fossil fuels. This report addresses this request.

It also presents an updated Statement of Investment Principles for the Lothian Pension Fund, Lothian Buses Fund and Scottish Homes Pension Fund (the Funds') for agreement by Committee.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Statement of Investment Principles

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 That the Committee notes the potential impact of divesting in fossil fuels.
- 1.3 That the Committee adopts the revised Statement of Investment Principles.

Background

- 2.1 At its meeting on 12 March 2015, the City of Edinburgh Council decided the following:

“This Council:

1. Notes the recent decision by the City of Oslo to partially divest from fossil fuel investments, and further notes that Oslo joins a growing number of cities and institutions around the world, including Oxford City Council, Dunedin City Council in New Zealand and the University of Glasgow, to agree to partially or completely divest from fossil fuels;
2. Notes the report to Corporate Policy and Strategy Committee on 3 December 2013 on Lothian Pension Fund Engagement Activities which set out the current arrangement for reviewing the social and environmental impact of the three Local Government Pension Funds under the Council's administration which concludes that the fiduciary duty must be paramount in all decision making around the funds;
3. Notes that recent studies, including by Impax Asset Management, have found that fossil fuel-based funds may underperform funds which exclude fossil fuels, and further notes reports including from business leadership think-tank Ceres which identify substantial unreported risks in fossil fuel funds, which suggest the fiduciary duty may be best served by divestment from fossil fuels;
4. Notes recent clarification from Cabinet Secretary for Finance John Swinney MSP that local authorities may decide that fulfilment of their Public Bodies Duties under the Climate Change (Scotland) Act 2009 requires them to reduce the carbon emissions associated with their funds and investments;
5. Calls for a report to Corporate Policy and Strategy Committee within three cycles setting out the feasibility, costs and benefits of introducing a partial or complete fossil fuel divestment strategy.

6. Asks the Convener of the Pensions Committee to request a report, on the potential impact to the fund of divesting in fossil fuels, to be brought forward to that Committee in the next quarter.
 7. Instructs the Head of Finance to review these proposals in the context of the Council's ethical investment policy."
- 2.2 This report addresses the request for a report under item 6 above on "the potential impact to the fund divesting in fossil fuels".
 - 2.3 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). This report also presents an updated SIP.

Main report

Divestment in Fossil Fuels

- 3.1 In advance of UN climate talks in Paris in December 2015, groups concerned about the potential effects of climate change have been campaigning for institutional investors, such as pension funds and university endowment funds, and other investors to sell their investments in fossil fuel companies.
- 3.2 The debate centres on "stranded assets", the risk that the fossil fuel reserves of companies are devalued by future carbon regulation. The issue is whether fossil fuel companies will be able to extract and monetise their oil, gas and coal reserves if climate regulation is increased. If the reserves cannot be extracted they will become "stranded assets" and form a "carbon bubble".
- 3.3 Some institutions have adopted varying degrees of fossil fuel divestment goals and other institutions have rejected divestment. The Council's decision refers to the decisions of several public bodies and institutions, which have agreed to partial or complete divestment. It is reported that:
 - City of Oslo committed to selling its pension fund investments in coal companies¹;
 - Oxford City Council pledged to make no direct investments in fossil fuel companies for ethical reasons. The Oxfordshire Pension Fund Committee manages the scheme on behalf of over 100 employers, including the county and city councils. The Committee determined that there was no clear financial justification for divesting in fossil fuel companies.²

¹ <http://www.theguardian.com/environment/2015/mar/02/oslo-divests-from-coal-companies>

² <http://www.oxfordshireguardian.co.uk/petition-calls-on-county-council-to-start-divesting>

- Dunedin City Council in New Zealand voted not to invest in fossil fuel extraction companies as part of an ethical policy that also excludes munitions, tobacco, gambling and pornography industries. It committed to divest the Waipori Fund, a Council fund, of any such investments within two years.³
- The University of Glasgow has committed to fully disinvesting from fossil fuel industry companies over a 10 year period, subject to reassurance that the financial impact for the University is acceptable.⁴

3.4 In addition, Council noted clarification by John Swinney MSP around local authorities' fulfilment of their Public Bodies Duties under the Climate Change (Scotland) Act 2009. However, to date no change has been made to the guidance provided by Scottish Ministers to Public Bodies under the Climate Change (Scotland) Act 2009.

Fiduciary Duty

- 3.5 The Council noted a 3 December 2013 report highlighting that fiduciary duty must be paramount in all decision making around the (pension) Funds. This is embodied in the Fund's Statement of Investment Principles.
- 3.6 In April 2014, the Local Government Association on behalf of the Local Government Pension Scheme (LGPS) Shadow Scheme Advisory Board in England and Wales obtained legal opinion⁵ on fiduciary duty. One of the conclusions was that "the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as that does not risk material financial detriment to the fund."
- 3.7 The Law Commission (England & Wales) also produced a report on "Fiduciary Duties of Investment Intermediaries"⁶ in 2014. The Law Commission concluded that, while the pursuit of a financial return should be the predominant concern of pension trustees, the law is sufficiently flexible to allow other, non-financial, concerns to be taken into account provided trustees have good reason to think that scheme members share their view, and there is no risk of significant financial detriment to the fund.
- 3.8 Whilst these developments do not strictly speaking apply to the Scottish Local Government Pension Scheme (LGPS), it can be reasonably concluded that the developments will have a strong influence. The workplan for the LGPS Scheme Advisory Board in Scotland includes consideration of fiduciary duty.

³ <http://www.odt.co.nz/news/dunedin/302183/agreement-ethical-investment>

⁴ http://www.gla.ac.uk/news/headline_364008_en.html

⁵ <http://www.lgpsboard.org/images/PDF/Publications/QCOpinionApril2014.pdf>

⁶ http://lawcommission.justice.gov.uk/docs/lc350_fiduciary_duties.pdf

- 3.9 Following the Law Commission report, the UK government launched a consultation⁷ on the Occupational Pension Schemes (Investment) Regulations (“The Investment Regulations”), which closed on 24 April 2015. The government response is expected later in 2015.

The Fund will continue to monitor developments in the interpretation of fiduciary duty and potential changes to investment regulations. For example, how can funds conclude that members share a particular view and balance this against complying with their fiduciary duty and the potential challenges.

Current Investment Approach

- 3.10 Currently, the Fund’s primary approach is to appoint investment managers who are expected to judge each investment on a number of factors, such as risk and return. As responsible investors, environmental, social and governance (ESG) issues are included in this process.
- 3.11 The Funds do not have a policy of divestment or exclusion. Rather, the policy is to consider ESG issues in the investment considerations. Further, the Fund engages with companies in order to manage any ESG risks, encourage greater transparency and encourage positive change as a shareholder. The Funds collaborate with other investors to improve the chances of successful engagement. The Funds also vote on all their shares.
- 3.12 Engagement provides the opportunity for the Fund to gain greater disclosure of a company’s risk of exposure to low carbon scenarios and potentially stranded assets. It also provides the opportunity to influence companies’ consideration of capital expenditure and lobbying against climate change policy.
- 3.13 For example, the Funds recently supported the “Aiming for A” resolutions on climate change resilience at the BP, Shell and Statoil AGMs. These special resolutions called for further reporting on ongoing operational emissions management, asset portfolio resilience to the International Energy Agency’s scenarios, low carbon research and development and investment strategies, relevant key performance indicators and executive incentives, and public policy positions relating to climate change.
- 3.14 Arguably divestment would remove that access to company management and would not change global levels of supply and demand of fossil fuel production. Divestment results in shares being sold to other investors, who may be less concerned about climate change and less inclined to engage with management to change behaviour for the better.

⁷ <https://www.gov.uk/government/consultations/changes-to-the-law-on-investments-in-occupational-pension-schemes>

Investment Considerations

- 3.15 From an investment perspective, the Funds own shares in companies as part of their strategies to achieve the primary goal of paying pensions over the life of the Funds. For example, equity investments constitute approximately two thirds of Lothian Pension Fund's assets and they generate a return from capital growth and the payment of dividends.
- 3.16 There is no recognised list of "fossil fuel" companies proposed as targets for divestment by campaigners. Analysis of the Fund's holdings using two different industry classifications shows that the Lothian Pension Fund and Lothian Buses Pension Fund own shares in:
- 29 companies in the GICS energy sector worth approximately £151m (equivalent to 3%);
- or using an alternative classification:
- 19 companies in the Carbon Underground 200 worth approximately £113m (equivalent to 2%). (These companies overlap).
- 3.17 The Funds appoint managers to invest in companies using a number of different investment strategies in order to achieve a diversification and the 'fossil fuel' companies (noted above) are held across a number of portfolios, managed both internally and externally. Managers are not compelled to hold any specific shares. Some managers undertake fundamental analysis of individual companies including forward-looking projections including consideration of ESG issues. Other managers select companies using quantitative analysis which is, by its nature, based on historic information.
- 3.18 It is also worth noting that the Funds also hold renewable energy investments. The Fund made its first investment in renewable/clean energy in 2006. At 31 December 2014, it had committed over £20m to renewable energy focused funds and approximately 28% of the Fund's infrastructure investments (£268m) are in renewable energy projects, including wind, water, solar, biogas and waste management. Two further commitments have been made to renewable energy investments this year. The Fund also invests in sustainable timberlands with Forest Stewardship Council or equivalent certification, having made over £80m of commitments since 2010.

Impact of Disinvestment from Fossil Fuels

- 3.19 As the Fund's primary aim is to pay pensions, its primary concern is the financial impact of divesting. There are three main types of costs of divestiture.
- 3.20 **Trading Cost:** disinvestment involves selling shares and buying other shares, both of which involve the payment of broker commissions, bid-ask spreads (the difference between the price to sell and the price to buy the same share),

exchange fees and taxes, such as stamp duty. The Fund's experience and industry studies show that processing and execution costs⁸ and the price impact⁹ of trading £150m of shares (selling £150m existing shareholdings and buying £150m of other shares) are significant. Some of the costs are fixed and some depend on market conditions at the time of trading. Total trading costs are estimated to be in the region of £1.5m and £2.5m. This would be a one-off cost.

- 3.21 **Compliance Cost:** as there is no definition of a 'fossil fuel' company, there could be significant cost involved in identifying shares to be sold, new shares to be bought and ongoing monitoring of shares to be included or excluded as investment criteria/exclusions are changed. Whilst a simple divestment programme could be instigated, there are practical issues. Individual companies' climate impacts change over time. Many of the obvious targets for divestment also invest in renewable energy; and other companies produce products that are complements for fossil fuels, such as car manufacturers and companies that provide support for fossil fuel production, such as banks. These complexities could be overcome by employing additional resource to develop and monitor 'fossil fuel' criteria or by appointing such specialist investment managers. This is an ongoing cost, which would depend on implementation approach.
- 3.22 **Diversification Cost:** according to widely-accepted financial theory, investors lose the benefits of diversification and suffer a lower investment return for a given level of portfolio risk whenever a category of shares is removed from a portfolio. To calculate this cost requires calculating the correlation of the category of shares with the rest of the portfolio over the long term. In a study¹⁰ (financed by the Independent Petroleum Association of America) Professor Daniel Fischel shows that the energy sector's low correlation with other sectors suggests that diversification costs could be high. This is necessarily a backward looking study (1965-2014), which showed that the diversification cost of divesting energy stocks was approximately 0.5% per year risk-adjusted. Over the fifty year period, the divested portfolio would have lost 23 percent due to divestment.
- 3.23 Of course, the future diversification cost cannot be known in advance as correlations and future performance will change. However, this is a potential cost and an ongoing cost, and as such all other things being equal, if investment performance disappoints, employer contributions would need to be higher.

⁸ Elkins/McSherry Bundled VWAP Global Universe 4Q12 Estimates.

⁹ Louis K.C. Chan & Josef Lakonishok (1995) "The Behavior of Stock Prices Around Institutional Trades," *Journal of Finance*, (4):1147-1174, at p. 1148.

¹⁰ http://divestmentfacts.com/pdf/Fischel_Report.pdf

Conclusion

- 3.24 Fiduciary duty remains paramount in all decision making around the pension funds. There have been some recent developments in the interpretation in fiduciary duty. However, they reinforce that the approach currently adopted by the Funds in incorporating environmental, social and governance issues in decision making is appropriate. It will be important to continue to monitor future developments in this area.
- 3.25 While the precise impact of divestment from fossil fuel companies is unknown, certain costs are guaranteed and the overall impact could be significant. To the extent that divestment reduces the Funds' investment return in the future as compared to one that retains the ability to invest in the shares of fossil fuel companies, there is risk to the employer contributions. Such an occurrence could be challenged, for example by employers and/or taxpayers to whom the financial burden would fall. This is a significant risk for the Funds.
- 3.26 Accordingly the revised Statement of Investment Principles (SIP), which is provided in the Appendix for approval, is largely unchanged from that agreed by Committee in June 2014. The SIP is formally reviewed annually whether there are policy changes or not. Changes are modest and include:
- updates in the investment management benchmarks, objectives and structures of the Funds reflecting the evolving investment strategies;
 - the role of the new Pension Board, which replaced the Consultative Panel on 31 March 2015;
 - the wording regarding responsible investments has been updated.

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 the Statement of Investment Principles report.
- 5.2 The report highlights that there is potentially a significant financial impact from divestment of fossil fuel companies.

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 Pension Board, comprising member and employer representatives, is integral to governance. The Statement is published on the Funds' website.

Background reading/external references

None

Alastair D Maclean

Director of Corporate Governance

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Appendices

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LOTHIAN PENSION FUND, LOTHIAN BUSES PENSION FUND and SCOTTISH HOMES PENSION FUND ('the Funds')

STATEMENT OF INVESTMENT PRINCIPLES (June 2015)

1. Introduction

- 1.1 This Statement of Investment Principles was agreed by the Pensions Committee of the City of Edinburgh Council on 24 June 2015.
- 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 environmental, social and corporate governance (ESG) issues 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 Pension Board
 - 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 for each Fund are documented in the Committee's Funding Strategy Statement.
- 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 The Lothian Pension Fund adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer. However some employers (typically those which have a short expected duration in the Fund) will be assumed to be invested in lower-risk investments i.e. index-linked government bonds. This aims to reduce the degree of short-term change in employer contribution rates in the period prior to an employer leaving the Fund. In addition it is recognised that there may also 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 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 Funds seek to control risk by investing in a diverse range of investments both domestically and globally. All investments are assessed consistently and include consideration of environmental, social and governance issues which affect financial risk and returns.

- 5.5 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

- 5.6 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

- 5.7 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

- 5.8 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

- 5.9 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 in a manner which is consistent with the paramount fiduciary duty to provide the highest standards of stewardship on behalf of the members, employers and tax-payers.
- 5.10 The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting.
- 5.11 As long term investors the Funds recognise the importance of promoting responsible stewardship and long term decision making. 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. The Funds' voting and engagement policies promote good governance and stewardship of companies.

Safekeeping of Assets

- 5.12 The services of a global custodian are employed to ensure the safekeeping of investments.

Performance measurement

- 5.13 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 have agreed 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

	Interim Strategy 01/04/15 (%)	Long Term Strategy 2012-2017 [1] (%)	Permitted Range [1] (%)
Total Equities	68	65	50 – 75
Index-Linked Assets	7	7	0 – 20
Alternatives	24	28	20 – 35
Cash	1	0	0 – 10
TOTAL	100	100	

[1] Revised strategy agreed by Committee October 2012, which will be implemented gradually over time.

Investment Management Structure at 30 April 2015

- 6 Global Equity Managers (external: Nordea, Cantillon, Harris; internal: 3 mandates)
- 6 Regional Equity Managers (external: Mondrian and UBS for Emerging Markets; 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 Index-Linked Manager (Internal)
- Alternative Investments include a range of direct funds, fund-of-funds and listed vehicles invested in infrastructure, debt, property and timber, some of which are managed internally.
- 1 Currency Manager (internal)
- 1 Cash Manager (managed alongside CEC cash)

The breakdown of assets by manager is provided in the Fund's Annual Report & Accounts which can be found at www.lpf.org.uk.

Lothian Buses Pension Fund

Investment Strategy

	Interim Strategy 01/04/15 (%)	Long Term Strategy 2012-2017 [1] (%)	Permitted Range [1] (%)
Equities	60.5	55	45-65
Index-Linked Assets	12.0	15	10-30
Alternatives	27.5	30	10-35
Cash	0	0	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 2015

- 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 include a range of direct funds, fund-of-funds and listed vehicles invested in infrastructure, debt, property and timber, some of which are managed internally.
- 1 Cash Manager (managed alongside CEC cash)

The breakdown of assets by manager is provided in the Fund's Annual Report & Accounts which can be found at www.lpf.org.uk.

Scottish Homes Pension Fund

Investment Strategy

Committee approved a change to the investment strategy in December 2014 whereby the equity and bond allocations are adjusted depending on the funding level in accordance with the following table:

Equity Allocation %	Funding level	Note [1]
35	89.5%	2011 TFL
30	91.5%	2014 TFL
25	93.0%	2017 TFL
20	94.5%	2020 TFL
15	95.5%	2023 TFL
10	96.5%	2026 TFL

[1] Target Funding Level as per the Guarantee

The strategy at 30 April 2015 is shown in the table below.

	Strategy at 30/04/2015 %
Equities	
UK	5.6
US	7.7
Europe (ex UK)	5.0
Pacific inc Japan	4.7
Emerging markets	2.0
Sub-total	25.0
Bonds	
UK Fixed Interest Gilts	14.1
UK Index Linked Gilts	55.9
Subtotal	70.0
Property	5.0
Cash	0.0
TOTAL	100.0

Investment Manager Arrangements at 30 April 2015

Equities: State Street.

Bonds: State Street and internal

Property: Schroders.

The breakdown of assets by manager is provided in the Fund's Annual Report & Accounts which can be found at www.lpf.org.uk.

Statement of Compliance with UK Stewardship Code

<p>Principle 1 Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.</p>	<p>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</p> <p>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.</p> <p>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.</p> <p>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</p> <p>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.</p> <p>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.</p> <p>Details are available at:- https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code/UK-Stewardship-Code-statements.aspx</p> <p>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.</p>
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Statement of Compliance with UK Stewardship Code

<p>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.</p>	<p>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.</p> <p>We also encourage the asset managers employed by the Funds to have effective policies addressing potential conflicts of interest.</p> <p>In respect of conflicts of interest within the Funds, Pensions Committee members are required to make declarations of interest prior to Committee meetings.</p> <p>Our policy of constructive engagement with companies is consistent with the Funds' fiduciary responsibilities.</p>
<p>Principle 3 Institutional investors should monitor their investee companies.</p>	<p>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.</p> <p>LAPFF also monitors and engages with companies and provides an 'Alerts' service which highlights concerns over corporate governance issues.</p> <p>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.</p>

Statement of Compliance with UK Stewardship Code

<p>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.</p>	<p>As highlighted above, responsibility for day-to-day interaction with companies is delegated, including the escalation of engagement when necessary.</p> <p>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.</p> <p>We may also propose escalation of activity through the Local Authority Pension Fund Forum.</p> <p>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.</p>
<p>Principle 5 Institutional investors should be willing to act collectively with other investors where appropriate</p>	<p>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:</p> <ul style="list-style-type: none"> - 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 Principles for Responsible Investment (PRI) and its Clearinghouse for engagements (as well as a number of more localised PRI initiatives); the International Corporate Governance Network; the Asian Corporate Governance Association; the Canadian Coalition for Good Governance , Eumedion and the NAPF. Hermes EOS seeks to work with these organisations and also alongside other individual investors to effect change most efficiently. - being a signatory of the 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

<p>Principle 6 Institutional investors should have a clear policy on voting and disclosure of voting activity.</p>	<p>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.</p> <p>Our preference is for managers to vote on the Funds' behalf and for responsible stewardship to be integral to the investment decision making process.</p> <p>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.</p> <p>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.</p> <p>Underpinning voting decisions are Hermes EOS Regional Corporate Governance policies which can be found at the "How we invest" section of our website.</p> <p>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.</p> <p>We disclose in arrears so that we are transparent and accountable but dialogue with companies in our portfolios is not compromised.</p>
<p>Principle 7 Institutional investors should report periodically on their stewardship and voting activities.</p>	<p>We report annually on stewardship activity through a specific section in the Funds' annual report and accounts and on our website.</p> <p>We also report annually on stewardship issues to the Pensions Committee.</p> <p>We have reviewed this Statement in June 2015. We will review the Statement annually.</p>
	<p>For further information please contact Marlyn.McConaghie@edinburgh.gov.uk</p>

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 members of the Pensions Committee and Pension Board) provides knowledge to be able to evaluate and challenge the advice they receive. 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 Pension Board also attends Committee meetings and is responsible for assisting the Committee in securing compliance with relevant regulations and other legislation.
- 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 advises the Director of Corporate Governance on the implementation of the agreed strategies, reviewing structure, funding monitoring, performance and risk and 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. A Code of Conduct applies to members of the Committee and the Pension Board. 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 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 a lower-risk investment strategy for their section(s) of the Fund may be deemed suitable. The Fund will also 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 assess the covenants of 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 assesses the external investment managers' performance and risk on a regular basis. The Investment Strategy Panel assess the performance and risk of the internal and external investment managers 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 and reports to Committee on its activities, typically annually.
- Training and attendance of members of the Pensions Committee and the Pensions Board are monitored and reported on a regular basis. The composition of the Committee and Pension Board 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 deputations at Committee meetings. Committee papers are available on the City of Edinburgh Council's website. The Pension Board 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

2.30 p.m., Wednesday, 24 June 2015

Investment Strategy Panel Activity

Item number	5.8
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 2015. The Terms of Reference for the Panel were agreed by the Pensions Committee in June 2014.

The focus of the Panel has been on the implementation of the investment strategies of the three pension funds. Panel and the internal team have focused on restructuring and reducing the equity asset exposure, increasing the allocation to alternative investments, researching available bond-related products and restructuring the Other Bond portfolio, reviewing currency hedging policy and de-risking the Scottish Homes Pension Fund. The Panel also continues to oversee the performance and asset allocation of the investments.

Links

Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

Investment Strategy Panel Activity

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 That Committee notes the activities of the Investment Strategy Panel during the financial year 2014/15.

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 2015.
- 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 Fund’s 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 The Panel considers 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 to ensure that scrutiny of portfolios is robust. 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. The traffic light monitoring was reviewed during 2014/15.

3.3 In addition to the regular agenda, at each meeting the Panel also considers special items. The primary focus for the Panel during 2014/15 has been the implementation of the investment strategies for all three pension funds agreed by Pensions Committee in October 2012 and the revised strategy for Scottish Homes Pension Fund, which was agreed by Pensions Committee in December 2014. This has involved:

- Detailed reviews and analysis of the internal team's research into complementary equity, bond and alternative investments that will produce improved and appropriate risk-adjusted returns;
- Oversight of internal portfolio management, including regular in-depth review of mandates. Internal mandates are subject to periodic scrutiny to assess whether they have achieved their objectives and to ensure the premise of the mandate remains sound. Where applicable, this includes external comparisons;
- Analysis of the impact of new strategies on the overall equities of the funds;
- Reviewing Fund objectives, benchmark indices and performance targets of individual mandates to ensure portfolios and their managers are aligned with the Fund objectives;
- Agreeing investment constraints for fund investments and benchmark allocation for Other Bonds;
- Analysis and oversight of the transitions of assets;

3.4 Other special items considered during 2014/15 included:

- Cash flow projections for unlisted assets;
- Review of currency hedging policy;
- Review of bond research;
- Review of AVCs;
- Draft Statement of Investment Principles;
- .

3.5 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 for Lothian Pension Fund and the Lothian Buses Pension Fund;
- Reduced funding level volatility for the Scottish Homes Pension Fund;
- Changes to the composition of the funds' bond holdings;
- A new internally managed global equity portfolio;
- Updated mandates for each of the investment portfolios including objectives and controls;

- Indicative timescales for further implementation of the investment strategies.
- 3.6 Each year, the Panel undertakes a self-assessment to review its effectiveness. The self-assessment in June 2014 resulted in the review of the mandate traffic lights (noted above) and the attendance of an independent adviser at the quarterly review meetings of internal mandates. The self-assessment in 2015 has highlighted the need for the Fund to ensure there is sufficient resource allocated to the Fund's bond investment which is expected to increase as the strategy is implemented further. In addition, Panel will also review the investment management costs in detail and will consider having a special meeting to review strategies later in the year.
- 3.7 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 2014/15, 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. This has included consideration of the most appropriate benchmark indices for individual mandates and specifically the suitability of that used for Alternative investments (Retail Price Inflation +3.5%p.a.). This review is continuing and its conclusion will be reported to Committee in due course.
- 3.8 The Panel has introduced new performance indicators that are useful tools to measure and demonstrate volatility of investment performance including analysis of relative performance for months when markets deliver positive and negative performance. Panel continues to review appropriate ways to demonstrate effectiveness of the investment strategy as it matures and the performance history is established.
- 3.9 Over 2015/16, 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;
 - undertaking an investment strategy review for Lothian Buses Pension Fund.
- 3.10 Importantly, the focus of the Panel is the long term superior asset returns of the Funds rather than the short term vacillations of the investment markets, but deploying each Fund's 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 employers' 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.
- 6.2 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. In addition, active engagement with the companies in which the Fund invests should reduce risk Fund and enhance the sustainability of investment performance.

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 Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

None

Alastair D 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

Single Outcome Agreement

Appendices None

Pensions Committee

2.30 p.m., Wednesday, 24 June 2015

Annual Investment Update – Lothian Pension Fund

Item number	5.9
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 2015.

The Fund's Investment Strategy 2012-17 is being implemented gradually. Fund risk declined further over the year, due to the reorganisation of equity and bond mandates and small adjustments to asset allocation.

Over the twelve months to 31 March 2015, investment markets returns were very strong (global equities, index-linked gilts and property all grew at a double digit rate).

The Fund produced a return of 16.5% over the year. The benchmark return was 14.4%.

The Fund's actuary completed the triennial valuation during 2014 and reported that Lothian Pension Fund's funding level (the ratio of assets to liabilities) was 91.3% at 31 March 2014. Despite very strong investment markets over the 2014/15 year, the decline in market yields has led to a deterioration of the funding level which is estimated to be 84% at 31 March 2015.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Annual Investment Update – Lothian Pension Fund

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 That the 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 2015.
- 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 2015

- 3.1 The UK economy has made a solid recovery since the dark days of the global financial crisis in 2008/09. Unemployment has shrunk to 6% from a peak of 8% in 2009, and the employment rate of 73.3% is the highest since records began in 1971. The public sector deficit has halved since 2010. In 2014, the UK economy expanded by 2.8%, although it slowed in the first quarter of 2015. US economic growth has been robust for the last few years, and even laggard countries and regions such as Japan and Europe are now displaying some springtime green shoots of recovery.
- 3.2 Asset markets continue to respond positively to low interest rates and unconventional monetary policies (bond buying by central banks) aimed at stimulating economic growth. Perhaps unsurprisingly, government and corporate bond markets made handsome gains as investors anticipated strong central bank buying support for these assets. Equity markets benefitted too. The US equity market is now comfortably in excess of its two previous peaks, Japanese equities continued to perform well and the UK stock market is once again hovering around its historical high point. Even the continental European stock markets have shown signs of reviving, but after a long period in the doldrums, the outstanding equity market performer over 2014/15 was the Shanghai Stock Exchange in China, which soared 56%. Other asset classes, such as property also made attractive returns. The key feature in currency

markets was US dollar strength. The only real disappointment was commodities, where oil and iron ore prices in particular fell sharply.

- 3.3 Looking ahead, investors are wondering how long the current positive environment for asset markets can last. Given that the low interest rates and unconventional monetary policy (so-called quantitative easing) are inextricably linked with prices in asset markets, the fear is that this element of support will be withdrawn and interest rates will rise. This is front and centre of mind in one of the two largest economies in the world, the USA, where wage inflationary pressure could cause the economy to overheat. This is not the case across the globe. The European Central Bank has only recently resorted to stimulating the economy with quantitative easing and the other giant economy in the world, China, seems quite out of sync with the USA, having recently embarked on a policy of cutting interest rates in the face of a slowing economy and low inflationary pressure. So, the timing of less supportive central bank policies is far from clear (further market gains are quite possible), but that tightening monetary policy will cause increased volatility and declines in bond and equity markets with high valuations is crystal clear. It appears unlikely that the high returns of 2014/15 will be sustained over the long term.
- 3.4 Other than monetary policy, there are a number of issues that will affect asset market returns in an unpredictable way going forward. There are numerous high profile geopolitical risks preying on investors' minds. These include Greek debt, Chinese expansion, the Ukraine conflict, war in Syria and fallout from the lower oil price in producing countries such as Norway, Russia, Venezuela and Saudi Arabia. These geopolitical risks are manageable to the extent that it is in nobody's interests to let them get out of control. Uncertainty is a constant in the investment backdrop and it is the uncertainty which creates the opportunities for investors to earn returns higher than those available from risk-free assets. With the benefit of economic growth and advancement over the coming years and decades, a diversified portfolio of assets should provide that risk premium over the long term.

Investment Strategy and Objectives

- 3.5 The Pensions Committee approved the Investment Strategy and Objectives 2012-17 for Lothian Pension Fund during the final quarter of 2012.
- 3.6 The Fund adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer. 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. Investment strategy includes Equities and Alternatives on the assumption that these assets will deliver better performance than Index-Linked Gilts in the long-term.

	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	

3.7 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 a gradually changing risk profile for the Fund, but retains significant exposure to real investments, such as Index-Linked Gilts and Equities, which have a history of protecting or enhancing purchasing power, after the effects of inflation have been taken into account.

3.8 The Fund's investment objectives 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 to 31 March 2015

3.9 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	5 Years	10 Years
Lothian Pension Fund	+16.5%	+9.5%	+8.9%
Benchmark	+14.4%	+8.8%	+7.6%
Relative	+2.0%	+0.7%	+1.3%

3.10 The benchmark shown in the table comprises equity, index-linked gilt and cash indices as well as an inflation-linked index for the alternatives allocation. Returns relative to the benchmark over a one year period need to be placed in the context that there are no ideal benchmarks for many of the assets held in the Fund, especially the Alternatives. The Fund's benchmark for Alternatives is inflation plus 3.5% per annum, which makes sense over the long term as the Fund's liabilities are linked to inflation. However, over shorter periods, there is less information content in the relative returns of the Fund because the development of asset prices is much more volatile than the development of UK

retail or consumer prices. The Investment Strategy Panel assesses the underlying risks of the portfolios that make up the asset allocation to ensure that these are consistent with the long term objectives of the Fund.

- 3.11 The Fund's return over the year was ahead of the benchmark return despite restructuring activity during 2014 and the first quarter of 2015. Asset allocation proved beneficial as the Fund is underweight the relatively low returning Alternatives and overweight higher returning Equities. Within Alternatives most assets were ahead of their benchmark returns.
- 3.12 The direction of the Fund's performance when markets are increasing and decreasing is one way of measuring the volatility. It has been a relatively short time since the lower volatility objective and strategy was put in place and markets volatility has been relatively benign. Nevertheless, performance over 2014/15 does indicate that the Fund is delivering lower volatility. Fund performance over the last 12 months was:
- better than the strategic allocation when markets fell (3 out of 3 months) with average performance of 0.69% better than the strategic benchmark and;
 - marginally worse than the strategic allocation when markets were rising (5 out of 9 months) with average performance 0.03% worse than the strategic benchmark.
- 3.13 The structure of the equity pool of assets and the currency hedge were helpful in achieving this outcome of lower volatility. The Fund hedges exposure to overseas equities where hedging is expected to reduce Fund risk and does not hedge exposure where hedging is expected to magnify Fund risk. Over 2014/15, the impact of currency hedging on overseas equities exposure was significantly positive - it generated a positive return as well as reducing Fund risk, its primary purpose.
- 3.14 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 16.1% over the year. Both developed and emerging markets produced strong returns in sterling terms although the UK market could only manage a mid-single digit gain.
 - The Fund's Index-Linked investments delivered a return of 23% over the year with the index-linked gilt portfolio rising 24% as real yields fell to new lows and with the Fund's small gold holding rising only 3% in sterling terms by virtue of being priced in US dollars.
 - The Fund's Alternative investment performance was 13% over the year. Within Alternatives, the bond portfolio generated very strong returns of 28%, while the timber assets returned 25% and listed infrastructure returned 23%. These standouts were offset by lower returns from other real assets, which returned 7%, held back by the write-down of a troubled

infrastructure fund. The bond portfolio was restructured early in the year when the corporate bond portfolio was replaced by a US Treasury portfolio, which benefited from price gains and the US dollar strength.

- As explained above, 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.

Funding Level

- 3.15 The funding level is the ratio of the pension scheme's assets to liabilities. At the last actuarial valuation at end March 2014, the funding level was 91.3%.
- 3.16 Over 2014/15, index-linked gilts (and hence the value of the liabilities) increased by more than equities and alternative investments. As a result the funding level has deteriorated and is estimated to be 84% at 31 March 2015.

Asset Allocation and Strategy Implementation

- 3.17 The implementation of the Investment Strategy 2012-17 is proceeding at a measured pace as investment opportunities become available and as research on opportunities is completed. This is reflected in the interim strategy allocation shown in the table below.
- 3.18 At 31 March 2015, 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 2015. The table below shows the changes in actual allocation over the financial year 2014/15 and the current interim strategy allocation at end of March 2015.

	Manager	Actual Allocation 31 March 2014 %	Actual Allocation 31 March 2015 %	Interim Strategy Allocation 31 March 2014 %	Interim Strategy Allocation 31 March 2015 %
EQUITIES					
UK All Cap	Internal	2.3	2.0	2.0	2.0
UK Mid Cap	Internal	2.3	2.0	1.8	1.8
Europe (ex UK)	Internal	2.3	2.0	2.1	2.1
US	Internal	2.3	2.3	2.1	2.1
Pacific	Baillie Gifford	3.5	0.0	3.9	0.0
Pacific	Invesco Perpetual	3.2	0.0	2.8	0.0
Emerging Markets	Mondrian	2.1	2.1	2.5	2.3
Emerging Markets	UBS	2.1	2.4	2.5	2.3
Global High Dividend Yield	Internal	14.8	13.3	14.6	14.3
Global Low Volatility	Internal	17.1	17.5	17.5	17.5
Global Value	Internal	0.0	6.6	0.0	6.5
Global	Cantillon	5.5	5.2	5.0	5.0
Global	Nordea	3.8	4.0	3.7	3.7
Global	Harris	4.1	4.0	3.5	3.5
Private Equity	Various	5.6	4.8	6.0	5.0
Currency Hedge	Internal	0.2	0.6	0.0	0.0
Transition Account	Internal	0.0	0.3	0.0	0.0
Subtotal		71.2	69.1	70.0	68.0
INDEX-LINKED ASSETS					
Index-linked gilts/gold	Internal	3.9	6.1	5.0	7.0
Subtotal		3.9	6.1	5.0	7.0
ALTERNATIVES					
Property	Various	8.8	8.4	10.0	10.0
Other Real Assets [1]	Various	7.6	7.6	8.0	8.0
Other Bonds [2]	Various	4.6	2.9	6.0	6.0
Alternatives Cash	Internal	1.4	2.1	0.0	0.0
Subtotal		22.4	21.0	24.0	24.0
Cash	Internal	2.4	3.8	1.0	1.0
TOTAL		100.0	100.0	100.0	100.0

[1] Includes infrastructure and timber; [2] includes sovereign bonds, corporate debt and private debt.

Equities

- 3.19 A key objective of the Fund's investment strategy is to reduce risk, including risk within the equity pool of assets. Further steps were taken during 2014/15 in this direction. A new internal global mandate was funded from the Asia Pacific equity holdings previously managed by Baillie Gifford and Invesco Perpetual, whose mandates were terminated in the second half of 2014. Both managers had produced very good performance for the Fund since inception. The new portfolio has lowered overall risk slightly and is expected to perform relatively well when equity markets are weak and produce absolute returns in rising equity markets, as is the whole equity pool of assets.
- a. None of the Fund's equity portfolios are constrained by market capitalisation indices, and hence by the tracking error measurement of risk, which is regarded as a suboptimal approach to portfolio construction. Instead the focus is capital preservation and the sustainability of income generation. The Fund's independent performance measurer, Portfolio Evaluation, estimates that the Fund's equity risk is now approximately 92% of the risk of the equity benchmark. This compares with 98% as at 31 March 2012.
 - b. The transition to the new portfolio has increased the equity assets managed by the internal team. Approximately three quarters 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.
 - c. 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, such as the US Dollar and Japanese Yen – fall as equities rise – and hedges exposure to currencies that are expected to increase volatility – rise as equities rise, such as the Australian Dollar. The hedge was very beneficial to the performance of the Fund over the year (+0.4%). Hedging the Australian and Canadian Dollars made gains for the Fund and reduced volatility, while hedging the Euro made large gains as the Euro weakened, but did not reduce volatility.

Index-Linked Assets

- 3.20 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. Over 2014/15, the allocation to index-linked gilts increased to 5.9% from 3.5% due to both market appreciation and new purchases. In addition, further restructuring of the portfolio was undertaken to extend its duration with the purchase of gilts of longer maturities to reflect the long-term nature of Fund liabilities. The long term

attractions of the asset have lessened over the course of the year and the Fund remains underweight the strategy allocation weight.

Alternative Investments

3.21 The Fund's strategy is to increase the actual allocation to alternative investments, which includes assets such as property, infrastructure, bond-like assets and timber, to provide greater diversification and attractive returns. Many of these investments are unlisted and increasing exposure is dependent on finding attractive opportunities. Despite considerable investment activity, the actual allocation fell slightly from 22.6% to 20.9% over 2014/15 for a number of reasons, including the restructuring of the other bond portfolio where the actual allocation was reduced and the relative strength of the other major asset classes, equities and index-linked gilts.

- The allocation to commercial property has fallen over the year as rental income has not been reinvested and as unlisted property has distributed capital.
- A strong pipeline of infrastructure investment opportunities allowed the Fund to make a number of investments and commitments with a focus on secondary fund interests, selective primary fund commitments and co-investments alongside the Fund's existing manager/fund relationships. The investment value of the Fund's infrastructure has, however, remained static held back by strong distributions from several successful investments and by one disappointing investment. The data in the table above includes cash distributions, which are being held for future investments, including capital calls related to existing commitments.
- The other sub-category in Other Real Assets is timber. 2014/15 was a productive year for the Fund in this category as the long periods of monitoring and appraisal of opportunities bore fruit and new investments were made, which increased the Fund's exposure to this alternative investment from 1.2% to 2.0%.
- As reported to Committee in June 2014, the Other Bond category was restructured. Activity in this category has been limited as attractive bond investments have become increasingly difficult to find as yields of the have fallen further. With a target return of 3.5% in excess of inflation for the Alternative portfolio, most bond related investments require the use of leverage to achieve such a target and are generally relatively risky. However, the Fund had made one investment in a relatively low risk, private debt fund during the year. Research continues in this area with a view to making further investments if they provide additional diversifications and produce secure returns. It is hoped that with the passage of time, better opportunities will present themselves.

3.22 The Fund makes commitments to unlisted investment 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 2015 were as follows:

	Unfunded Commitments in Local Currency			TOTAL
	US\$ m	Euros m	£ m	£ m
Private Equity	65	11	3	55
Infrastructure	14	46	-	43
	79	57	3	98

3.23 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). Over recent years, the internal team has been expanded, which has facilitated further in-sourcing of investment functions as well as the development of innovative and low cost investment strategies to meet the significant funding challenges faced by the pension funds. The Fund continues to outsource investment management services for specialist mandates, which complement the portfolio strategies employed internally. The internal team currently manages over £3bn, approximately two thirds of the Fund's assets.

Scrutiny & Transparency of Investments

3.24 On 29 April 2015 Scottish Parliament's Local Government and Regeneration Committee met to consider local authority pension funds' investment in infrastructure. The Committee took evidence from a number of parties including Scottish Public Pensions Agency, UNISON, Scottish Futures Trust and a number of LGPS officers. The Committee was critical over what was perceived to be a lack of transparency of investments. A link to the report of the meeting is provided later in this report. Since the meeting, the Fund has received a request for information regarding:

- the Fund's Statement of Investment Principles including the social, environmental or ethical policy;
- investment in Scottish or UK infrastructure projects;
- consideration of the investment in Pensions Infrastructure Platform;
- work undertaken in partnership with other Scottish Local Government Pension Funds to invest in Scottish or UK infrastructure projects;
- current barriers to investing in infrastructure projects.

3.25 The Fund's response to the Scottish Parliament's request for information is provided in Appendix 1.

3.26 The Scheme Advisory Board for the Scottish Local Government Pension Scheme met for the first time on 30 April 2015. They discussed and agreed a workplan which includes 'Collection and Consistency of Fund Data' and 'Transparency of Investments'.

3.27 Details of the Lothian Pension Fund's investments are reported regularly, both in Committee reports and in the Report & Accounts, both of which are publicly available. The Fund is also subject to regular Freedom of Information requests to which it responds promptly. A complete list of holdings is also made available on the Fund's website. However, there may be further requirements for the Fund to produce additional information and/or in different formats.

Conclusion

3.28 The absolute performance of Lothian Pension Fund over the twelve month period was 16.5%. Five year performance is 9.5% per annum. Over ten years, the Fund returned 8.9% per annum.

3.29 At the 2014 triennial actuarial valuation the funding level was 91.3% at the end of March 2014. The actuary has provided an updated estimate for the funding level of 84% at end of March 2015. This deterioration largely reflects the fact that the strong performance of the Fund's assets was offset by the fall in real gilt yields, which caused the value of liabilities to increase.

3.30 Implementation of the investment strategy has progressed steadily over the last twelve months. Increased exposure to and restructuring of the index-linked asset portfolio was pursued; the other bonds portfolio was reorganised; a new global equity portfolio lowered risk further; and a strong pipeline of real asset opportunities was reviewed.

3.31 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 strategies.

Measures of success

4.1 The investment performance of the Lothian Pension Fund is crucial to the achievement of the required investment return which impacts on the funding level and employers' 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 The 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.
- 6.2 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 Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9931>

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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 Response to the Scottish Parliament's Local Government and Regeneration Committee

Claire Menzies-Smith
Senior Assistant Clerk
Local Government and Regeneration Committee
Room T3.40
The Scottish Parliament
Edinburgh EH99 1SP

Date 12 June 2015

Your ref

Our ref

Dear Ms Menzies-Smith

Budget Strategy Phase 2016-17 – Local Government Pension Funds

I write with reference to your letter dated 15 May 2015, addressed to Alastair Maclean, Director of Corporate Governance, The City of Edinburgh Council, to which I have been asked to respond. Please find below the response to your questions on behalf of the Lothian Pension Fund, the Lothian Buses Pension Fund and Scottish Homes Pension Fund.

Statement of Investment Principles

The Funds' Statement of Investment Principles is available on our website:
http://www.lpf.org.uk/info/70/statement_of_investment_principles.

Responses to your questions are as follows:

1. When your statement is next due for review

Our statement is reviewed annually and is next due to be reviewed by Pensions Committee on 24 June 2015.

2. Details of your social environmental or ethical policy and how it is implemented having regard to fiduciary duties

Details of the Funds' policy on environmental, social and governance issues (ESG) can be found in the Statement of Investment Principles. While fiduciary duty remains paramount in all decision making, the Pensions Committee believes that it has a responsibility to take environmental, social and governance (ESG) issues seriously and where appropriate, to act upon them. As such, ESG considerations are embedded within the investment processes of the Fund and its investment managers.

Investment and Pensions

The City of Edinburgh Council, Suite 2, Atria One
144 Morrison Street, Edinburgh EH3 8EX
Tel: 0131 529 4638 email: pensions@lpf.org.uk

Infrastructure Investment

1. Details of any investment you have made in Scottish or UK infrastructure projects

At 31 March 2015, the Funds had approximately £300 million invested in infrastructure. Infrastructure makes up 6% and 5% of the assets of Lothian Pension Fund and Lothian Buses Pension Fund respectively.

Whilst some investments are invested in single infrastructure projects, most of the Funds' infrastructure holdings are funds which are invested across geographies, typically Europe or UK. The value of the investments in a specific country is not readily available. However it is estimated that over 70% of the Funds' infrastructure investment is based in the UK, with approximately 50% (of the 70%) in social infrastructure, 20% in transportation, 15% in regulated utilities with the remaining invested in energy, renewable and communications. Further detail on the Funds' infrastructure investments is provided in the Appendix.

2. Whether your Fund has considered investing in the Pensions Infrastructure Platform when it opens to non-founder members

The Funds had an established infrastructure investment programme before the Pensions Infrastructure Platform (PIP) was founded and continues to have a strong pipeline of investment opportunities in leading projects in this sector. Dalmore, the first investment manager selected by the PIP, is one of the Fund's existing managers - Lothian Pension Fund invested in Dalmore's first infrastructure fund.

We attended the PIP seminar in February 2015 and will continue to monitor its progress and consider the PIP's investment propositions as they become available.

3. Whether your Fund has worked in partnership with other Scottish Local Government Pension Funds to invest in Scottish or UK Infrastructure projects

Lothian Pension Fund currently collaborates on a shared service basis with Falkirk Council Pension Fund to share specialist investment staffing resource to assist with monitoring investments as well as to identify UK infrastructure investment projects of mutual interest. Recent due diligence has resulted in a commitment by both funds to a renewable energy investment in Scotland. Work continues on sourcing other potential infrastructure investments by Lothian and Falkirk on an efficient and collaborative basis.

4. Details of the current barriers to investing in infrastructure projects

We believe the current barriers to investing in infrastructure projects are as follows:

Human resources – expertise to be able to conduct appropriate levels of due diligence and deal execution

The due diligence required to make and monitor infrastructure investments can be intensive, as the asset class tends to be unlisted and a broad spread of investments is needed to diversify risk. Relying on a fund-of-funds investment manager to undertake that due diligence can be expensive.

Lothian Pension Fund has an established internal investment team, with specialist infrastructure resource, which has been built up over a number of years. This has enabled the Fund to invest in infrastructure through commitments to primary funds, purchases in the secondary market and co-investments. Legal and analytical resource was added in recent years in recognition of the desire to increase infrastructure investment and the complexities of investing. The ability to provide execution certainty (both commercial and legal) is critical to operating effectively in this sector and building up the necessary market presence to be offered an attractive pipeline of suitable opportunities.

The recruitment and retention of key staff is one of the highest risks on the Lothian Pension Fund risk register. In order to manage this risk, the Fund has recently established a new legal structure for the purposes of strengthening internal controls and pursuing authorisation from the Financial Conduct Authority.

Access to projects/fund managers and co-investment rights

The infrastructure sector often involves “off market” transactions, which require a presence in the sector to be able to access such investments.

The Funds’ presence and expertise in this sector, and its ability to execute deals efficiently, means it can access projects and benefit from preferential commercial terms. In addition, co-investment opportunities with existing managers have enabled the Funds to gain direct access to projects, which provides the benefit of greater transparency and beneficial commercial terms.

However, Lothian Pension Fund is a relatively small investor in the infrastructure market and with increasing interest in the asset class from other, larger, investors, there is a risk that access to projects could be more difficult for the Fund in the future.

Risk/Return

Some infrastructure investment opportunities lack the risk/return characteristics needed to deliver the Funds’ requirements. Lothian Pension Fund’s performance target for infrastructure investments is 3.5% above inflation.

Local Government Investment Regulations

Lothian Pension Fund has long held the view that the Local Government Pension Scheme (Management and Investment of Funds) regulations would benefit from significant review and that the existing limits on investments should be replaced by a prudential code. In particular, the limits on investment in partnerships are a

potential impediment to large scale infrastructure investment which is typically structured as a limited partnership. The existing limits are 2% (of total assets) in a single partnership and 5% in all partnerships. There is scope in the regulations for a fund to increase these to 5% and 15% respectively and the Lothian Pension Fund has used this additional headroom.

Please do not hesitate to contact me, if you need any further information.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'C Scott', written in a cursive style.

CLARE SCOTT
Investment & Pensions Services Manager
Lothian Pension Fund

APPENDIX: Selected UK/Scottish Infrastructure as at 31 March 2015

Fund	Details of UK/Scottish investments
Listed Infrastructure	LPF's investment in the listed HICL infrastructure company is worth c£24 million. HICL is a UK focused infrastructure investment company with 89% of its assets invested in the UK. The fund has 39%, 23%, 19% and 13% invested in Health Service, Education, Accommodation and Transport, respectively. At 31 March 2015, the Group had 13 investments in Scotland, accounting for 13.8% of the portfolio by value. LPF also has a c£11 million investment in the listed 3i Infrastructure fund, which has 68% investment in the UK mainly in transportation and regulated utilities sectors.
EIG European Clean Energy	In 2006, LPF committed €15 million to the EIG European Clean Energy fund which has 26% invested in a UK wind farm asset.
Alinda Infrastructure	LPF committed £15 million in 2006 to Alinda Infrastructure Fund, which currently has 17% invested in a UK airport.
Dalmore Capital Fund	In 2012, LPF committed £25 million to Dalmore Capital Fund which has 100% of its assets invested in the UK. In 2013, LPF further committed £25 million to a UK Schools and Hospitals projects including Scottish schools.
EISER Infrastructure Fund	Lothian Pension Fund committed €25 million to this fund. It currently has 47% assets in the UK including a UK airport and a gas distribution company.
DeAWM managed Pan-European Infrastructure Fund I	LPF's commitment was €35 million. It has 63% invested in UK Ports and a water supply company. After the disposal of its German asset, the holdings in the UK will increase to 85%.
Macquarie Infrastructure Funds	Since 2011, LPF has made various investments in Macquarie managed infrastructure funds. Funds I and II have 40% - 50% invested in UK infrastructure including transportation, water supply, communications and car parks. The latest (fund IV) recently made its first investment in the UK which includes 3 UK airports.
NIBC Infrastructure fund	LPF committed €17 million in 2014 to NIBC Infrastructure Fund which has 56% invested in the UK including stakes in MAS (motor area service) as well as school and hospital projects.
Water	LPF has a £20 million commitment in a UK water supply company via a co-investment with KKR.
Renewable	LPF has recently committed £8m to a Scottish mini-hydro project through a co-investment.

***Please note that the details contained in this letter and, in particular, the schedule are strictly private and confidential and not for further disclosure or publication.**

Pensions Committee

2.30 p.m., Wednesday, 24 June 2015

Annual Investment Update – Lothian Buses Pension Fund

Item number	5.10
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 2015, investment markets returns were very strong (global equities, index-linked gilts and property all grew at a double digit rate).

The Fund produced a return of 15.1% over the year. The benchmark return was 14.9%. Over five years, the fund produced a return of 11.0% per annum compared with a benchmark return of 9.2% per annum.

Despite very strong investment markets over the 2014/15 year, the decline in market yields has led to a deterioration of the funding level. The funding levels on an ongoing and gilts basis at 31 March 2015 were estimated to be 106% and 81% respectively.

The Fund's Investment Strategy 2012-17 is being implemented gradually. The Fund's risk reduced further over the year with a modest reduction in the equity weighting accompanied by an increased allocation to index-linked gilts and alternative investments.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Annual Investment Update – Lothian Buses Pension Fund

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 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 investment and funding position of the Lothian Buses Pension Fund to 31 March 2015.
- 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 Strategy

- 3.1 Asset markets continued to respond positively to low interest rates and unconventional monetary policies over 2014/15. Global equities generated returns of 18% in sterling terms benefiting from the US dollar strength because of the large exposure to US stocks. These returns were matched by UK property, which returned 18% as the commercial property recovery took hold. Yet, these returns were outshone by a greater than 20% return from index-linked gilts, for which demand appears to be insatiable in the face of pension fund de-risking, quantitative easing and general inflation uncertainty.
- 3.2 The Fund adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer. 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. Investment strategy includes Equities and Alternatives on the assumption that these assets will deliver better performance than Index-Linked Gilts in the long-term.
- 3.3 The Pensions Committee approved the Investment Strategy 2012-17 for Lothian Buses Pension Fund in October 2012.

	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	

- 3.4 The strategy reduces the allocation to equities (including private equity) from 63.5% at the end of 2012 to 55% by the end of 2017 and increases the allocation to index-linked gilts and alternatives. It recognises a gradually changing risk profile for the Fund, but retains significant exposure to real investments, such as Index-Linked Gilts and Equities, which have a history of protecting or enhancing purchasing power, after the effects of inflation have been taken into account.
- 3.5 The Fund's investment objectives 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 implementation of the Investment Strategy 2012-17 has continued to proceed at a measured pace as investment opportunities became available and as research on opportunities was completed. Progress towards the long term strategy allocation involves the interim strategy allocation and the actual asset allocation changing gradually over time. The pace of change can be accelerated or slowed depending on asset prices, the availability of alternative investments and research conclusions on new strategies.
- 3.7 This is reflected in the interim strategy allocation and actual allocation over the financial year 2014/15 which are shown in the table below.

	Manager	Actual Allocation 31 March 2014 %	Actual Allocation 31 March 2015 %	Interim Strategy Allocation 31 March 2014 %	Interim Strategy Allocation 31 March 2015 %
EQUITIES					
Global Alpha	Baillie Gifford	32	31		
Global High Dividend Yield	Internal	32	30		
Private Equity	Internal	1	1		
Subtotal		65	62	62.5	60.5
INDEX-LINKED ASSETS					
Index-linked bonds	Baillie Gifford	7	7		
Index-linked gilts	Internal	4	4		
Subtotal		11	11	10	12
ALTERNATIVES					
Property	Standard Life	9	10		
Other Real Assets [1]	Various	5	6		
Other Bonds [2]	Baillie Gifford	8	7		
Subtotal		22	23	27.5	27.5
Cash	Internal	2	4	0	0
TOTAL		100	100	100	100

[1] Includes infrastructure and timber

[2] Includes corporate bonds and loans

- 3.8 The Investment Strategy Panel reviews asset allocation and the progress to the new investment strategy on a quarterly basis and the internal team reviews it monthly.
- 3.9 At 31 March 2015, the Fund has an overweight position in equities and cash compared to the interim strategy allocation. The Fund is modestly underweight index-linked assets and more significantly underweight Alternative investments. Many of these investments are unlisted and increasing exposure is dependent on finding attractive opportunities.
- 3.10 Changes to the underlying structure of the Fund were more modest in 2014/15 following the significant changes implemented in the prior year (notably the move to have approximately half of the Fund's equity exposure managed by the internal team in a low cost, low turnover strategy).
- 3.11 The changes made in 2014/15 are described below:
- As part of the move to reduce equity exposure towards the interim strategy allocation, £7.5m was withdrawn from Baillie Gifford's equity

portfolio in February 2015 after a period of strong equity market performance over the year. The sale proceeds are being held in cash pending investment in Alternative assets.

- Dividend income is being withdrawn regularly from the internally managed global equity portfolio to further aid the targeted reduction in equities.
- There was little change to the allocation to index-linked gilts as the pace of investment has been gradual due to the high valuations/low real yields available in the market.
- Further investments were made in the Other Real Assets portfolio during the year in line with the long term strategy to increase the exposure to Alternatives. However, despite a strong double-digit return from Alternative investments, there was only a small increase in the percentage allocation in the Fund. Four UK and European infrastructure investments and four global timber investments amounting to £3.7m were made, but distributions from existing investments were high at £2.4m, meaning that net investment was fairly modest at £1.3m.

- 3.12 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 2015 were as follows:

	Unfunded Commitments in Local Currency			TOTAL
	US\$ m	Euros m	£ m	£ m
Infrastructure	-	2.1	-	1.5

- 3.13 Following the completion of the 2014 actuarial valuation, the Fund will work with Lothian Buses plc and its investment advisers to revisit the investment strategy to ensure it remains appropriate.

Investment Performance to 31 March 2015

- 3.14 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	5 Years	10 Years
Lothian Buses Pension Fund	+15.1	+11.0	+10.3
Benchmark	+14.9	+9.2	+8.8
Relative	+0.2	+1.8	+1.5

- 3.15 The benchmark shown in the table comprises equity, index-linked gilt and cash indices as well as an inflation-linked index for the alternatives allocation. Returns relative to the benchmark over a one year period need to be placed in the context that there are no ideal benchmarks for many of the assets held in the Fund, especially the Alternatives. The Fund's benchmark for Alternatives is

inflation plus 3.5% per annum, which makes sense over the long term as the Fund's liabilities are linked to inflation. However, over shorter periods, there is less information content in the relative returns of the Fund because the development of asset prices is much more volatile than that of UK retail or consumer prices. The Investment Strategy Panel assesses the underlying risks of the portfolios that make up the asset allocation to ensure that these are consistent with the long term objectives of the Fund.

- 3.16 Over 2014/15, the Fund (+15.1%) modestly outperformed the benchmark (+14.9%). Asset allocation within the Fund proved beneficial over the year driven by the underweight exposure to the relatively lower returning Alternatives.
- 3.17 Within Alternatives, the Fund's relative performance was strong due to the high returns from the Standard Life Property Fund (+16.5%), Baillie Gifford Investment Grade Bonds (+13.3%) and Timber & Agriculture (+28.8%). Collectively, the Fund's Alternatives investments returned +14.8% over the year, comparing favourably to the Alternatives benchmark gain of 4.4% (inflation plus 3.5% per annum).
- 3.18 The Fund's Index Linked assets gained 16.2% over the year, lagging their benchmark return of 23.8%. The internal index linked gilts portfolio lagged notably over the year as a result of the decision to invest cash gradually. Despite valuations being historically high and real yields very low, the price of index-linked gilts continued to rise, so uninvested cash acted as a drag on performance.
- 3.19 The Fund's equity investments delivered good gains over the year, advancing 15.3%, though lagged the equity index return of +18.4%. Outperformance from Baillie Gifford's Global Alpha portfolio (+19.2%) was not sufficient to offset the relative underperformance from the internal Global High Yield Equity portfolio (+10.9%), which invests in lower risk equities and is expected to perform relatively well in weaker markets in line with the Fund's overall strategy. While equities tend to be a more volatile asset class, the Global High Dividend Yield portfolio specifically invests in financially stable equities with risk of less than 90% of the equity benchmark index, which helps to reduce the overall expected volatility of the Fund's returns.

Funding Level

- 3.20 The funding level is the ratio of the pension scheme's assets to liabilities. Last year, the actuary estimated the funding level to be 116.7% at 31 March 2014 on an ongoing basis, which shows that the Fund met its objective of holding sufficient assets to meet the estimated current cost of past service liabilities at that date.
- 3.21 The actuary also calculated the funding level on the more prudent gilts basis to be 88.2% at 31 March 2014. The gilts basis is a more conservative approach reflecting the ultimate funding objective – the assets the Fund should hold at the point when the last active member leaves the Fund. The Fund is closed to new

members and the liabilities are expected to mature further over time. As the Fund is in deficit on a 'gilts' basis, the assets do not cover the liabilities, so the Fund continues to invest in growth assets, such as equities, to achieve full funding in the future.

- 3.22 Over the year 2014/15, despite very strong investment markets, a further decline in market yields points has led to a deterioration of the funding level. The funding levels on an ongoing and gilts basis at 31 March 2015 were estimated to be 106% and 81% respectively.

Conclusion

- 3.23 Implementation of the investment strategy has continued to progress over the last twelve months with a modest increase in the actual allocation to alternatives and an increase in cash combined with a reduction in equity exposure. Following the completion of the 2014 actuarial valuation, the Fund will work with Lothian Buses plc and its investment advisers to revisit the investment strategy to ensure it remains appropriate.
- 3.24 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 has deteriorated over the last twelve months. As the Fund is in deficit on a 'gilts' basis at 31 March 2015, the assets do not cover the liabilities, so the Fund continues to invest in growth assets, such as equities, to achieve full funding in the future.
- 3.25 The absolute performance of Lothian Buses Pension Fund over the twelve month period was +15.1%. Five year performance was +11.0% per annum. Over ten years, the Fund returned +10.3% per annum.

Measures of success

- 4.1 The investment performance of the fund is crucial to the achievement of the required investment return which impacts on the funding level and employer contributions. The objectives for the investment 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 Fund's 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 Fund's investments.

Consultation and engagement

- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund. The Pension Board includes a union representative from Lothian Buses.
- 9.2 Regular meetings are held with Lothian Buses plc to update them on the Fund and to consult on strategic issues.

Background reading/external references

None

Alastair D 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

Single Outcome Agreement

Appendices None

Pensions Committee

2.30 p.m., Wednesday, 24 June 2015

Annual Investment Update – Scottish Homes Pension Fund

Item number	5.11
Report number	
Executive/routine	
Wards	All

Executive summary

Over the twelve months to 31 March 2015, the Fund produced a return of 19.7%. The Fund's actuary estimates that the Scottish Homes Pension Fund's funding level (the ratio of assets to liabilities) had increased to 92.8% at 31 March 2015, which is an increase over the 88.8% level recorded at the last formal valuation date of 31 March 2014.

Changes to the Fund's asset allocation based on funding level progress were agreed by the Pensions Committee in December 2014. During the last quarter of 2014/15, the equity allocation was reduced from 30% to 27.5% and following the end of the financial year, the equity allocation was reduced again from 27.5% to 25%.

Further engagement with the Scottish Government is planned during 2015 to review the funding approach and progress will be reported to Pensions Committee in due course.

Links

Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

Annual Investment Update – Scottish Homes Pension Fund

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 That the Pensions Committee notes the performance, funding update and asset allocation of the Scottish Homes Pension Fund.

Background

- 2.1 The City of Edinburgh Council took over the administration of the deferred and pensioner liabilities of Scottish Homes in July 2005. An agreement between the Scottish Government and the City of Edinburgh Council ('the Guarantee') was put in place in June 2005. The Scottish Government acts as the 'Guarantor' for the Fund liabilities.
- 2.2 The Guarantee 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.
- 2.3 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 changes the allocation to equities, bonds and property dependent on the development of the actuary's estimate of the funding level.
- 2.4 The Target Funding Levels (TFLs), as set out in the Guarantee, were 89.5% and 91.5% at 31 March 2011 and 2014 respectively. The actual funding levels were below the respective targets at these dates. Therefore Scottish Government will be paying a contribution of £675,000 p.a. from April 2015 to March 2018.
- 2.5 As previously reported to Committee, discussions regarding potential changes to the funding agreement were held with the Scottish Government during 2014/15. Options to change the funding approach to one where contributions would be determined by fund cash flows, rather than funding level, were explored. However, the Scottish Government preferred that the 2014 actuarial valuation and contributions for the 3 years starting April 2015 are determined in accordance with the existing funding agreement.

- 2.6 Pending further engagement with the Scottish Government, Committee approved a change to the investment strategy in December 2014 whereby the equity and bond allocations are adjusted depending on the funding level in accordance with the following table:

Equity Allocation %	Funding level	Note [1]
35	89.5%	2011 TFL
30	91.5%	2014 TFL
25	93.0%	2017 TFL
20	94.5%	2020 TFL
15	95.5%	2023 TFL
10	96.5%	2026 TFL

[1] TFL: Target Funding Level

- 2.7 The purpose of the report is to provide an update on the investment and funding position of the Scottish Homes Pension Fund to 31 March 2015.
- 2.8 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 2015

- 3.1 The Fund's investment objectives agreed in December 2013 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'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 since inception, and has outperformed its benchmark by a small margin over the 1- and 5-year timeframes. The Fund's equity and bond assets are currently managed passively and the Fund's risk has been similar to that of the benchmark.

% per annum	1 Year	5 Years	Since Inception (July 2005)
Scottish Homes Pension Fund	+19.7	+10.9	+9.2
Benchmark	+19.4	+10.8	+9.2
Relative	+0.3	+0.1	+0.0

Funding Level and Investment Strategy

- 3.3 The funding level is monitored regularly by the Fund's actuary and the internal investment team. The progression of the estimated funding level since 31 March 2015 is shown below:

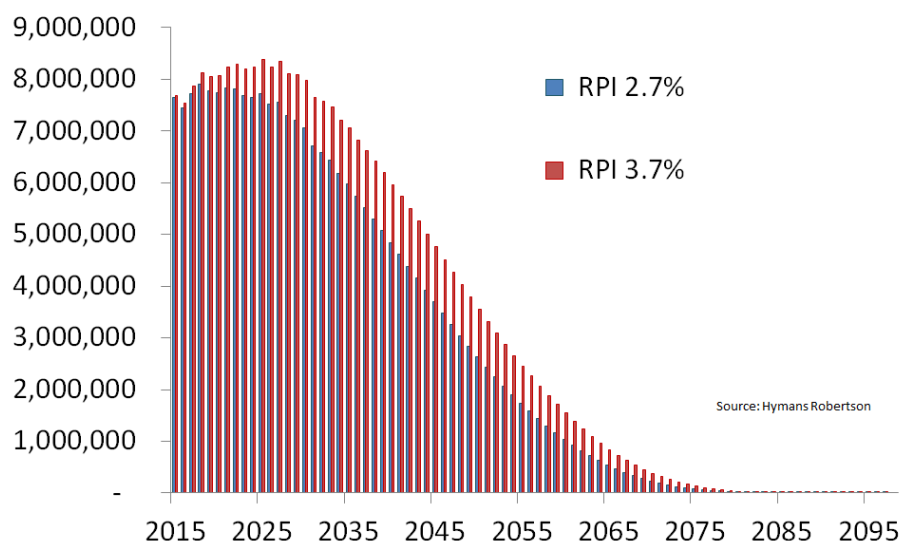


- 3.4 Based on the actuary's funding level, the strategic equity allocation was reduced from 30% to 27.5% in January 2015 with the bond allocation increasing from 65% to 67.5%.
- 3.5 The funding level at 31 March 2015 was estimated to be 92.8%.
- 3.6 During April 2015, with equity markets having continued to rally, the funding level estimate rose above the 2017 target funding level of 93%. The equity allocation was reduced further to 25% resulting in an increased bond allocation of 70%, up from 67.5%.
- 3.7 The changes in investment strategy are summarised below:

Scottish Homes Pension Fund – Evolution of Strategy 2014/15			
Asset Class	Strategy Allocation 31 March 2014	Strategy Allocation 31 March 2015	Strategy Allocation 30 April 2015
	%	%	%
Equities	30.0	27.5	25.0
Bonds	65.0	67.5	70.0
Property	5.0	5.0	5.0
TOTAL	100.0	100.0	100.0

- 3.8 As part of the 2014 actuarial valuation, analysis of the Fund's liability cash flow projections was undertaken. A graph of the expected liability payments using two different inflation assumptions is shown below.

Figure 1: Projected cashflows at differing inflation rates (£)



- 3.9 The analysis highlighted significant differences between the term/duration of the Fund's investments (particularly the index linked gilts) compared to the liabilities. This has been partly due to the fact that the investments have tracked a standard market index of gilts and issuance of new government bonds over recent years has tended to be of longer duration. During September 2014, the duration of the Fund's investments was reduced accordingly and part of the Fund's holdings is now being managed internally. Approximately half of the bond portfolio was moved to in-house management. The equity and bond allocations did not change over this time. This change in duration should result in the investments providing a closer match to the liabilities in the future.
- 3.10 Over the year assets are also withdrawn from the investment manager(s) to pay pensions (approximately £650,000 per month).
- 3.11 The Fund's actual allocation to each manager and asset class at 31 March 2015 is shown in the table below, together with the strategic allocation at 31 March 2015. Also shown is the strategic allocation at 30 April 2015 following the most recent reduction in equity allocation.

Asset Class	Manager	Actual Allocation 31 March 2015 %	Strategy Allocation 31 March 2015 %	Strategy Allocation 30 April 2015 %
Equities				
UK	State Street	6.0	6.1	
US	State Street	8.3	8.5	
Europe Ex-UK	State Street	5.6	5.5	
Asia Pacific	State Street	2.3	2.2	
Japan	State Street	3.5	3.0	
Emerging Markets	State Street	2.3	2.2	
Subtotal		28.0	27.5	25.0

Bonds				
Index-linked gilts	In-house	35.9	35.6	
Index-linked gilts	State Street	16.9	17.8	
Fixed income gilts	State Street	14.0	14.1	
Subtotal		66.8	67.5	70.0
Property				
Property	Schroders	5.2	5.0	
Subtotal		5.2	5.0	5.0
Cash		0.0	0.0	0.0
TOTAL		100.0	100.0	100.0

- 3.12 Discussions regarding potential changes to the funding agreement were held with the Scottish Government during 2014/15 with the assistance of the Fund's investment advisers. However, the Scottish Government decided to make no changes, preferring that the 2014 actuarial valuation and contributions for the 3 years starting April 2015 be determined in accordance with the existing Guarantee.
- 3.13 The Scottish Government would like to further explore funding options previously discussed as part of the 2014 actuarial valuation. These discussions are expected to take place later in 2015. Irrespective of whether the Guarantee and funding approach are formally reviewed, a review of the investment strategy is required, particularly to review the way in which the individual asset classes are managed. Updates to the Committee will be provided as this work progresses.

Conclusions

- 3.14 The absolute performance of Scottish Homes Pension Fund is positive over the 12 month period to 31 March 2015 with a return of 19.7%. Five year performance is 10.9% per annum.
- 3.15 The returns for Scottish Homes Pension Fund since inception to 31 March 2015 are in line with the benchmark, and over one and five years are slightly ahead of the benchmark.
- 3.16 Funding levels are monitored by the Fund regularly. The estimated actual funding level has improved over the year and was 92.8% at 31 March 2015, which is broadly in-line with the target funding level of 93.0% for 2017.
- 3.17 The investment strategy (and potentially the funding agreement) of the Fund will be reviewed in consultation with the Scottish Government.

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 Fund's 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 Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.
- 9.2 Regular updates are provided to Scottish Government with ongoing liaison and consultation.

Background reading/external references

None

Alastair D 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

Single Outcome Agreement

Appendices None

Pensions Committee

2.30 p.m., Wednesday, 24 June 2015

Risk Management Summary

Item number	5.12
Report number	
Executive/routine	
Wards	All

Executive summary

In line with the pension funds' ongoing risk management procedures, this paper provides an overview of the risk analysis for Q1 2015 for consideration by the Committee.

Links

Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

Risk Management Summary

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 We recommend the Pensions Committee notes the Quarterly Risk Overview, having regard to any points raised by the Audit Sub-committee and the Pension Board.

Background

- 2.1 The pension funds' risk management procedures require us to:
 - 2.1.1 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
 - 2.1.2 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**").

Main report

- 3.1 The Operational Risk Register has been issued to the conveners of the Pensions Committee and the Pensions Audit-Sub Committee.
- 3.2 The Quarterly Risk Overview, as at 14 May 2015, is set out in the appendix to this report for consideration.

Measures of success

- 4.1 Improved visibility of the risks facing the pension funds and progress in analysing/mitigating these risks. Regular, focused and relevant risk updates to the Committee should increase general awareness and allow productive analysis/feedback by the Committee members on these fundamental issues.
- 4.2 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

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

Risk, policy, compliance and governance impact

6.1 Please see the Quarterly Risk Overview appended to this report.

Equalities impact

7.1 None.

Sustainability impact

8.1 None.

Consultation and engagement

9.1 The Pension Board, 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 partnerships to improve services and deliver agreed






Single Outcome Agreement





Appendices Appendix 1 – Quarterly Risk Summary, as at 14 May 2015.

QUARTERLY RISK OVERVIEW

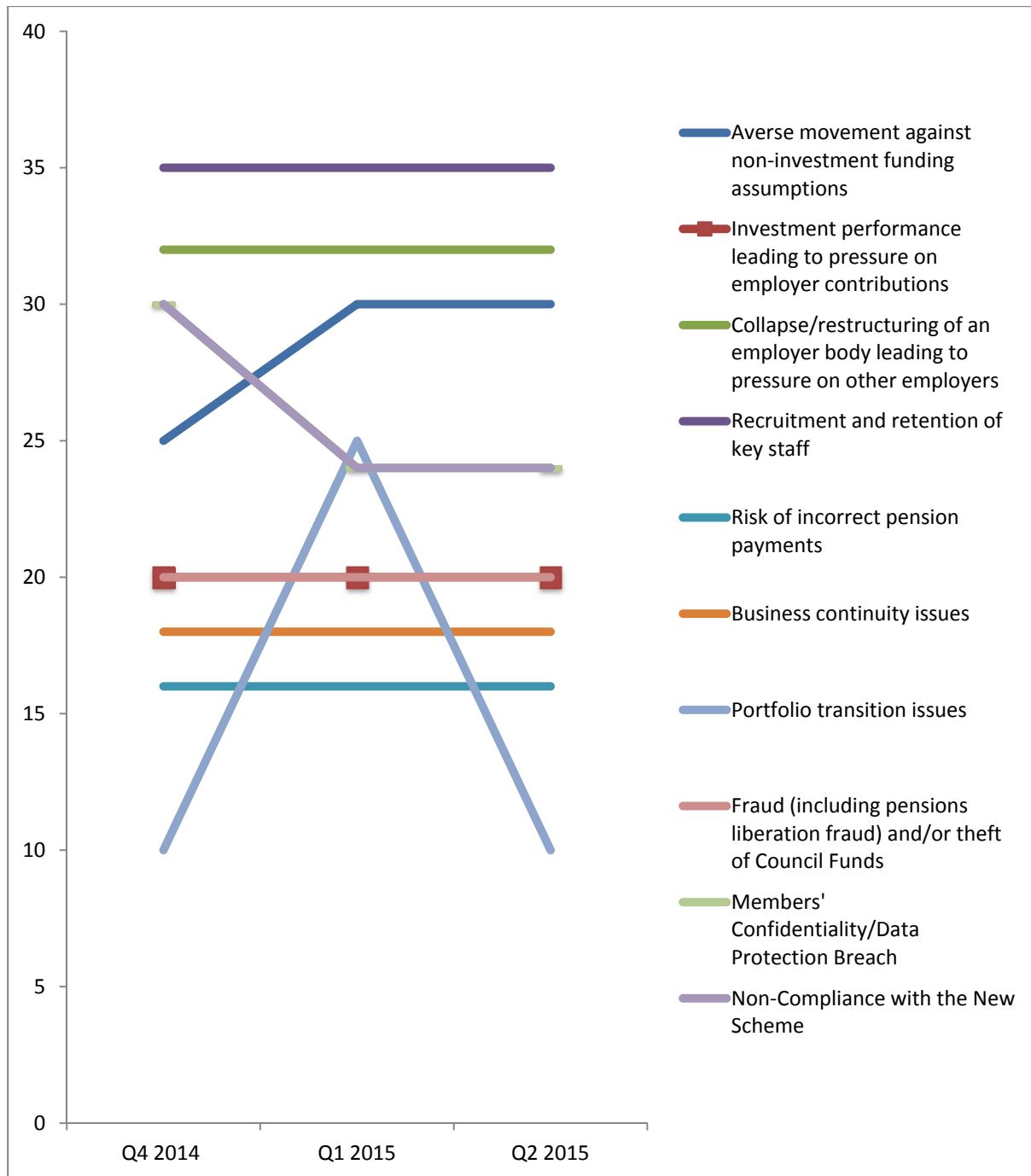
14 May 2015

UPDATE ON MOST NOTABLE RISKS

Risk & Reference Number	Update	Trend/RAG
Adverse Investment performance leading to pressure on employer contribution (1)	The new lower volatility investment strategy continues to be implemented to mitigate this risk and more detailed reporting on the Investment Strategy is covered elsewhere on the agenda.	Static 
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions (2)	The 2014 actuarial valuation is complete and experience against funding assumptions and employer contributions has been assessed. See also below regarding impact on employers.	Static 
Collapse/restructuring of an employer body leading to pressure on other employers (3)	The revised funding approach for employers close to exiting the Fund reduces the risk to the Fund and the other employers. We continue to engage with a group of smaller employers within the Fund regarding the potentially adverse financial impact of the revised funding strategy arising from the 2014 valuation. This is covered elsewhere on the agenda.	Static 
Recruitment and retention of key staff (4)	The new corporate structure is now in place, with the affected investment staff having TUPE transferred to LPFE Limited on 1 May 2014. This risk remains high due to the continued improvement in UK economic and market conditions in the private sector. External HR consultancy resource for LPFE Limited is being put in place and it is anticipated that this risk will therefore reduce during the course of Q2 2015.	Static 
Members' Confidential Data is lost or made public / breach of Data Protection Act (12)	There have continued to be several minor and unrelated administrative errors in mailing leading to the inadvertent disclosure of members details. The team continue to be made aware of their obligations in this regard and certain additional manual checks have been introduced. We await a response from the provider of the pensions administration software before we are able to finalise the cost/benefit analysis of outsourcing certain printing and mailing functions. We are continuing to liaise with the Information Compliance team to separately register the two corporate vehicles with the Information Commissioner as data controllers and this process is now near to being finalised. We have also provided input to the Information Commissioner's audit of the City of Edinburgh Council.	Static 

Risk & Reference Number	Update	Trend/RAG
Business continuity issues (11)	<p>The Pensions Audit Sub-Committee, at its meeting on 16 June 2014, requested that the Director of Corporate Governance considers whether a test of the disaster recovery system (of the pension administration system) was necessary to establish sufficient assurance. The software system for pension administration is hosted by the supplier. In February 2015, the supplier tested and verified the recovery of servers from its outsourced provider for both the core administration and the member self-service platforms. The Fund was able to access this test data. The Fund has also requested a comprehensive report on the testing procedures and outcome from the supplier. Receipt of this report is overdue and the matter has been raised with the supplier's senior management.</p> <p>We anticipate that business continuity risk will further reduce following the conclusion of the Council's ICT tender in the summer of 2015.</p>	<p>Static</p> 
Non-compliance with the new LGPS Scheme in Scotland / Public Service Pensions Act 2013 (26)	<p>Implementing the new scheme from 1 April 2015 continues to place an increased pressure on existing resources, with staff being involved in presentations across the Lothians.</p> <p>Whilst the pension administration software has been updated for LGPS2015, some changes remain outstanding including transfers and late retirements. This is causing delay of processing in some instances. We continue to engage with the software provider.</p> <p>We have scheduled an Internal Audit assessment of our compliance with the new scheme for Q3 2015 and will report back to the Pensions Committee on the findings of that review.</p>	<p>Static</p> 
Over-reliance on single service provider for core functions (31)	<p>We continue to monitor the position in relation to our core providers and are looking to put in place arrangements to further mitigate this risk where it exists in relation to our Pension Administration systems, as far as this is possible.</p>	<p>Static</p> 
Portfolio Transition Issues (17)	<p>As anticipated, the risk has reduced following the successful completion of the transition. We would not anticipate any escalation or detailed reporting of this risk until such time as a further transition is required.</p>	<p>Down</p> 

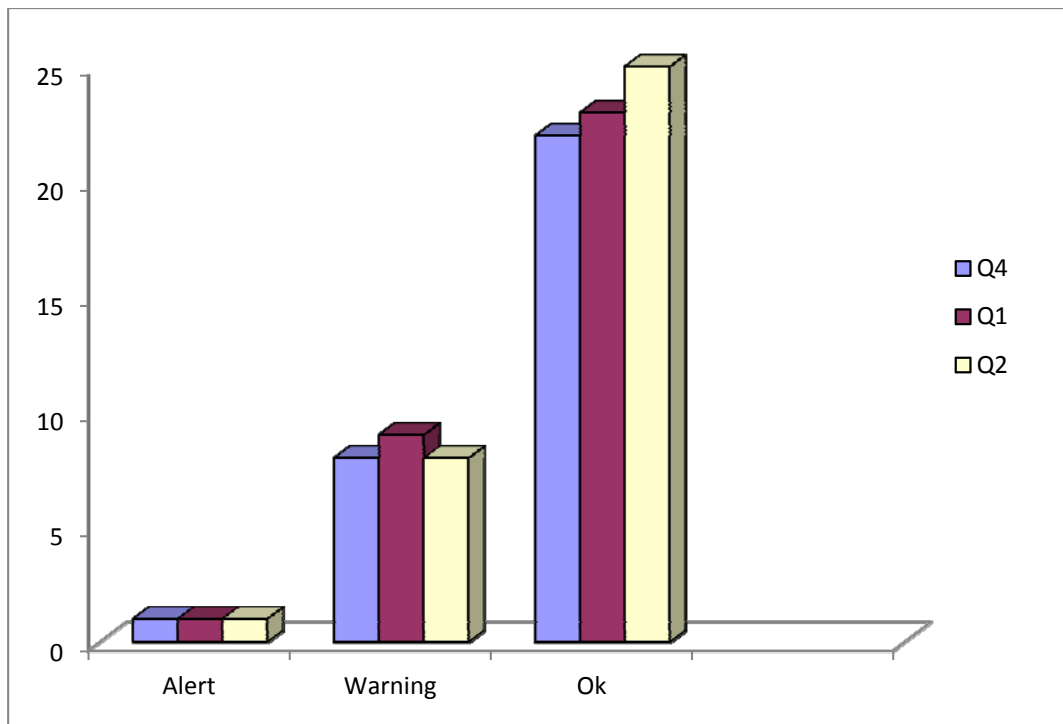
NOTABLE RISKS: PROGRESSION OF CURRENT RISK (ACCOUNTING FOR CONTROLS) IN LAST THREE QUARTERS



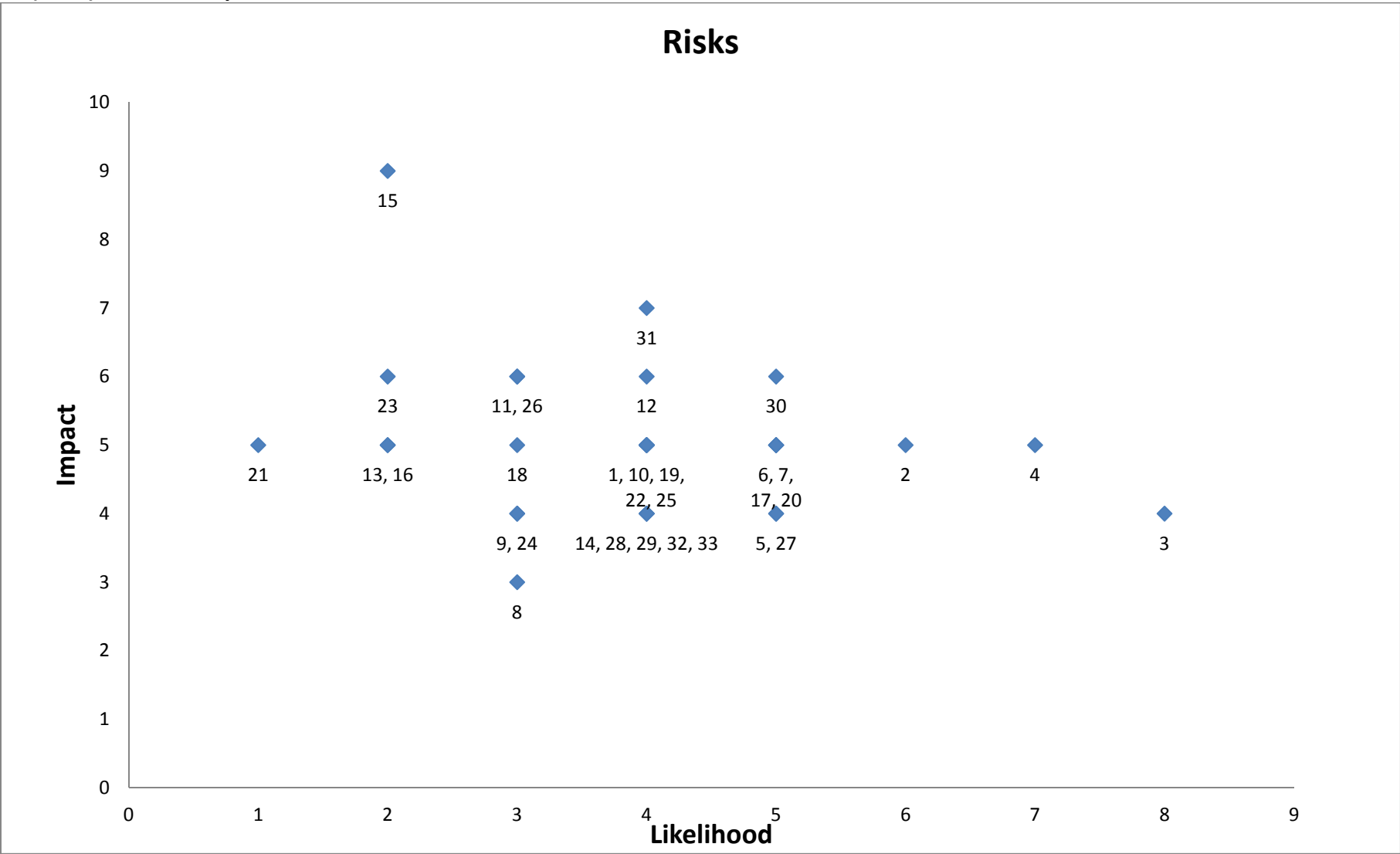
OTHER KEY POINTS

	Comments
New significant risks	None
Other new risks	None
New controls	HR resource, including external advice, in place for FCA/Staffing project. (4)
Eliminated risks	Failure to complete annual accounts on time (a routine business process).
Notable initiatives / actions	<p>Liaising with Falkirk Council to ensure procedures for the secondment arrangement are embedded. (27)</p> <p>Recruitment of Legal & Compliance support in progress, albeit we will not have a legal trainee for the six months from March – August 2015. (32)</p>
Material Litigation	<p>None.</p> <p>Please however note that ongoing discussions with certain employers around the implementation of the funding strategy have require us to put in place appropriate caveats in the relevant courts to ensure we receive early warning of any action to interdict the Fund in implementing its business or otherwise.</p>

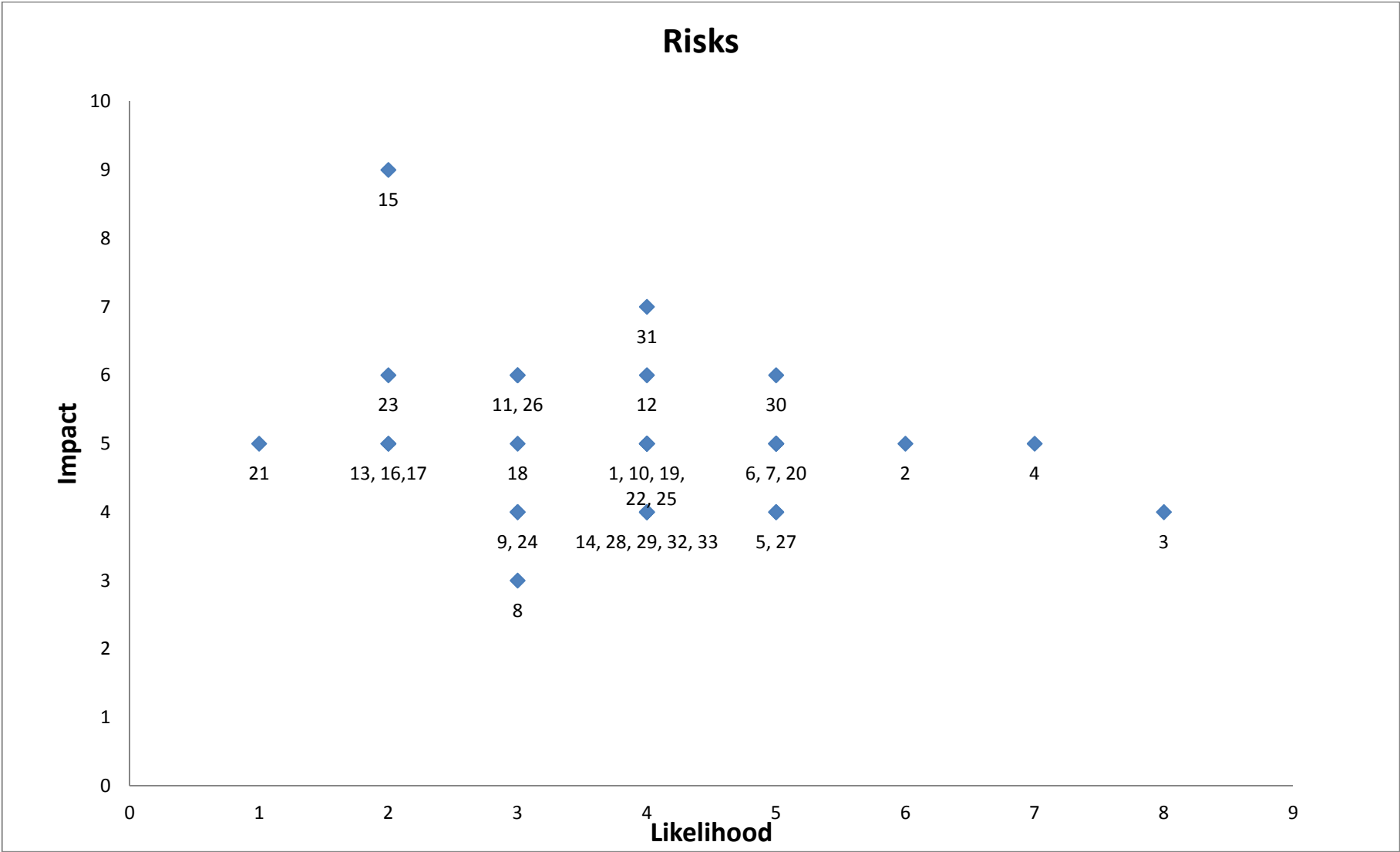
All Risks: Status Overview



Q1 (2015) All Risks: Impact and Likelihood Overview



Q2 (2015) All Risks: Impact and Likelihood Overview



Key: Risks by Number

- 1** Adverse Investment Performance - pressure on employer contributions
- 2** Adverse Movement of non-investment funding assumptions- pressure on employer contributions
- 3** Collapse of an employer
- 4** Recruitment and retention of key staff
- 5** Fraud or theft of Council/Pension Fund assets
- 6** Staff negligence
- 7** Failure of IT systems
- 8** Employers HR decisions without consideration of fund
- 9** Committee members take decisions against sound advice
- 10** Pension Board not operating effectively
- 11** Business continuity issues
- 12** Members' confidential data is breached
- 13** Loss due to stock lending default
- 14** Risk of incorrect pension payments
- 15** Late payment of pension
- 16** Market abuse by investment team or others
- 17** Portfolio transition issues
- 18** Disclosure of confidential information
- 19** Material breach of contract
- 20** Regulatory breach
- 21** FOI process not in accordance with law
- 22** Incorrect communication with members
- 23** Not acting in accordance with proper authority/delegations
- 24** Inappropriate use of pension fund monies
- 25** Procurement/framework breach
- 26** Non-compliance with the new LGPS
- 27** Claim or liability arising from shared services
- 28** Unauthorised access to PensionsWEB
- 29** Incorrect data from Employers leading to fines etc.
- 30** Inadequate contractual protection for services
- 31** Over reliance on single core service provider
- 32** HR insufficient to carry out active projects
- 33** Breach of Health and safety regulations