

# Notice of meeting and agenda

## Pensions Committee

**2.00pm, Tuesday 15 March 2016**

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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Committee Services Manager

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## **1. Order of business**

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- 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**

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- 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**

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- 3.1 If any.

## **4. Minute**

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- 4.1 Previous Minute 16 December 2015 – Submitted for approval as a correct record (circulated)

## **5. Reports**

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- 5.1 Considerations and matters to be raised by the Pension Board regarding any items on the agenda
- 5.2 Agenda Planning – report by the Acting Executive Director of Resources (circulated)
- 5.3 External Audit - Annual Audit Plan 2015-16 – report by the Acting Executive Director of Resources (circulated)
- 5.4 Internal Audit plan for 2016/17 – report by the Chief Internal Auditor (circulated)
- 5.5 Investment strategy reviews for Lothian Buses – report by the Acting Executive Director of Resources (to follow)
- 5.6 Scottish Homes pension funds – report by the Acting Executive Director of Resources (to follow)
- 5.7 Governance Update – report by the Acting Executive Director of Resources (circulated)
- 5.8 Appointments - Pensions Audit Sub-Committee – report by the Chief Executive (circulated)
- 5.9 Appointment of Providers – report by the Acting Executive Director of Resources (circulated)
- 5.10 2015-2018 Service Plan Update – report by the Acting Executive Director of Resources (circulated)
- 5.11 2016-2018 Service Plan and Budget – report by the Acting Executive Director of Resources (circulated)

- 5.12 Employers Participating in the Lothian Pension Fund and updates to the Funding Strategy Statement – report by the Acting Executive Director of Resources (circulated)
- 5.13 Risk Management Summary – report by the Acting Executive Director of Resources (circulated)

## **6. Motions**

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- 6.1 If any

### **Kirsty-Louise Campbell**

Interim Head of Strategy and Insight

## **Committee Members**

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Councillor Rankin (Convener), Councillor Child, Councillor Bill Cook, Councillor Orr and Councillor Rose, John Anzani and Richard Lamont.

## **Information about the Pensions Committee**

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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**

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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](mailto: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](http://www.edinburgh.gov.uk/cpol).

# Item 4.1 - Minutes

## Pensions Committee

**2.00pm, Monday 16 December 2015**

### Present

Councillor Rankin (Convener), John Anzani, Councillor Bill Cook, Richard Lamont, Councillor Orr and Councillor Rose

### Pensions Board Members Present:

Eric Adair, Jim Anderson, Thomas Carr-Pollock, Darren May, Linda McDonald, Jim Rodgers and Catrina Warren

## 1. Minutes

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### Decision

To approve the minute of the Pensions Committee of 16 November 2015 as a correct record.

## 2. Considerations and matters to be raised by the Pensions Board regarding any items on the agenda

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An issue was raised regarding the late arrival of the committee papers and that this did not provide sufficient time for Pension Board members to properly scrutinise the papers.

### Decision

To note the concerns raised by the Board regarding the late circulation of hard copies of the papers and to ask that all efforts are made to minimise the risk of this happening in the future

## 3. Referrals and recommendations from the Pensions Audit Sub-Committee

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Councillor Rose advised the Committee of the discussion and decisions taken at the Pensions Audit Sub-Committee the previous day.

### Decision

To note the update.

## 4. Agenda Planning

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Details were provided of potential reports for future Pensions Committee and Pensions Audit Sub-Committee meetings in March and June 2016.

### Decision

To note the agenda planning document.

(Reference – report by the Deputy Chief Executive, submitted.)

## 5. Lothian Pension Fund – Investment Strategy Review and Update

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An update was provided on the investments of the Lothian Pension Fund to 30 September 2015 and the outcome of the recent review of strategy undertaken by the Investment Strategy Panel.

### Decision

- 1) To note the investment update of strategy implementation and performance.
- 2) To agree that progress towards the investment strategy for 2012-17 should continue.
- 3) To note the recent Investment Strategy Panel discussion reviewing benchmarks, in particular for the Alternative investments with the decision to retain the existing benchmark of RPI +3.5%.

(Reference – report by the Deputy Chief Executive, submitted.)

## 6. Lothian Buses Pension Fund – Investment Strategy Review Update

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An update was provided on the investments and the investment strategy review of the Lothian Buses Pension Fund.

### Decision

To note the investment update and the progress of the investment strategy review of the Lothian Buses Pension Fund.

(Reference – report by the Deputy Chief Executive, submitted.)

## 7. Scottish Homes Pension Fund – Investment Strategy Review and Update

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An update was provided on the investments of the Scottish Homes Pension Fund and the outcome of the recent review of strategy undertaken by the Investment Strategy Panel.

## **Decision**

To note the update on discussions with the Scottish Government on funding options, and the investment strategy review, investment performance, funding level and asset allocation of the Scottish Homes Pension Fund.

(Reference – report by the Deputy Chief Executive, submitted.)

## **8. Investment Controls and Compliance**

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Details were provided of the key matters in relation to investment controls and the development of the in-house investment operations. These matters were investment controls, Financial Conduct Authority authorisation, investment pooling and wider financial services regulation.

### **Decision**

- 1) To note the progress made in relation to implementing the recommendations of the external consultant, the establishment of a Financial Conduct Authority authorised structure, the Fund's involvement in the investment pooling discussions and the potential impact of new financial service regulation on the Fund.
- 2) To note that a briefing would be arranged on investment pooling.

(Reference – report by the Deputy Chief Executive, submitted.)

## **9. Pension Fund Cost Benchmarking**

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Details were provided of the benchmarking of investment for Lothian Pension Fund and pension administration costs for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

### **Decision**

- 1) To note the report.
- 2) To note that CEM Investment Benchmarking Analysis 2014 and the CIPFA Pensions Administration Benchmarking 2015 comparator reports had been provided, on a confidential basis, to the Convener of the Pensions Committee, Convener of the Pensions Audit Sub-Committee and the Independent Professional Observer.

(Reference – report by the Deputy Chief Executive, submitted.)

## 10. Environmental Social and Governance Activity Report Update (including class actions)

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An annual update was provided on the activity of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund in regard to environmental, social and governance issues. In addition, the Funds' class action activity was detailed.

### Decision

- 1) To note the report.
- 2) To endorse Councillor Rose's nomination to stand for re-election to the Local Authority Pension Fund Forum (LAPFF) Executive and also for the position of Vice Chair at the January 2016 AGM.

(Reference – report by the Deputy Chief Executive, submitted.)

### Declaration of Interest

Richard Lamont declared a non-financial interest in the above item as a friend of the Chief Executive of Hermes Equity Services.

## 11. Service Plan Update

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An update was provided on progress against the 2015-18 Service Plan, performance indicators and the key actions of the Fund.

### Decision

- 1) To note the progress of the Fund against the 2015-2018 Service Plan.
- 2) To note the Fund's change to the customer care service standard for paying retirement lump sums.

(Reference – report by the Deputy Chief Executive, submitted.)

## 12. Communications Policy and Pensions Administration Strategy Update

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The Lothian Pension Fund, as a result of the Local Government Pension Scheme, is required to formulate and publish a statement setting out its policy on communicating with certain key stakeholders. Details were also provided of the Pensions Administration Strategy which had been reviewed for regulatory changes and to further enhance data quality and service standards.

### Decision

- 1) To approve the Communications Policy as attached in Appendix 1 to the Deputy Chief Executive's report.

- 2) To note that the Fund had consulted with employers on the proposed changes to the Pensions Administration Strategy.
- 3) To approve the revised Pensions Administration Strategy as attached in appendix 2 of the Deputy Chief Executive's report subject to an error referencing a piece of legislation being amended and fines not being applied in the first year to those employer members who provide their year-end contribution information by the end of April. The deadline though should remain 19 April.

(Reference – report by the Deputy Chief Executive, submitted.)

### **13. Risk Management Summary**

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An overview of the pension funds' risk analysis for quarter 3 of 2015/16 was provided.

#### **Decision**

To note the Quarterly Risk Overview.

(Reference – report by the Deputy Chief Executive, submitted.)



# Pensions Committee

2.00 p.m., Tuesday, 15 March 2016

## Agenda Planning

Item number	5.2
Report number	
Executive/routine	
Wards	All

### Executive summary

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This document provides Committee with an overview of the agendas 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

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Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

## Agenda Planning

### Recommendations

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- 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

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- 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

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- 3.1 Based on the Committee cycle and the current position, the proposed agendas for the next two meetings are set out below.

#### June 2016

<b>Pensions Committee</b>	<b>Audit Sub Committee</b>
<ul style="list-style-type: none"><li>• Considerations and matters to be raised by the Pension Board regarding any items on the agenda</li><li>• Lothian Pension Fund Annual Report (&amp; Accounts) Unaudited</li><li>• Statement of Investment Principles</li><li>• Investment Strategy Panel Activity</li><li>• Annual Investment Update – Lothian Pension Fund/Lothian Buses Pension Fund/Scottish Homes Pension Fund</li><li>• Risk management summary</li></ul>	<ul style="list-style-type: none"><li>• Lothian Pension Fund Annual Report (&amp; Accounts) Unaudited</li><li>• Risk management summary</li></ul>

## September 2016

<b>Pensions Committee</b> <ul style="list-style-type: none"><li>• Considerations and matters to be raised by the Pension Board regarding any items on the agenda</li><li>• LPF Annual Report (&amp; Accounts) Audited</li><li>• ISA 260 Audit Report</li><li>• Employers Participating in Lothian Pension Fund'</li><li>• Service Plan Update</li><li>• Risk management summary</li></ul>	<b>Audit Sub Committee</b> <ul style="list-style-type: none"><li>• LPF Annual Report (&amp; Accounts) Audited</li><li>• ISA 260 Audit Report</li><li>• Pensions Data Quality</li><li>• Delegated authorities – Write offs</li><li>• Fraud Prevention</li><li>• Risk management summary</li></ul>
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### Future Pensions Committee and Audit Sub Committee dates:

<b>Pensions Committee</b> <ul style="list-style-type: none"><li>• Monday, 27 June, 2pm, Dunedin Room, City Chambers.</li><li>• Wednesday, 28 September, 2pm Dunedin Room, City Chambers</li><li>• Tuesday 6 December, 2pm Dunedin Room, City Chambers</li><li>• Wednesday 15 March 2017, 2pm Dunedin Room, City Chambers</li><li>• Wednesday 28 June 2017, 2pm Dunedin Room, City Chambers</li></ul>	<b>Pensions Audit Sub Committee</b> <ul style="list-style-type: none"><li>• Thursday, 23 June 2016, 2pm, Dunedin Room, City Chambers</li><li>• Tuesday 27 September 2016, 2pm Dunedin Room, City Chambers</li><li>• Monday 5 December 2016, 2pm Dunedin Room, City Chambers</li><li>• Tuesday 27 June 2017, 2pm Dunedin Room, City Chambers</li></ul>
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## Measures of success

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- 4.1 The Committee and Pension Board have greater clarity regarding the content of the Committee Cycle.

## Financial impact

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- 5.1 None

## Risk, policy, compliance and governance impact

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- 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

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

## Sustainability impact

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

## Consultation and engagement

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

## Background reading/external references

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None

### Hugh Dunn

Acting Executive Director of Resources

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## Links

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### 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	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
	Policies/Strategies/Training (including revised Pension Administration Strategy biennial from March 2016)	N/A	March
	Service Plan and Budget		March
	Governance Update (as from March 2016)		March
	Audit Sub-Committee Appointments		March
	LPF Annual Report (& Accounts) Unaudited	LPF Annual Report & Accounts (Unaudited)	June
	Statement of Investment Principles	N/A	June
	Investment Strategy Panel Activity	N/A	June
	Annual Investment Update, Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.	N/A	June
	LPF Annual Report & Accounts Audited	LPF Annual Report & Accounts (Audited)	September
	ISA 260 Audit Report	ISA 260 Audit Report	September
	N/A	Pensions Data Quality	September
	N/A	Delegated authorities: Write offs	September
	N/A	Fraud Prevention	September
N/A	Audit of Foreign Exchange Transaction Costs	September	
Annual Report by External Auditor	Annual Report by External Auditor	December (or September if available)	
Benchmarking Report	N/A	December	
N/A	EU Tax Claims & Income Recovery	December	
N/A	Investment Income Review-Cross-Border withholding tax	December	
Stewardship	N/A	December	
N/A	Investment Controls & Compliance	December	

Frequency	Pensions Committee	Audit Sub Committee	Month
Semi Annually	Employers Participating in Lothian Pension Fund	N/A	March & September
3 Times per year	Service Plan Update	N/A	March, September & December
	Referrals / recommendations from Pensions Audit-Sub	N/A	June, September & December
Quarterly	Risk management summary	Risk management summary	March, June, September and December
	Considerations and matters to be raised by the Pension Board regarding any items on the agenda	N/A	March, June, September and 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.) N/A Regulatory Update Investment Strategy Reviews (at least every 3 years) N/A	N/A Audit reports Internal Audit Reports N/A N/A Risk management (in depth review)	

# Pensions Committee

2.00 p.m., Tuesday, 15 March 2016

## External Audit - Annual Audit Plan 2015-16

Item number	5.3
Report number	
Executive/routine	
Wards	All

### Executive summary

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Audit Scotland, the external auditor to the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2015/16. This is shown at Appendix 1 - "Audit Scotland Annual Audit Plan 2015-16".

Stephen O'Hagan, Senior Audit Manager, Audit Scotland, will present the Annual Audit Plan 2015-16 to Committee.

Progress against the Plan will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Pensions Committee.

The proposed audit fee for 2015/16 is £47,660, which is the same as the previous year's fee.

### Links

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Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

## External Audit - Annual Audit Plan 2015-16

### Recommendations

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- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 Note the formal reliance placed on the work of Internal Audit;
- 1.3 Note that suitable provision has been made in the approved budget 2015-16 for the audit fee; and
- 1.4 Note that progress against the Annual Audit Plan 2015-16 will be reported to future meetings of the Pensions Audit Sub-Committee and the Pensions Committee.

### Background

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- 2.1 The Audit Plan is reported annually to Pensions Committee by the external auditor, Audit Scotland.

### Main report

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- 3.1 Audit Scotland, the external auditor to the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2015/16. This is shown at Appendix 1 - "Audit Scotland Annual Audit Plan 2015-16".

### Measures of success

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- 4.1 Progress against the Annual Audit Plan 2015-16 will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Pensions Committee. The prime objective is to ensure an unqualified audit opinion of the Annual Report 2015-16. This will be determined in due course.

### Financial impact

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- 5.1 The proposed audit fee for 2015/16 is £47,660, which is the same as the previous year's fee. Suitable provision has been made in the budget for 2015/16.



## Risk, policy, compliance and governance impact

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6.1 External audit is a critical part of the governance of the pension funds.

## Equalities impact

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

## Sustainability impact

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

## 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

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The responsibilities of Audit Scotland, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, as approved by the Auditor General for Scotland and the Accounts Commission. Appropriate cognisance is also taken of ethical guidance of the auditing profession.

### Hugh Dunn

Acting Executive Director of Resources

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## Links

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### 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 - Audit Scotland Annual Audit Plan 2015-16



# Lothian Pension Funds

Annual Audit Plan

2015/16

Prepared for Members of Pensions Committee

March 2016



# Key contacts

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The Accounts Commission is a statutory body which appoints external auditors to Scottish local government bodies ([www.audit-scotland.gov.uk/about/ac/](http://www.audit-scotland.gov.uk/about/ac/)). Audit Scotland is a statutory body which provides audit services to the Accounts Commission and the Auditor General ([www.audit-scotland.gov.uk/about/](http://www.audit-scotland.gov.uk/about/)).

The Accounts Commission has appointed David McConnell as the external auditor of Lothian Pension Fund for the period 2011/12 to 2015/16.

This report has been prepared for the use of Lothian Pension Fund and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the council. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits published on its website and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

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# Summary

## Introduction

1. Our audit is focused on the identification and assessment of the risks of material misstatement in Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund financial statements (collectively referred to as the Funds).
  2. This report summarises the key challenges and risks facing the Funds and sets out the audit work that we propose to undertake in 2015/16. Our plan reflects:
    - the risks and priorities facing the Funds
    - current national risks that are relevant to local circumstances
    - the impact of changing international auditing and accounting standards
    - our responsibilities under the Code of Audit Practice as approved by the Auditor General for Scotland
    - issues brought forward from previous audit reports.
- they give a true and fair view of the financial transactions of the Funds and their group during the year ended 31 March 2016, and of the amount and disposition at that date of their assets and liabilities
  - the accounts have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the 2015/16 Code of Practice on Local Authority Accounting in the United Kingdom (the Code)
  - a review and assessment of the Funds' governance and performance arrangements in a number of key areas including a review of adequacy of internal audit, arrangements to support the annual governance statement and management commentary in the annual report.

## Summary of planned audit activity

3. Our planned work in 2015/16 includes:
  - an audit of the financial statements and provision of an opinion on whether:

# Responsibilities

4. The audit of the financial statements does not relieve management or the Pensions Committee, as the body charged with governance, of their responsibilities.

## Responsibility of the appointed auditor

5. Our responsibilities, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.
6. Auditors in the public sector give an independent opinion on the financial statements. We also review and report on the arrangements set in place by the audited body to ensure the proper conduct of its financial affairs and to manage its performance and use of resources. In doing this, we aim to support improvement and accountability.

## Responsibility of the Pensions and Accounting Manager

7. It is the responsibility of the Pensions and Accounting Manager, as the appointed "proper officer", to prepare the financial statements in accordance with relevant legislation and the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). This means:
  - maintaining proper accounting records

- preparing financial statements which give a true and fair view of the financial transactions of the Funds and their group during the year ended 31 March 2016, and of the amount and disposition at that date of their assets and liabilities for the year then ended.

## Format of the accounts

8. The financial statements should be prepared in accordance with the Code, which constitutes proper accounting practice.

# Audit Approach

## Our approach

9. Our audit approach is based on an understanding of the characteristics, responsibilities, principal activities, risks and governance arrangements of the Funds and their group. We also consider the key audit risks and challenges in the local government sector generally. This approach includes:
  - understanding the business of the Funds and their group and the risk exposure which could impact on the financial statements
  - assessing the key systems of internal control, and considering how risks in these systems could impact on the financial statements
  - identifying major transaction streams, balances and areas of estimation and understanding how the Funds will include these in the financial statements
  - assessing and addressing the risk of material misstatement in the financial statements
  - determining the nature, timing and extent of the audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements give a true and fair view.
10. We have also considered and documented the sources of assurance which will make best use of our resources and allow us to focus audit testing on higher risk areas during the audit of the financial statements. The main areas of assurance for the audit come from planned management action and reliance on systems of internal control. Planned management action being relied on for 2015/16 includes:
  - comprehensive closedown procedures for the Funds and group financial statements accompanied by a timetable issued to all relevant staff
  - clear responsibilities for preparation of financial statements and the provision of supporting working papers
  - delivery of unaudited financial statements to agreed timescales with a comprehensive working papers package
  - completion of the internal audit programme for 2015/16.
11. Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. Internal audit is provided on a co-sourced basis between PricewaterhouseCoopers (PwC) and the City of Edinburgh Council, the administering authority for the Funds.
12. We seek to rely on the work of internal audit wherever possible and as part of our planning process we carry out an early assessment of the internal audit function to determine whether it has sound documentation standards and reporting procedures in place and complies with the main requirements of the Public Sector Internal Audit Standards (PSIAS).

13. Overall, we concluded that the internal audit service operates in accordance with Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.
14. We plan to place formal reliance on aspects of the work of internal audit in the following areas, to support our audit opinion on the financial statements:
  - immediate payments to pensioners
  - externally managed investments
  - compliance arrangements.

## Materiality

15. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, the failure to achieve a statutory requirement or, an item contrary to law). In the event of such an item arising, its materiality has to be viewed in a narrower context; such matters would normally fall to be covered in an explanatory paragraph in the independent auditor's report.
16. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements both individually and collectively.
17. Based on our knowledge and understanding of the Funds we have set our overall planning materiality at 0.5% of net assets for each separate Fund. We set a lower level, known as performance materiality, when defining our audit procedures. This level depends on professional judgement and is informed by a number of factors including:
  - extent of estimation and judgement within the financial statements
  - nature and extent of prior year misstatements
  - extent of audit testing coverage.
18. As the net assets of the Funds are significantly more than the income and expenditure streams, we set separate planning materiality levels for income and expenditure through the fund accounts. These levels are based on 1% of total contributions received for each Fund. We also set separate performance materiality levels for these areas.
19. **Exhibit 1** summarises the materiality levels applied across the financial statements areas.

**Exhibit 1: Materiality levels**

Financial statements area	Planning materiality £000s	Performance materiality £000s
Main fund – net assets statement	25,535	19,375
Main fund – fund account	1,910	1,435
Lothian Buses – net assets statement	1,930	1,450
Lothian Buses – fund account	95	70
Scottish Homes – net assets statement	775	580
Scottish Homes – fund account	8	6

20. Subject to the comments in the paragraph 21, we will report to those charged with governance all individual misstatements over the following thresholds:
- Main fund - £100,000
  - Lothian Buses – £20,000
  - Scottish Homes - £10,000.
21. In addition, an inaccuracy which would not normally be regarded as material in terms of monetary value may be important for other reasons (for example the failure to achieve a statutory requirement,

or an item contrary to law). In the event of such an item arising, its materiality has to be viewed in a narrower context; such matters would normally fall to be covered in an explanatory paragraph in the independent auditor's report.

**Reporting arrangements**

22. The Local Authority Accounts (Scotland) Regulations 2014 require that the unaudited annual accounts are submitted to the appointed external auditor no later than 30 June each year. The Pensions Committee is required to consider the unaudited annual accounts at a meeting by 31 August 2016.
23. The Funds must publish the unaudited accounts on their websites and give public notice of the inspection period.
24. The 2014 regulations require the Pensions Committee to meet by 30 September to consider whether to approve the audited annual accounts for signature. Immediately after approval, the annual accounts require to be signed and dated by specified members and officers and then provided to the auditor. The Controller of Audit requires audit completion and issue of an independent auditor's report (opinion) by 30 September each year.
25. The Funds are required to publish on their website their signed audited annual accounts, and the audit certificate, by 31 October 2016. The local authority is also required to publish a copy of the accounts of its subsidiaries. The annual audit report is required to be published on the website by 31 December 2016.



26. A proposed timetable for the audit of the 2015/16 financial statements is included at [Exhibit 2](#) below which takes account of submission requirements and planned Pension Committee dates.

**Exhibit 2: Financial statements audit timetable**

Key stage	Date
Testing and review of internal control systems and transactions	By 31 March 2016
Meetings with officers to clarify expectations of working papers and financial system reports	By 31 March 2016
Consideration of unaudited financial statements by those charged with governance	27 June 2016
Latest submission date of unaudited council financial statements with complete working papers package	13 June 2016
Progress meetings with lead officers on emerging issues	As required
Latest date for final clearance meeting with Pensions and Accounting Manager	9 Sept 2016
Agreement of audited unsigned financial statements, and issue of Annual Audit Report which includes the ISA 260 report to those charged with governance	30 Sept 2016
Independent auditor's report signed	30 Sept 2016

27. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the Pensions and Accounting Manager to confirm factual accuracy. Responses to draft reports are expected within two weeks of submission. A copy of all final agreed reports will be sent to the Executive Director of Resources, Investment and Pensions Services Manager, Pensions and Accounting Manager (as Proper Officer), Internal Audit and Audit Scotland's Performance Audit and Best Value Group. In addition key findings will be submitted to the Pensions Audit Sub-Committee and Pensions Committee for their consideration.

28. We will provide an independent auditor's report to the Funds and the Accounts Commission that the audit of the financial statements has been completed in accordance with applicable statutory requirements. The combined ISA 260 and Annual Audit Report will be issued by 30 September 2016.

29. All annual audit reports produced are published on Audit Scotland's website: ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)).

30. Planned outputs for 2015/16 are summarised at [Appendix 1](#).

**Quality control**

31. International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established as part of financial audit procedures. This is to provide reasonable assurance that those professional standards and regulatory and legal requirements are being complied with and that the independent

auditor's report or opinion is appropriate in the circumstances. The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice issued by Audit Scotland and approved by the Accounts Commission. To ensure that we achieve the required quality standards, Audit Scotland conducts peer reviews and internal quality reviews and has been subject to a programme of external reviews by the Institute of Chartered Accountants of Scotland (ICAS).

32. As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We do, however, welcome feedback at any time and this may be directed to the engagement lead, David McConnell, Assistant Director.

## Independence and objectivity

33. Auditors appointed by the Accounts Commission must comply with the Code of Audit Practice. When auditing the financial statements, auditors must also comply with professional standards issued by the Financial Reporting Council (FRC) and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has in place robust arrangements to ensure compliance with these standards including an annual "fit and proper" declaration for all members of staff. The arrangements are overseen by the Assistant Auditor General, who serves as Audit Scotland's Ethics Partner.

34. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff.
35. Audit Scotland is an admitted body within Lothian Pension Fund, and represents around 1% of fund membership. Staff involved in the audit are members of the fund. While this merits disclosure, it is not considered to represent a conflict of interest for the organisation or individuals involved. We are not aware of any other relationships pertaining to the audit of the Funds.

# Audit issues and risks

## Audit issues and risks

36. Based on our discussions with staff, attendance at committee meetings and a review of supporting information we have identified the following main risk areas for the Funds. We have categorised these risks into financial risks and wider dimension risks. The financial statements issues and risks, which require specific audit testing, are summarised below and detail contained in [Appendix 2](#).

## Financial statement issues and risks

37. **Management override of controls:** Auditing standards (ISA 240 *The auditor's responsibility to consider fraud in an audit of financial statements*) highlights the unique position of management to influence the financial statements by overriding controls that otherwise operate effectively.
38. The ability to override these controls exists in all entities and therefore represents a significant financial statements risk. We will undertake focused substantive testing of journal entries, accounting estimates and significant transactions outside the course of normal business.
39. **Group Accounting:** The Pensions Committee, and subsequently City of Edinburgh Council, agreed in October 2014 to the creation of two special purpose vehicles wholly owned and controlled by the council. One company was established in May 2015 for directly

employing certain key staff associated with the Funds investment function to minimise the risk of not retaining staff and has an impact on the 2015/16 financial statements. The Funds have recently signed off on the revised terms and conditions of service for transferred staff. The second company can only become operational once the Funds receive Financial Conduct Authority (FCA) authorisation. It is anticipated this will happen during 2016/17. The impact of these changes have been discussed in detail with Funds' officers in relation to accounting for these special purpose vehicles in such areas as group accounting and any potential changes to accounts presentation.

40. Where a group arrangement exists, the Code requires both single-entity financial statements and group financial statements to be produced. Officers have elected to use a columnar approach to show the single entity and group within one single fund account and net asset statement rather than produce two separate sets of financial statements. We will review this area through the course of our audit and will provide an update in our annual audit report.
41. **Changes to LGPS:** The Public Service Pension Act 2013 and associated regulations has replaced the final salary scheme with a career average revalued earnings (CARE) scheme from 1 April 2015. These arrangements introduce an increased complexity of pension benefit calculations and an increased workload of the funds administration. This may result in an increased risk of pension administration errors as well as possible regulatory breaches if members are not able to retrieve up to date information timeously. We plan to assess the funds' arrangements to address the

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increased workload and undertake focused substantive testing of members calculations during the financial statements and will provide an update in our annual audit report.

- 42. Annual governance statement:** The Code was amended in 2014/15 to include both an annual governance statement and an annual compliance statement within the annual report and accounts. However, our review of the 2014/15 Annual Governance Statement noted that it has been based primarily on the content of the City of Edinburgh Council's Annual Governance Statement. Whilst some of the content within the council's statement is pertinent to the Funds, there are aspects which are of less relevance. Officers have indicated their intention for producing a more specific pension fund annual governance statement. We will review the disclosure as part of the financial statements audit and will provide an update in our annual audit report.
- 43. ICT infrastructure:** The Funds rely on internal and third party hosted IT systems. In relation to the internal infrastructure, the council's ICT services contract is due to transfer from BT to the new supplier CGI on 1 April 2016. Officers report regularly to committee on progress in implementing the project. However, there remains a risk over business continuity management in the interim and as a result the Funds require to manage the adverse effect that any outage may have on internal business operations. We plan to review project updates to committee, discuss the ongoing risk with management and will provide an update in our annual audit report.
- 44. Section 95 officer responsibility:** In previous years, the Pension and Investment Manager reported to Executive Director level within the City of Edinburgh Council. The Section 95 responsibility for the Funds has been delegated to the Pensions and Accounting Manager. Following a revision to the council's organisation structure in December 2015, the Pension and Investment Manager now reports to the Head of Finance at the City of Edinburgh Council. The Section 95 responsibility continues to be delegated to the Pensions and Accounting Manager.
- 45.** Following this change in line management, the Funds should consider whether the current governance and Section 95 reporting arrangements in place remain appropriate. We will consider this area prior to expressing our opinion of the audit and will provide an update in our annual audit report.
- 46. Breach in Regulation – Scottish Homes investment limits:** The statutory regulations set out limits for the proportion of a pension fund invested in certain types of investment. It was highlighted in the Pension Compliance Internal Audit report in November 2015 that a single insurance contract should not exceed 25% of the total value of existing investments. However, approximately 59% of the total value of the Scottish Homes pensions Fund investments, under an insurance contract, are managed by one provider. The Scottish Homes Pension Fund has agreed to restructure the current contract to ensure compliance with LGPS investment regulations. We will monitor progress in this area through the course of our audit and will provide an update in our annual audit report.

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# Fees and resources

## Audit fee

47. Over the past four years, Audit Scotland has reduced audit fees by 24% in real terms, exceeding our 20% target. Due to further refinement of our audit approach we have been able to maintain audit fees for 2015/16 at the same level as last year. This represents an additional real term fee reduction of 1.6%.
48. In determining the audit fee we have taken account of the risk exposure of the Funds, the planned management assurances in place, and the level of reliance we plan to take from the work of internal audit. We have assumed receipt of a complete set of unaudited financial statements and comprehensive working papers package by 13 June 2016.
49. The proposed audit fee for the 2015/16 audit of the Funds is £47,660. Our fee covers:
  - the costs of planning, delivering and reporting the annual audit including auditor's attendance at committees
  - a contribution towards functions that support the local audit process (e.g. technical support and coordination of the National Fraud Initiative), support costs and auditors' travel and subsistence expenses.
50. Where our audit cannot proceed as planned through, for example, late receipt of unaudited financial statements or being unable to take

planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises outwith our planned audit activity.

## Audit team

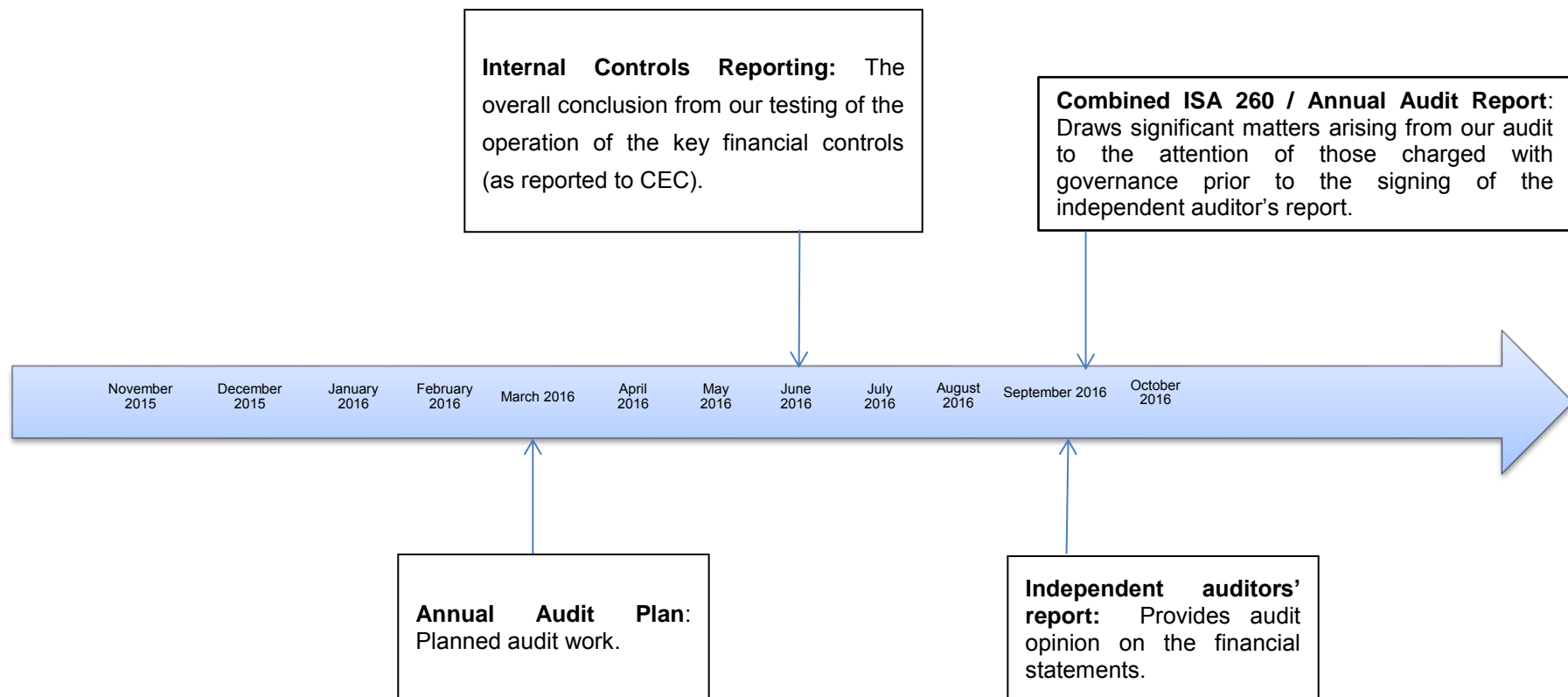
51. David McConnell, Assistant Director, Audit Services is your appointed auditor. The local audit team will be managed by Stephen O'Hagan and supported by Neil Reid who will be responsible for the day to day management of the audit and who will be your primary contact. Details of the experience and skills of our team are provided in [Exhibit 3](#). The core team will call on other specialist and support staff as necessary.

## Exhibit 3: Audit team

Name	Experience
<b>David McConnell MA CPFA, Assistant Director</b>	David has worked in public sector audit since 1981, firstly with the National Audit Office and since 1985, with the Accounts Commission/Audit Scotland. He therefore, has extensive experience of audit in Central Government, Local Government and the NHS. Dave is currently Audit Scotland's lead on financial management and impact reporting.
<b>Stephen O'Hagan, CPFA Senior Audit Manager</b>	Stephen has over 18 years experience of public sector audit with Audit Scotland, covering local government, central government, health and the education sector. Prior to joining Audit Scotland, Stephen worked in local government finance for 5 years.
<b>Neil Reid CMIIA &amp; QICA, Senior Auditor</b>	Neil has over twenty five years public sector experience working across a mix of local government, police and central government bodies within internal and external audit. Neil's previous experience has also involved a secondment to Deloitte, as a manager, working in their Scottish and Northern Ireland public sector advisory and Enterprise Risk Services teams.
<b>Inire Evong BA (Hons) CPFA Senior Auditor</b>	Inire has worked in public sector audit for 8 years, building up her knowledge of audit across the 3 main sectors with the last 5 years spent in local government.
<b>Euan Millar, Professional Trainee</b>	Euan joined Audit Scotland as a Trainee Auditor in 2014 and is studying for his ICAS qualification.

# Appendix 1: Planned audit outputs

The diagram below shows the key outputs planned for Lothian Pension Funds in 2015/16.



## Appendix 2: Significant audit risks

The table below sets out the key audit risks, the related sources of assurance received and the audit work we propose to undertake to address the risks during our audit work.

#	Audit Risk	Source of assurance	Audit assurance procedure
<b>Financial statement issues and risks</b>			
1	<p><b>Management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	N/A	<ul style="list-style-type: none"> <li>• Detailed testing of journal entries.</li> <li>• Review of accounting estimates for bias.</li> <li>• Evaluating significant transactions that are outside the normal course of business.</li> </ul>
2	<p><b>Group Accounting</b></p> <p>Investment and other senior staff have been transferred to a new company created to provide the Funds more flexibility in the terms and conditions on which staff are recruited and investment transactions. There is a risk that transactions between the Funds and the newly established company may not be recorded and disclosed in accordance with the accounting requirements of 'The Code'.</p>	<ul style="list-style-type: none"> <li>• Management's implementation of service level agreements and charging schedules.</li> <li>• Officers have put arrangements in place to ensure that the financial statements are consistent with the Companies Act and the applicable UK accounting framework.</li> </ul>	<ul style="list-style-type: none"> <li>• Substantive testing of transaction between the Funds and the newly established company.</li> <li>• Review of the disclosures made in the Funds' 2015/16 financial statements concerning the relationship between the Funds and the company against the requirements of 'The Code' and sector specific guidance.</li> </ul>



#	Audit Risk	Source of assurance	Audit assurance procedure
3	<p><b>Changes to LGPS</b></p> <p>The Public Service Pension Act 2013 and associated regulations replaced a final salary scheme with a career average revalued earnings (CARE) scheme from 1 April 2015. There is a risk of increased complexity of pension calculations and increased workload of the Funds Administration which may result in an increase in errors.</p>	<ul style="list-style-type: none"> <li>• Various recruitment exercises have taken place during the year to ensure appropriate resources to cope with demands including formation of a Systems Data Quality Team.</li> <li>• Pensions administration software system has also been rigorously tested by the eleven administering authorities in Scotland.</li> </ul>	<ul style="list-style-type: none"> <li>• Review of Funds performance reporting.</li> <li>• Substantive testing of pension calculations during financial statements audit.</li> </ul>
4	<p><b>Annual governance statement</b></p> <p>The Funds Annual Governance Statement in the past has been based primarily on the content of the council's Annual Governance Statement. However, there is a risk that the disclosures are not focused on the governance arrangements of the Pension Funds.</p>	<ul style="list-style-type: none"> <li>• Project planning and preparatory work is underway to ensure compliance with the regulations.</li> <li>• Officers have indicated their intention for producing a more specific pension fund annual governance statement.</li> </ul>	<ul style="list-style-type: none"> <li>• Review of compliance as part of the detailed financial statements review for 2015/16.</li> </ul>

# Pension Committee

2.00 p.m., Tuesday, 15 March 2016

## Internal Audit plan for 2016/17

Item number	5.4
Report number	
Executive/routine	
Wards	All

### Executive summary

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This document outlines the planned Internal Audit activities for the financial year 2016/17.

The Internal Audit plan has been developed using a risk based methodology to ensure that assurance activity is focussed on the key areas of risk faced by the Fund.

### Links

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**Coalition pledges**

**Council outcomes**

CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.

**Single Outcome Agreement**

## Internal Audit plan for 2016/17

### Recommendations

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- 1.1 Committee is requested to note the planned audit activity for the year 2016/17.

### Background

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- 2.1 The internal audit plan for the Fund is risk based and focuses on the governance, risk and controls within the Fund. In line with the requirements of the Public Sector Internal Audit Standards (PSIAS) which have been adopted by Internal Audit, the audit plan has been developed using a risk based methodology to ensure that assurance activity is focussed on the key areas of risk.
- 2.2 The methodology used to create the internal audit plan for the Fund is the same as was used for the City of Edinburgh Council's 2016/17 Internal Audit Plan, which was approved by the Governance, Risk and Best Value Committee on 3 March 2016.

### Main report

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#### Internal Audit Plan for the Lothian Pension Fund

- 3.1 The areas proposed for inclusion in the Pensions section of the Internal Audit plan were identified subsequent to consideration of the Fund's risk register, discussions with the Fund management team and discussions with elected members of the Pensions Audit Sub- Committee to identify current areas of risk and to prioritise where obtaining assurance is appropriate.
- 3.2 The planned reviews for the year to 31 March 2016 are set out below:

	Audit remit	Planned days
1	<u>Investments Managed Internally</u> The review will assess the processes and controls in place around internally managed funds and review the procedures in place to monitor investment performance. This will include the management of funds invested within Private Equity investment vehicles.	20

2	<p><u>External vulnerability assessment</u></p> <p>The review will consider the security in place and the vulnerability to external threats to the supplier hosted, web-based, pension administration system, including the Employer online and Member online modules, which are external externally accessible by employers &amp; members of the Fund.</p>	20
3	<p><u>Governance of LPFE</u></p> <p>LPFE is the Fund's service company which employs senior management within the Fund. The review will assess the governance arrangements &amp; mechanisms in place to ensure conformance with external reporting &amp; compliance requirements. The review will also consider the internal reporting mechanisms in place &amp; supervision provided by the Pension Committee to ensure that Best Value is achieved.</p>	20

3.3 It is proposed to conduct the Investments Managed Internally review in Q1 of the financial year with the other two reviews expected to be undertaken simultaneously in Q3, with the expectation that all reviews will be complete in advance of the December 2016 Pension Committee meeting.

3.4 Planned days are indicative at this stage as the nature, timing and extent of the audit work is not confirmed until the detailed Terms of Reference have been finalised following the completion of the planning process with Fund management, for each review.

## Measures of success

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

## Financial impact

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5.1 A central support charge will be made to the Fund for the provision of Internal Audit services provided. This is in the process of being finalised by Finance but is expected to be in the region of £52,000.

## Risk, policy, compliance and governance impact

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6.1 The Internal Audit plan sets out the areas of focus for Internal Audit activities for 2016/17. Internal Audit provides assurance over the governance and control environment operating in the Fund.

## Equalities impact

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

## Sustainability impact

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

## Consultation and engagement

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9.1 The internal audit team consulted with the Risk team, Lothian Pension Fund management and members of the, Pensions Audit Sub- Committee in preparing the Internal Audit plan.

## Background reading / external references

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None.

Magnus Aitken, Chief Internal Auditor

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## Links

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### Coalition pledges

**Council outcomes** CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.

### Single Outcome Agreement

### Appendices

# Pensions Committee

2.00 p.m., Tuesday, 15 March 2016

## Investment Strategy Review – Lothian Buses Pension Fund

Item number	5.5
Report number	
Executive/routine	
Wards	All

### Executive summary

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The Lothian Buses Pension Fund's Investment Strategy 2012-17 is being implemented gradually, with a reduction in the equity weighting accompanied by an increased allocation to index-linked gilts and alternative investments.

The Investment Strategy Panel's review of strategy post the 2014 Actuarial Valuation has concluded and Committee is asked to approve a revised investment strategy which aims to reduce risk further, over the next 5 years.

### Links

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Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

## Investment Strategy Review – Lothian Buses Pension Fund

### Recommendations

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- 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 outcome of the review of investment strategy for the Lothian Buses Pension Fund undertaken by the Investment Strategy Panel;
- 1.3 That Committee approve the revised investment strategy for the Lothian Buses Pension Fund;
- 1.4 That Committee agrees that the option for Lothian Buses Pension Fund to be merged into Lothian Pension Fund, and the most appropriate timing, is explored further in consultation with stakeholders.

### Background

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- 2.1 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. Alternative investments include property, non-government debt, infrastructure and timber.
- 2.2 The Investment Strategy Panel undertakes a strategy review at least every three years, typically following a triennial actuarial valuation. The Pensions Committee approved the Investment Strategy 2012-17 for Lothian Buses Pension Fund in October 2012.

<b>Asset Category</b>	<b>Long term Strategy Allocation 2012-17 %</b>	<b>Permitted Range %</b>
Equities	55	45 - 65
Index-Linked Assets	15	10 - 30
Alternatives	30	10 - 35
Cash	0	0 - 10
<b>TOTAL</b>	<b>100</b>	

- 2.3 The current strategy reduces the allocation to equities (including private equity) from 65% at the end of 2012 and increases the allocation to index-linked gilts and alternatives.
- 2.4 An update on the implementation of the investment strategy was reported to Pensions Committee in December 2015 and the table below provides the Fund's current investments. The increase in the allocation to alternative investments has proceeded at a measured pace as suitable investment opportunities have become available. The equity weighting has also reduced.

	<b>Manager</b>	<b>Interim Strategy Allocation 31 March 2012 %</b>	<b>Interim Strategy Allocation 31 January 2016 %</b>	<b>Actual Allocation 31 January 2016 %</b>
<b>EQUITIES</b>				
Global Alpha	Baillie Gifford			29
Global High Dividend Yield	Internal			29
Private Equity	Internal			1
<b>Subtotal</b>		<b>65</b>	<b>58.5</b>	<b>59</b>
<b>INDEX-LINKED ASSETS</b>				
Index-linked bonds	Baillie Gifford			8
Index-linked gilts	Internal			5
<b>Subtotal</b>		<b>10</b>	<b>14.0</b>	<b>13</b>
<b>ALTERNATIVES</b>				
Property	Standard Life	10		11
Other Real Assets [1]	Various	15		8
Other Bonds [2]	Baillie Gifford			8
<b>Subtotal</b>		<b>25</b>	<b>27.5</b>	<b>27</b>
<b>Cash</b>	<b>Internal</b>	<b>0</b>	<b>0</b>	<b>1</b>
<b>TOTAL</b>		<b>100</b>	<b>100</b>	<b>100</b>

[1] Includes infrastructure and timber; [2] Includes corporate bonds and loans

## Main report

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- 3.1 Following the 2014 Actuarial Valuation, the Investment Strategy Panel has reviewed the Fund's investment strategy in light of developments in pension fund membership, expected cash flow, funding level, fund maturity, historic and prospective investment risk and returns.
- 3.2 Net cash flow (excluding investment income) has been marginally negative. Investment income will become an increasingly important source of stability as the Fund is closed to new members.



3.3 The funding level declined between the 2011 and 2014 valuations, due to liabilities growing at a faster pace than assets, largely the effect of falling gilt yields. This trend has continued since the 2014 actuarial valuation.

#### **Employer Covenant**

3.4 The ability and willingness of the employer to pay contributions to the pension fund (i.e. its covenant) is an important consideration in setting investment strategy for any pension fund.

3.5 In the context of a standalone transport company, the current investment strategy contains meaningful funding level volatility which could affect affordability. While the company is currently in a healthy financial position, the review has afforded the opportunity to clarify the funding approach if the position worsened and also when the last active member leaves the Fund.

3.6 As Lothian Buses Pension Fund closed to new members in 2008, the number of active members is reducing and in due course the Fund will consist entirely of deferred and pensioner members. In normal circumstances, on the departure of an admitted body's last active member the admission agreement is terminated, a cessation valuation is undertaken on a prudent basis and any debt is crystallised with no recourse to further employer contributions.

3.7 After discussion with shareholder and the company, the investment strategy review has assumed that Lothian Buses will continue to pay deficit contributions (if required) after the last active member has left the Fund. The funding position and required employer contributions would be reviewed at triennial actuarial valuation in the normal way. The Admission Agreement is currently being updated accordingly.

3.8 With this clarity, the Fund can continue to adopt a long-term investment approach.

#### **Outcome of Investment Strategy Review**

3.9 The review was aided by asset liability modelling undertaken by the Fund's investment adviser which highlighted the potential impact of the future funding level volatility on the company's balance sheet and contributions.

3.10 The largest funding risks identified were those driven by the liability value, which is a function of changes in long term interest rates and inflation, and the equity risk, which is expected to diminish over the very long term.

3.11 The asset liability modelling explored options to reduce investment risk in the Fund including the use of derivatives to hedge inflation and interest rate risk. Investment Strategy Panel concluded that, whilst derivatives may be useful in some circumstances, the Lothian Buses Pension Fund should initially look to reduce risk by:

- Continuing to reduce equities allocation in favour of bonds;
- Further de-risking within equities;
- Lengthening the duration of the Fund's bonds to provide greater downside protection in the event of reductions in interest rates.

3.12 The Committee is asked to approve the investment strategy for the Lothian Buses Pension Fund for 2016 – 2021 as follows:

<b>Asset Category</b>	<b>CURRENT Long term Strategy Allocation 2012-17 %</b>	<b>REVISED Long term Strategy Allocation 2016-21 %</b>	<b>Change in Long Term Strategy %</b>	<b>Change from Current Allocation %</b>
Equities	55	40	-15	-19
Index-Linked Assets	15	20	+5	+7
Other 'Real' Assets	30	18	-	-1
Fixed Income Assets		22	+10	+14
Cash	0	0	-	-1
<b>TOTAL</b>	<b>100</b>	<b>100</b>	-	-

3.13 The strategy includes:

- further reduction in the Fund's equity exposure;
- a distinct asset class of 'Fixed Income Assets'. Currently the Fund holds approximately 10% of fixed income assets within 'Alternative' investments.

3.14 Given the financial strength of the company, and confirmation that the company is committed to continue to pay contributions after the last active member leaves, it is proposed to implement the strategy over the next five years. Implementation should depend on the progression of the funding level and the availability of suitable fixed income assets.

3.15 The Committee is also asked to agree that the revised strategy be implemented over the next 5 years and delegate its implementation to the Executive Director of Resources in consultation with the Investment Strategy Panel.

3.16 The objectives for the investment strategy are currently:

- 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.

3.17 Discussions on appropriate funding and investment objectives for all three pension funds have commenced with the Fund's Independent Professional Observer and will be reported to Committee in June 2016.

## **Review of Option to Merge Lothian Buses Pension Fund into Lothian Pension Fund**

- 3.18 Lothian Buses Pension Fund is defined in regulations as a sub-Fund of Lothian Pension Fund and there is an option within regulations for the Fund to be subsumed into Lothian Pension Fund. During the investment strategy review this has been highlighted and explored.
- 3.19 Currently, unlisted investments such as infrastructure, timber and private debt are made for the Lothian Buses Pension Fund (if appropriate) at the same time as the Lothian Pension Fund. In most cases, such investments would be impractical for Lothian Buses Pension Fund as a relatively small pension fund. The two funds share such investments in fixed proportions for ease of administration. With the change in the Lothian Buses Pension Fund investment strategy, the way in which such investments are allocated between the two funds will need to be reviewed.
- 3.20 Different employer investment strategies (unitisation) have recently been put in place for the Lothian Pension Fund. Currently two different investment strategies are in place for employers within Lothian Pension Fund; 100% index-linked gilts and that for the remaining employers. There is scope to increase the number of different strategies for employers within Lothian Pension Fund and Investment Strategy Panel is exploring these options.
- 3.21 The unitisation functionality could help with implementation of the new investment strategy for the Lothian Buses Pension Fund, as it allows more flexible allocation of investments. It would also bring other efficiencies such as accounting, actuarial valuations and investment manager arrangements.
- 3.22 It is recommended that the Committee agree that the option for Lothian Buses Pension Fund to be merged into Lothian Pension Fund, and the most appropriate timing, is explored in consultation with stakeholders.

### **Measures of success**

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- 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 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**

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- 5.1 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

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- 6.1 Investment Strategy is the main determinant of funding level and volatility of employer contribution rates.
- 6.2 There is no governance impact as a result of this report. Committee delegates the implementation of investment strategy to the Executive Director of Resources, 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

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- 7.1 There are no equalities implications as a result of this report.

## Sustainability impact

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- 8.1 The Statement of Investment Principles 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

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- 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, to consult on strategic issues and to ensure that the risks inherent in the strategy are understood and are acceptable.

## Background reading/external references

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None

### **Hugh Dunn**

Acting Executive Director of Resources

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## Links

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**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

2.00 p.m., Tuesday, 15 March 2016

## Investment Strategy Review – Scottish Homes Pension Fund

Item number	5.6
Report number	
Executive/routine	
Wards	All

### Executive summary

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This paper updates the Committee on a review of the investment strategy of the Scottish Homes Pension Fund. The review has concluded and has put forward proposals to the Scottish Government for discussion as follows:

- Changing the agreement which governs the funding and investment for the Fund;
- Removing the direct link between the funding level of the Fund at the date of the triennial actuarial valuation and the contributions required from the Scottish Government;
- Introducing a more flexible, income focussed investment strategy to reduce the requirement for regular asset sales;
- Providing a longer-term projection of Scottish Government contributions at the time of the actuarial valuation.

The Committee is asked to approve that the Executive Director of Resources concludes an updated funding agreement with Scottish Government accordingly, in consultation with the Actuary, Investment Strategy Panel and Convener of the Pensions Committee.

### Links

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Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

## Investment Strategy Review – Scottish Homes Pension Fund

### Recommendations

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- 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 progress on the review of the Scottish Homes Pension Fund investment and funding strategy which proposes:
  - Changing the agreement which governs the funding and investment for the Fund;
  - Removing the direct link between the funding level of the Fund at the date of the triennial actuarial valuation and the contributions required from the Scottish Government;
  - Introducing a more flexible, income focussed investment strategy to reduce the current requirement for regular asset sales;
  - Providing a longer-term projection of Scottish Government contributions at the time of the actuarial valuation.
- 1.3 That Committee approves that the Executive Director of Resources concludes an updated funding agreement with Scottish Government accordingly, in consultation with the Actuary, Investment Strategy Panel and Convener of the Pensions Committee.

### Background

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- 2.1 The funding arrangements and contributions from the Scottish Government for the Fund are currently determined by the 'Operation of the Scottish Executive (Government) Guarantee' ('the Guarantee').
- 2.2 The Actuary to the Fund assesses the value of the assets and liabilities at each triennial valuation and contributions are determined by comparing the funding level with targets set out in the agreement. Essentially, the assets and liabilities are 'marked to market' every three years. The resulting contributions by the Scottish Government depend on achieving increasing target funding levels at each actuarial valuation. The contribution calculation includes a provision to smooth contributions if the funding level fails to meet the current funding target but exceeds the previous funding target. However, contribution rates are largely dependent on current funding levels and hence depend on short-term market movements.

2.3 The equity allocation within the investment strategy is determined by the Guarantee as shown in the table below.

<b>Equity Allocation %</b>	<b>Target Funding Level at 31 March</b>	<b>Target Funding Level %</b>
35	2011	89.5%
30	2014	91.5%
25	2017	93.0%
20	2020	94.5%
15	2023	95.5%
10	2026	96.5%

2.4 The guarantee prescribes that the proportion of the Fund invested in equities will reduce over time and, as the actual funding level exceeds the target funding level, 'surpluses' will be locked away by increasing investment in government bonds. The monitoring of the funding level is undertaken by the internal investment team using a system provided by the Actuary. Changes to the equity exposure are undertaken in consultation with the Investment Strategy Panel.

2.5 An update on the investment strategy was provided to the Committee in December 2015. Following improvements in the funding level, in January 2015, the equity allocation was reduced from 30% to 25%. Subsequent market movements lead to a deterioration of the funding level and in October 2015 the equity allocation was increased to 27.5%.

2.6 Following further deterioration in funding level in 2016 (approximately 90.5% at the beginning of February), the equity exposure was increased to 30%.

2.7 The asset exposures at 22 February 2016 are shown in the table below.

<b>Market Exposure</b>	<b>Actual Allocation (%)</b>	<b>Target Allocation (%)</b>
Equities	30.9	30.0
Bonds	63.7	65.0
Property	5.4	5.0
Total	100.0	100.0

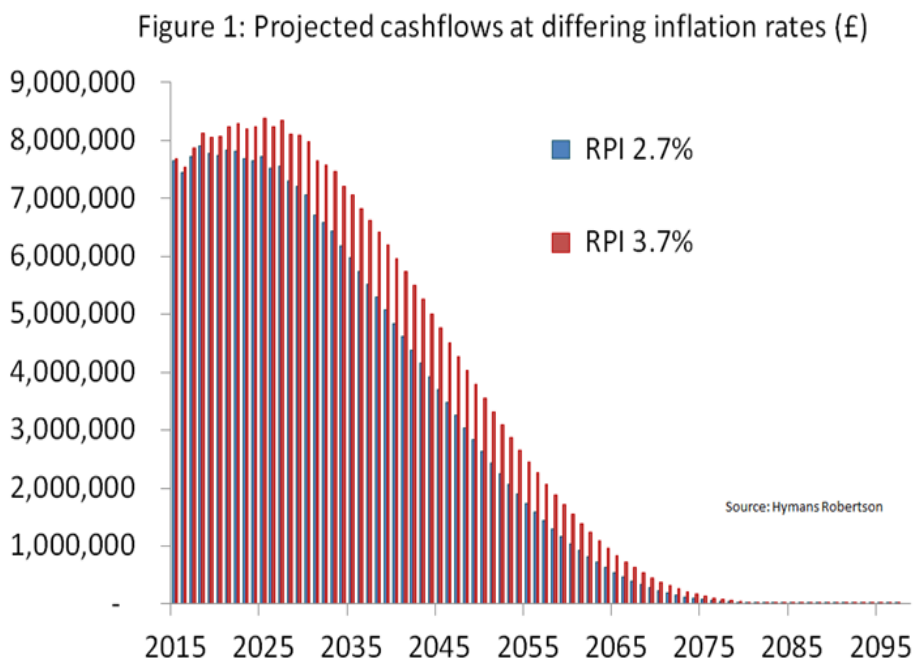
2.8 As previously reported to Committee, discussions regarding potential changes to the funding agreement were held with the Scottish Government during the 2014 actuarial valuation. Options to change the funding approach to one where contributions would be determined by fund cashflows, rather than funding 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 guarantee. However, they indicated they would be willing to explore funding options further ahead of the 2017 actuarial valuation.



## Main report

3.1 The Investment Strategy Panel has undertaken a review of the investment strategy. The review included analysis of the forecast liability cashflow and the requirements of the investments of the Fund to meet the pension liability payments.

3.2 The liability projections are as follows:



3.3 The review explored a number of investment and funding approaches and included consideration of different investment scenarios for income yield and growth of income.

3.4 The key conclusions of the analysis are as follows:

- Current bond-focussed investment strategy provides income yield of less than 2%. With a yield of less than 4-5%, the Fund is required to sell assets on a regular basis to pay pensions;
- The current strategy places a high reliance on the growth of assets and the market pricing at the point at which sales are required;
- Without significant contributions from Scottish Government, the current investment strategy is expected to be insufficient to fund the liabilities in the long-term.

3.5 The review has concluded that a less prescriptive investment and funding strategy is introduced to allow a higher-yielding investment strategy and a more flexible approach to setting contributions.

3.6 A higher yielding investment strategy would involve a lower allocation to government bonds (with a current yield of less than 1%) and increased allocation to equities, property and/or non-government bonds. Global equities currently yield approximately 3%.

### 3.7 Considerations for an alternative funding approach are:

- a lower allocation to government bonds means that the funding level on a particular day will be more volatile than under the current arrangement. However with a change to the funding agreement, short term market movements will not necessarily have a direct impact on the contributions required from Scottish Government;
- employer contributions could be determined by the Fund's cashflow requirements, focussing on the forecast of pension payments, administration costs and investment income. The details would be developed with the Actuary;
- the actuarial valuation could provide a forecast of contributions for a period longer than the current period of 3 years;
- a higher investment income (lower bond) focussed strategy should reduce the required contributions from Scottish Government in the long term;
- a higher investment income strategy will reduce the requirement for asset sales and hence smoothes the risk that asset sales are required after markets fall;
- if the contributions required depend on the receipt of income from investments, there is the risk that the assets do not deliver the anticipated income, for example, due to companies not paying dividends, failure of a counterparty or movements in currency. (These risks will be managed, but cannot be eliminated, by ensuring a diversified, income-focussed investment portfolio);
- currently non-property assets are managed on a passive, low cost basis and costs for some higher-yielding investments are likely to be higher. However, assumptions have been based on returns net of fees.

### 3.8 In practice, such an alternative funding arrangement would mean that:

- The funding level would continue to be calculated by the Actuary at the actuarial valuation.
- Regular analysis of assets and liability cashflow would be required to determine required contribution rates. This would happen every 3 years during the actuarial valuation process or more frequently if cashflow varies significantly from forecasts.
- A prudent approach to funding would continue to be taken. The Actuary would retain the right to revisit the actuarial valuation and contributions between the formal triennial cycle in the event of unforeseen experience or extreme changes in cashflow and/or investment markets.

### 3.9 The Actuary has confirmed he is comfortable with these high-level principles. Discussions with Scottish Government regarding alternative funding options are ongoing, including their requirement for stability or otherwise of the funding level.

3.10 It is envisaged that the next steps will be:

- Agreement in principle from Scottish Government;
  - Develop the funding agreement with the Fund's Actuary;
  - Agree and sign an updated funding agreement;
  - Identify appropriate market opportunities and implement changes to investment strategy;
- Develop cashflow forecasts in advance of the 2017 actuarial valuation.

3.11 Committee is asked to approve that the Executive Director of Resources concludes an updated funding agreement with Scottish Government accordingly, in consultation with the Actuary, Investment Strategy Panel and Convener of the Pensions Committee.

3.12 Updates on progress will be provided to Committee.

## Measures of success

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4.1 The City of Edinburgh Council's primary requirement is to ensure appropriate funding arrangements for the Scottish Homes Pension Fund to ensure there are, or will be, sufficient assets to pay the liabilities.

## Financial impact

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5.1 The financial impact for the Scottish Government is a key consideration for the review. The conclusions propose a change to the funding guarantee which could provide greater certainty for the contributions required from the Scottish Government, but with a more volatile funding level.

## Risk, policy, compliance and governance impact

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6.1 The funding and investment risks are addressed in this report. The agreement and funding guarantee ensures that any contributions required for the Fund are paid by the Scottish Government.

## Equalities impact

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7.1 There is no equalities impact as a result of this report.

## Sustainability impact

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8.1 The funding approach ensures that the investments, together with contributions required from the Scottish Government, are sufficient to sustain the payment of pension liabilities now and in the future. The review of the funding aims to improve sustainability of the Fund in the long term.

## Consultation and engagement

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- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.
- 9.2 The Fund consults and engages with Scottish Government at least annually on the progress of the Fund. Scottish Government's priorities have been a key consideration of the review and discussions on the conclusions are ongoing in order to agree the way forward.

## Background reading/external references

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None.

### Hugh Dunn

Acting Executive Director of Resources

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## Links

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### 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

2.00 p.m., Tuesday, 15 March 2016

## Governance Update

Item number	5.7
Report number	
Executive/routine	
Wards	All

### Executive summary

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The purpose of this report is to update the Committee on the rotation of the Pension Board chair and training activities over 2015/16.

### Links

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Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

## Governance Update

### Recommendations

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- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Pensions Committee should consider.
- 1.2 That Committee notes the verbal update from the Pension Board regarding the newly appointed chair of the Pension Board effective from 1 April 2016 to 31 March 2017.
- 1.3 That the Committee note Eric Adair's contribution as the first chair of the Pension Board.
- 1.4 That the Committee note the training hours over 2015/16.

### Background

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- 2.1 The Fund's constitution states that '*the chairman of the Pension Board will be rotated on an annual basis*'. In the first year the chair was drawn from the employer membership of the Pension Board. The 2016/17 chair is required to be drawn from the employee membership of the Pension Board.
- 2.2 The Fund's training policy sets out that a minimum of 21 training hours are expected of Pensions Committee and Pension Board members. In addition, the Pensions Regulator now requires those involved with the governance of local government pension schemes to develop and build sufficient knowledge to effectively carry out their role.
- 2.3 In 2014/15 year the total training hours for the Pension Committee members was 167.5 hours and the total for the (now dissolved) Consultative Panel was 60.5 hours.

### Main report

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#### **Rotation of the Pension Board Chair**

- 3.1 The Pension Board are meeting in advance of the Pensions Committee and are expected to provide a verbal update to the Pensions Committee regarding who they have appointed as chair.

#### **Training hours 2015/16 for the Pensions Committee and Pension Board**

- 3.2 The total training hours for Pensions Committee members as at 15 February 2016 in 2015/16 is 219.89 and the total number of training hours for Pension Board members as at 15 February 2016 is 301.75 hours.

- 3.3 Overall training hours have increased considerably over the last year. This is partly due to the new Pension Board and the requirement for members to develop their knowledge and understanding of the Fund. Pensions Committee members have also completed more training.
- 3.4 Although one Pensions Committee member and two Pension Board members as at 15 February 2016 do not meet the required training hours there are two further training opportunities in March and it is expected that all Committee and Board members will fully achieve the minimum training requirement by the end of March.
- 3.5 The Fund aims to continue to provide quarterly reminders of training hours and details of future training opportunities to ensure the Pensions Committee and Pension Board members continue to achieve the training requirements.

### **Measures of success**

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- 4.1 The Fund is governed effectively with each Pensions Committee and Pension Board member having a clear knowledge of their responsibilities and a fully functioning Board.
- 4.2 The Pension Committee and Pension Board members meet the required training and knowledge standards set out by the Pension Regulator.

### **Financial impact**

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- 5.1 None

### **Risk, policy, compliance and governance impact**

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- 6.1 Pension Committee and Pension Board members meet the required training and knowledge standards set out by the Pension Regulator.

### **Equalities impact**

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- 7.1 None

### **Sustainability impact**

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- 8.1 None

### **Consultation and engagement**

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

## Background reading/external references

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None

### Hugh Dunn

Acting Executive Director of Resources

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## Links

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### 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 – Committee and Consultative Panel Members' Training Record from 1 April 2015 to 31 March 2016



**Committee and Consultative Panel Members' Training Record  
From 1 April 2015 to 31 March 2016**

Event:	TPR code e-learning	UKSIF	Pension Board Induction	NAPF local authority conference	Nordic Horizons	Induction catch up sessions	Internal Training Investments	LGPS Seminar	Pension Board Meeting	Sarah Smart Session	Audit Sub Committee Preparation	Pension Committee Preparation	LGPS conference	Internal training session	Audit Sub Committee Preparation	Sarah Smart Session	Pension Committee Preparation	LGPS Scotland Seminar	Sarah Smart Session	Pension Committee Preparation	Internal Training Session	LAPFF conference	Audit Sub Committee Preparation	Pension Committee Preparation	Pensions Committee Investment training	Additional training/reading	Total
Date	on-line	22/4/15	8/5/15	18-20/05/15	18/5/15	16/6/15	3/6/15	26/5/15	24/6/15	24/6/15	23/6/15	24/6/15	25&26/06	8/9/15	29/9/15	30/9/15	30/9/15	09/0/2015	16/11/15	16/11/15	25/11/15	2,3,4,12/15	15/12/15	16/12/15	16/12/15		
<i>Please note 1/2 an hour preparation is given to all those that attend the audit sub committee. 1 hour is given to those who attend the Pensions Committee.</i>																											
<b>Pensions</b>																											
Maureen Child			n/a		0	n/a	3	5.5	n/a	0.5		1		3			1	7.5	0	0.5	3.25	0	n/a	0	0		25.25
Bill Cook			n/a		0	n/a	3	0	n/a		0.5	1		0	0		0	0	0	0.5	2.57	10	0.5	1	0.5		19.57
Jim Orr			n/a		2	n/a	2.5	5.5	n/a		0.5	1		3	0.5	0.25	1	7.5	0.5	0.5	3.25	0	0.5	1	0.5	0.5	30.5
Alasdair Rankin (Convener)			n/a		0	n/a	3	0	n/a			1		3			1	7.5	0	0.5	1.5	12	n/a	1	0.5	1	32
Cameron Rose			n/a		2	n/a	2.5	0	n/a		0.5	1		3	0.5			0	0	0.5	1.07	12	0.5	1	0.5	21	46.07
John Anzani			n/a	10	0	n/a	2.5	0	n/a			1		0		0.5	1	7.5	0.5	0.5	3.25	12	n/a	1	0.5		40.25
Richard Lamont			3		0	n/a	3	0	n/a			1		3			1	7.5	0	0.5	3.25	0	n/a	1	0.5	2.5	26.25
<b>Lothian Pension Employer Representatives</b>																											
Eric Adair (EDI Group)	7				0	3	0	0	1			1		0			0	0	0	0.5	0	0	n/a	1	0.5	3.25	17.25
Linda McDonald (Handicabs)	7		2.5		2	n/a	0	5.5	1	0.5	0.5	1		3			1	7.5	1	0.5	3.25	8	n/a	1	0.5		45.75
Darren May (Scottish Water)	7				2	3	0	5.5	0.5	0.5		1		3			0	0	0	0.5	3.25	0	n/a	1	0.5	11	38.75
Rucelle Soutar (the Edinburgh Military Tattoo)	7				0	1.5	3	0	1			1		0		0.5	1	0	0	0	3.25	0	n/a	0	0		18.25
Simon Belfer (Napier University)	7				0	3	0	0	no			1		3	0.5		1	7.5	0	0.5	3.25	0	0.5	0	0		27.25
<b>Member Representatives</b>																											
Graeme Turnbull (UCATT)			3		0	n/a	0	5.5	1	0.5		1		3			1	7.5	1	0.5	1.5	0	n/a	0	0		25.5
John Rodgers (UNITE)	7		3		0	n/a	0	0	no			1		3		0.5	1	7.5	0	0	3.25	0	n/a	1	0.5		27.75
Jim Anderson (UNISON)	7		3		2	n/a	3	0	1	0.5		1		3		0.5	1	7.5	1	0.5	3.25	0	n/a	1	0.5		35.75
Catrina Warren (UNISON)	8.75		3		2	n/a	0	5.5	1	0.5		1		3	0.5		1	7.5	0	0.5	3.25	0	0.5	1	0.5		39.5
Thomas Carr Pollock (GMB)	7		3		1.5	n/a	0	5.5	1			1		3			1	0	1	0.5	0	0	n/a	1	0.5		26
<b>Total</b>																											<b>521.64</b>

**Separate sessions/training**

Richard Lamont visited the Fund Office 17/7/2015 to discuss pension matters [2.5 hours](#)  
Alasdair Rankin and Cameron Rose additional briefing on appeals- [1 hour](#)

Jim Orr - 0.5 hrs Call to Clare Scott re: employer cessations 20/11/15  
Darren May additional reading e.g. Professional Pensions - [11 hours \(over 12 months\)](#)  
Eric Adair - Employer seminar 2/12/15 and preparation time - [3.25](#)

Clr Rose 02/06/2015 - LAPFF Executive meeting [2.25](#)      21/09/2015 to 22/09/2015 – LAPFF Executive meeting [2.25 hours](#)  
Clr Rose 15/06/2015 to 16/06/2015 – LAPFF Business meeting [2.25 hrs](#)      05/10/2015 to 06/10/2015 – LAPFF Forum Business meetings [2.25](#)  
Clr Rose 03/11/2015 – LAPFF Executive Strategy & Conference Planning meeting [5 hours](#)      14/12/15 Toyota and Shall ESG meeting [2 hrs](#)  
Clr Rose 12/01/16 and 27/01/16 LAPFF meetings [4 hours](#)

# Pensions Committee

2.00pm, Tuesday, 15 March 2016

## Appointments - Pensions Audit Sub-Committee

Item number	5.8
Report number	
Executive/routine	
Wards	All

### Executive summary

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

### Links

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Coalition pledges	
Council outcomes	CO25
Single Outcome Agreement	

## Appointments – Pensions Audit Sub-Committee

### Recommendations

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- 1.1 To appoint three of the members of the Pensions Committee, to take effect from 2 June 2016, as members of the Pensions Audit Sub-Committee subject to confirmation of their appointment as members of the Pensions Committee at the meeting of the City of Edinburgh Council on 2 June 2016.
- 1.2 To appoint the Convener of the Pensions Audit Sub-Committee.

### Background

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

### Main report

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- 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. The previous year's membership consisted of Councillors Cameron Rose, Bill Cook and Jim 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.

### Measures of success

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- 4.1 Not applicable.

### Financial impact

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- 5.1 Not applicable.

## Risk, policy, compliance and governance impact

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- 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

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- 7.1 Not applicable.

## Sustainability impact

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- 8.1 Not applicable.

## Consultation and engagement

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- 9.1 Not applicable.

## Background reading/external references

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

[Minute of the Pensions Committee 24 June 2015](#)

### Andrew Kerr

Chief Executive

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### Links

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#### Coalition pledges

**Council outcomes** CO25 – The Council has efficient and effective services that deliver on objectives

**Single Outcome Agreement Appendices**

# Pensions Committee

2.00 p.m., Tuesday, 15 March 2016

## Appointment of Providers

Item number	5.9
Report number	
Executive/routine	
Wards	All

### Executive summary

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This report provides an update on the appointment of providers for services to the pension funds. It also asks Committee to extend the contracts with Hermes Equity Ownership (for stewardship services) and State Street (for investment services to the Scottish Homes Pension Fund). The stewardship service will be procured from the National LGPS Framework once a framework is put in place (expected to be late 2016). The investment management arrangements for the Scottish Homes Pension Fund are under review, as covered elsewhere on the agenda

### Links

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Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

## Appointment of Providers

### Recommendations

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- 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 appointments of the providers for the pension funds.
- 1.3 That the Committee agrees to the extension of the contract with Hermes Equity Ownership until March 2017.
- 1.4 That the Committee agrees the extension of the contract with State Street to March 2017.

### Background

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- 2.1 Service providers to the pension fund are reviewed, and tendered, on a regular basis. The way in which services are procured, and the process and resource involved in the process, depends on the expected costs of the service. The more significant contracts are typically procured via advertising in the Official Journal of the European Union (OJEU), with a number of officers involved in assessing potential providers. Each provider is required to evidence their ability to provide the service, for example by providing references and via interviews.
- 2.2 Collective procurement by the Local Government Pension Scheme (LGPS) has increased over recent years, particularly using the National LGPS Framework which is coordinated by Norfolk County Council. Frameworks are available for all funds to use, enabling the LGPS to optimise combined buying power to deliver greater value for money and offering all funds fast and efficient access to services via a fully OJEU compliant route.

### Main report

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#### Unitisation System

- 3.1 A competitive EU procurement exercise for the provision of a unitisation system for Lothian Pension Fund's has been completed. The system aims to provide enhanced tracking of employer assets within Lothian Pension Fund. Tenders were assessed on a weighting of 60% for quality and 40% for price. The quality assessment was weighted: 50% for functionality, 10% for ICT security / standards, 10% for implementation / training and 30% for the content of the presentation / question responses. The evaluation was made by a joint team of

investment and accounting staff. Hymans Robertson has been appointed for a period of 4 years.

### **Stewardship Services**

- 3.2 Hermes' EOS contract to provide stewardship (i.e. engagement and voting) services expires in June 2016.
- 3.3 The National LGPS Framework is intending to put in place a framework for stewardship services and it is expected to be available in the autumn of 2016. Lothian Pension Fund staff, together with representatives from a range of funds, will help to set up the framework.
- 3.4 Committee is asked to approve the extension of the Hermes contract until March 2017 to enable Lothian Pension Fund to appoint a provider from the framework once it is established.

### **Investment Management Services**

- 3.5 The contract with State Street for investment services for the Scottish Homes Pension Fund is due to expire on 31 March 2016. The investment strategy review for this Fund is in process and is due to conclude in the near future. Committee is therefore asked to approve the extension of the State Street contract until March 2017, pending implementation of the conclusions of the review.

### **Performance Measurement Services**

- 3.6 Portfolio Evaluation's contract to provide investment performance measurement service expired in February 2016. Under delegated authorities, the Acting Executive Director of Resources has extended the contract to 1 January 2017, pending a review of the service and potential tender exercise. The extension provides the most beneficial timing for a new procurement process in terms of provider options for the service and also covers the full 15/16 financial year and ensures consistency of reporting format year to year.

### **Accounting Services**

- 3.7 As provider of accounting and auditing of Council companies, Scott Moncrieff are providing the equivalent function for LPFE and LPFI companies owned by Lothian Pension Fund. They are also providing the payroll service for LPFE staff.

### **Other Providers**

- 3.8 The following providers have been appointed:
  - MSCI for the provision of environmental, social and governance research for use in the internal investment process;
  - PWC for remuneration benchmarking for LPFE staff;
  - 121 HR consulting for ongoing HR support for LPFE.
- 3.9 The above were appointed after mini-tender exercises.

- 3.10 Western Union was appointed to provide existence checks and banking services for overseas pensioners for a three year period to improve the management of fraud risk. The appointment was made under a waiver of the City of Edinburgh's contract standing orders due to the low costs involved.

#### **Future Service Procurement**

- 3.11 As noted above, stewardship services will be tendered using the National LGPS Framework once it is established later in 2016.
- 3.12 Preparations are being made to commence a tender of pension administration system, including the system which allows members to access their pension information.
- 3.13 The current investment custody contract is for an initial period of six years to February 2017 with an option to extend for a further three years. Over the next six months we will be reviewing the contract to make a decision on the option to extend the contract.

### **Measures of success**

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- 4.1 Providers are set objectives against which performance is assessed. Regular tendering of providers ensures service is reviewed.

### **Financial impact**

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- 5.1 Appropriate provision for costs has been provided within the approved budget 2015/16, the proposed budget for 2016/17 and indicative budget for 2017/18.

### **Risk, policy, compliance and governance impact**

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- 6.1 Management of service providers and appropriate procurement reduces risk to the pension funds.

### **Equalities impact**

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- 7.1 There is no equalities impact as a result of this report.

### **Sustainability impact**

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- 8.1 The provider of stewardship services will include consideration of environmental implications in its engagement with companies.



## Consultation and engagement

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

## Background reading/external references

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None

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## Links

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### 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

2.00 p.m., Tuesday, 15 March 2016

## 2015-2018 Service Plan Update

Item number	5.10
Report number	
Executive/routine	
Wards	All

### Executive summary

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The purpose of this report is to provide an update on progress against the 2015 – 2018 Service Plan, performance indicators and the key actions to enable the Fund to meet its four key objectives:

- Customer First;
- Honest & Transparent;
- Working Together; and
- Forward Thinking.

Overall progress is being made against the service plan objectives.

With the exception of the customer satisfaction and the timeliness of employer contribution payments, which remain below target, it is likely that performance targets will be achieved by the end of the year.

### Links

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Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

## 2015-2018 Service Plan Update

### Recommendations

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- 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 progress of the Fund against the 2015 – 2018 Service Plan.

### Background

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- 2.1 The 2015 – 2018 Service Plan for Lothian Pension Fund was agreed by Pensions Committee in March 2015.
- 2.2 The purpose of this report is to provide an update on the Plan, performance indicators and the key actions to enable the Fund to meet its four key objectives:
  - Customer First;
  - Honest & Transparent;
  - Working Together; and
  - Forward Thinking.

### Main report

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- 3.1 Progress on the following areas is covered elsewhere on the agenda:
  - Investment strategy reviews for Lothian Buses Pension Fund and Scottish Homes Pension Fund;
  - Governance including training for Committee and Pension Board.

Other progress of particular note is shown below.

#### **Upgrade of website and My pension Online services**

- 3.2 An upgrade is being carried out to both the Fund's website and the My Pension Online service. The website upgrade follows changes to the way the Council's IT is provided and incorporates the April 2015 regulation changes. The service upgrade for the My Pension Online service is designed to add flexibility to the site and resolve difficulties some members encountered in registering for the service.

### **Investment transition**

- 3.3 At the time of writing, plans are in place to further implement Lothian Pension Fund's investment strategy within equities and a verbal update will be provided at Committee.

### **Internal Investment Team - Terms and conditions**

- 3.4 The employment of internal investment team was transferred to LPFE Ltd, a company wholly owned by the Lothian Pension Fund, in May 2015. The LPFE Board has recently completed a review of the terms and conditions, taking into account external benchmarking. Contracts are in the process of being updated. New terms and conditions are now closer to those of potential employers including salaries, holiday entitlement, notice periods (now 3 or 6 months, depending on the role) and confidentiality clauses.

### **Aiming for A investor coalition**

- 3.5 Lothian Pension Fund is supporting the investor call for climate risk transparency from large mining companies. Investors have called on companies to be more transparent over climate change risks and opportunities in their business. The Fund is co-filing a supportive but stretching shareholder resolution at Rio Tinto's AGM. Co-filing the resolution demonstrates the Fund's commitment to responsible stewardship.

### **Membership and Cashflow monitoring**

- 3.6 Officers of the Fund continue to monitor movements in membership numbers in order to assess potential implications upon cashflow. Early retirement initiatives could trigger significant and immediate outflows due to the payment of tax free lump sums and pensions and reductions in contributions received. However payment of strain costs by the employer help to mitigate current cashflow pressures.
- 3.7 A programme of staff departures is being embarked upon by the City of Edinburgh Council. There have been a significant number of early retirements at the end of 2015. It is expected that such programmes will move Lothian Pension Fund to a generally negative cash flow position in the coming years, whereby pension payments exceed total contributions received.

3.8 A summary of the year-to-date and projected cash flows for the pension funds is shown below.

<b>Lothian Pension Fund</b>	<b>2015/16 YTD</b>	<b>2015/16 Projected</b>
<b><u>Income</u></b>	<b>£'000</b>	<b>£'000</b>
Contributions from Employers	114,185	157,213
Contributions from Employees	33,424	42,824
Transfers from Other Schemes	2,229	2,829
	149,838	202,866
<b><u>Expenditure</u></b>		
Pension Payments	(111,504)	(134,254)
Lump Sum Retirement Payments	(33,005)	(42,570)
Refunds to Members Leaving Service	(714)	(796)
Transfers to Other Schemes	(5,125)	(5,925)
Other Expenditure	(6,914)	(11,757)
	(157,263)	(195,303)
<b>Net Additions/(Deductions) From Dealings with Members</b>	<b>(7,425)</b>	<b>7,563</b>
<b>Lothian Buses Pension Fund</b>		
Income	7,156	9,406
Expenditure	(9,189)	(11,454)
<b>Net Additions/(Deductions) From Dealings with Members</b>	<b>(2,032)</b>	<b>(2,048)</b>
<b>Scottish Homes Pension Fund</b>		
Income	7,156	9,406
Expenditure	(9,189)	(11,454)
<b>Net Additions/(Deductions) From Dealings with Members</b>	<b>(2,032)</b>	<b>(2,048)</b>

3.9 Cashflow projections indicate that income and expenditure will remain broadly the same for the Lothian Pension Fund for the next year, taking into account forecast early retirements from City of Edinburgh Council. This is helped by the strain costs received from the employer. Thereafter expenditure is expected to exceed income. Increased investment income has been targeted in recent years, partly for use in this scenario and investment income is expected to exceed net cashflow for the foreseeable future.

3.10 In Lothian Buses and Scottish Homes Pension Funds expenditure is expected to continue to exceed income.

## **Pension Increase 2016**

- 3.11 Each April, HM Treasury uses the Consumer Price Index from the previous September to ensure pensions are keeping up with the cost of living. The Consumer Price Index is the Government's measure of how prices are rising or falling. In September 2015, the Consumer Price Index was -0.1%.
- 3.12 Her Majesty's Treasury has laid a Parliamentary Order requesting that the negative pension increase be applied to benefits. At the time of writing this report, the Order is being debated in Parliament and no decision has been made.
- 3.13 This Order would only apply where a member has Career Average benefits and how this applies to members with active, deferred and pensioner benefits is complex. The Fund has received contradictory advice from the Scottish Public Pension Agency (SPPA) and the Local Government Association (LGA) and is awaiting clarification of the position. A verbal update will be provided on the position.

## **Performance Indicators**

- 3.14 Performance for the key performance indicators against targets are shown in the Appendix.
- 3.15 Following an external assessment, the Fund has successfully retained the award Customer Service Excellence (CSE) award. The Fund remains compliant in all of the 57 award criteria and now has six 'compliance plus' awards, increased from four. The additional two compliance plus awards cover customer insight and analysis of the customer journey.
- 3.16 Performance indicators highlighted as 'amber' are:
- Customer satisfaction over the 12 months to 31 December 2015 is behind target at 84.6% compared to the target of 87%. The satisfaction of new members continues to be strong at 84%. The email survey is showing the lowest satisfaction at 60% and work is continuing to improve these results including ensuring respond within the target of 10 days.
  - The staff training indicator is still behind target at 87.2%. However, staff training is ongoing and this indicator is expected to be met by the end of the year.
  - The timeliness of payment of employer contributions has improved but the year-to-date performance (98.6%) remains below target of 99%. The cumulative year total is 98.64% to the end of December.

## **Measures of success**

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- 4.1 Measures of success include meeting targets for performance indicators and progressing the actions set out in the Service Plan.

## Financial impact

5.1 A summary of the projected and year-to-date financial outturn compared to the approved budget for 2015/16 is shown in the table below:

Category	Approved Budget £'000	Projected Outturn £'000	Projected Variance £'000	Budget to date £'000	Actual to date £'000	Variance to date £'000
Employees	2,489	2,253	(236)	2,074	1,792	(282)
Transport & Premises	225	234	9	188	172	(16)
Supplies & Services	1,095	1,037	(58)	912	882	(30)
Investment Managers Fees	8,100	7,800	(300)	6,750	6,460	(290)
Other Third Party Payments	1,286	751	(535)	1,072	490	(582)
Central Support Costs	276	315	39	230	262	32
Depreciation	80	91	11	67	76	9
<b>Direct Expenditure (Invoiced)</b>	<b>13,551</b>	<b>12,481</b>	<b>(1,070)</b>	<b>11,293</b>	<b>10,134</b>	<b>(1,159)</b>
Income	(1,657)	(1,203)	454	(1,381)	(1,002)	379
<b>Net Expenditure (Invoiced)</b>	<b>11,894</b>	<b>11,278</b>	<b>(616)</b>	<b>9,912</b>	<b>9,132</b>	<b>(780)</b>
<b>Indicative Expenditure (Un-invoiced Manager Fees)</b>	<b>18,924</b>	<b>19,024</b>	<b>100</b>	<b>15,770</b>	<b>16,187</b>	<b>417</b>
<b>Total Cost to the Funds</b>	<b>30,818</b>	<b>30,302</b>	<b>(516)</b>	<b>25,682</b>	<b>25,319</b>	<b>(363)</b>

5.2 The financial outturn includes year to date budget, actual expenditure and variance as at the end of January 2016. Year to date actual expenditure includes provision for services incurred but for which no invoice has yet been received. Un-invoiced expenditure (i.e. investment management costs deducted from capital) is generally assumed to be in-line with the budget. With delays in splitting out research costs from brokers fees (see below) a £500k overspend in un-invoiced fees has been forecast with a corresponding underspend in 'Other Third Party Payments'.

5.3 Committee will recall that a budget of £200K was included in the budget for increased opportunities for direct investment to enable the team to pursue investments where costs may be incurred during the due diligence process before the investment is made. Five such opportunities have arisen during the year. So far no such costs have been incurred by the Fund as all investments have completed. £200k continues to be included in the projection.

5.4 The projection shows an underspend of approximately £516k. The key variances against budget are:

- Investment Managers Fees - **£300k underspend**. Manager fees are based on market values. An 8% increase in market values was projected however year to date market prices have fallen.
- Other Third Party Payments - **£535k underspend**. A majority of this underspend is due to delays in splitting out research costs from broker's fees. A £500k budget was allocated to this however the new arrangement will not be in place before the end of the financial year. As mentioned above these costs have been offset in the Un-invoiced expenditure.
- Employees - **£236k underspend**. Various recruitment exercises have taken place through the year to fill vacant positions. The primary reason for the underspend are vacant positions of a solicitor and a portfolio manager where recent recruitment exercises have been unsuccessful. (Note that an additional Portfolio Manager was included in the budget incorrectly).
- Central Support Costs (CSC) - **£39k overspend**. Budgeted figures produced from forecasted 2014/15 figures. Final 2014/15 CSC was actually £50k higher. Work commencing to have service level agreements in place instead of CSC allocation to provide more certainty of actual costs.
- Income - **£454k below budget**. This relates to stock lending commission. The budget was modelled on Northern Trust projections based on last year's income. 50% of last years revenue was derived from one stock. The income from this stock was less reliable in the first quarter of the year and the stock was sold (unrelated to stock lending revenue) during the second quarter.

5.5 Contained within the table of 5.1 are the expenses in relation to LPFE Limited. LPFE is the company that employs the key investment personnel of the Fund. To date the total expenditure of LPFE is £660k with projected outlays for the year expected to be below £900k.

## Risk, policy, compliance and governance impact

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6.1 The pension funds' service plan aims to manage risk, improve compliance and governance. There are no direct implications on these issues as a result of this report.

## Equalities impact

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7.1 None.



## Sustainability impact

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8.1 None.

## Consultation and engagement

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

## Background reading/external references

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None

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## Links

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### 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 – Performance Indicators

## Service Plan Performance Indicators – Targets &amp; Actual Performance

	Q1 April to June	Q2 July to Sept	Q3 Oct to Dec	Target	Status
<b>Customer First</b>					
Maintain Customer Service Excellence Standard	Annual assessment carried out in February 2016 – CSE retained			Retain CSE Award	
Overall satisfaction of employers, active members and pensions measured by surveys	Rolling 12 month performance is 84.6%			87%	
Proportion of active members receiving a benefit statement and time of year statement is issued	98% issued on 28 August			Over 96% by end August	
<b>Forward Thinking</b>					
Performance and Risk of Lothian Pension Fund	Actual 8.4%pa, Benchmark 6.9%pa. Exceeding benchmark.  Risk/return measures will take some time to demonstrate the success or otherwise of the investment strategy.			Meet benchmark over rolling 5 year periods with lower risk with risk/return measures including performance in rising and falling markets.	
Proportion of critical pensions administration work completed within standards	91.5%	91.8%	92.5%	Greater than 90%	
<b>Honest &amp; Transparent</b>					
Audit of annual report	Achieved			Unqualified opinion	
Percentage of employer contributions paid within 19 days of month end	98.96%	97.27%	99.6%	99%	
Data quality – compliance with best practice as defined by the Pensions Regulator	Assessment will be made at year-end			Fully compliant	Not yet known
Monthly Pension Payroll paid on time	Yes	Yes	Yes	Yes	
<b>Working Together</b>					
Level of sickness absence	1.45%	0.28%	1.05%	4%	
Annual staff survey question to determine satisfaction with present job	73%			67%	
Percentage of staff that have completed two days training per year.	61%	74%	87%	100%	

# Pensions Committee

2.00 p.m., Tuesday, 15 March 2016

## 2016-2018 Service Plan and Budget

Item number	5.11
Report number	
Executive/routine	
Wards	All

### Executive summary

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The Service Plan provides details of the pension fund's key challenges over the coming years including increased external scrutiny, increasing changes in employer participation in the Fund and opportunities afforded by investment pooling. It also sets budget and performance targets for the service.

### Links

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Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

## 2016-2019 Service Plan and Budget

### Recommendations

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That Committee:

- 1.1 Invites the Pension Board to raise any relevant matters or concerns which the Committee should consider;
- 1.2 Approves the two-year Service Plan for 2016-2018;
- 1.3 Approves the budget for 2016-2017;
- 1.4 Notes the indicative budget for 2017-2018.

### Background

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- 2.1 The Lothian Pension Fund's Service Plan has been reviewed to ensure its key performance indicators and objectives are up-to-date, clear, challenging and achievable.

### Main report

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- 3.1 The draft Service Plan for 2016-2018 is provided as Appendix 1.
- 3.2 The Fund's objectives remain unchanged as follows:
  - Customer First;
  - Honest & Transparent;
  - Working Together; and
  - Forward Thinking.
- 3.3 The Service Plan provides details of the pension fund's key challenges over the coming years including increased external scrutiny, increasing changes in employer participation in the Fund and opportunities afforded by investment pooling.
- 3.4 Notable initiatives are:
  - The use of the Pension Administration Standards Association to drive further improvements in service;
  - A proactive approach to investment collaboration to explore opportunities;
  - Reviewing the approach to employer covenant monitoring and management to ensure efficient and effective working.

- 3.5 The proposed budget for 2016/17 is included in the Appendix, together with an indicative budget for 2017/18. The main points to note are summarised below at “Financial Impact”.
- 3.6 Lothian Pension Fund’s Service Plan has until now been reviewed on an annual basis. It is proposed to change this to every two years i.e. the next review of the Plan will be in March 2018. However the budget for 2017/18 would be submitted to Committee for approval in March 2017.

## Measures of success

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

## Financial impact

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- 5.1 The proposed budget for invoiced expenditures for 2016-2017 of £12.2m and indicative figures of £12.9m for 2017-2018 are provided in the Appendix.
- 5.2 Notable movement in the proposed budget, compared to the 2015/16 budget are as follows:

**Invoiced Expenditure** increased by £348K, made up of

- £980K reduction in investment fees incurred via invoiced investment management, partly due to changes in investment management arrangements and partly due to lower market values;
- £700K reduction in stock lending income;
- Increased employee costs £417K, made up of increased national insurance, salary increments and implementation of new terms and conditions of staff in LPFE. Additional investment analyst support has also been included to build capacity for potential further insourcing;
- £100K additional fees pending a review of the Fund’s management of employer covenant monitoring management;
- Note that Central Support Costs are estimated due to lack of available information.

**Uninvoiced Expenditure** - The Budget also includes indicative costs of un-invoiced investment fees which are deducted from capital. This increased cost transparency aligns to the best practice accounting methodology adopted in the Fund’s accounts in recent years. Committee is reminded that investment fees are difficult to predict accurately in the short term as fees are typically based on market values which can be volatile and performance fees payable in a single accounting year are difficult to forecast. Similarly, transaction costs are difficult to estimate as they are dependent on the level of trading which may be affected, for example, by changes in investment managers’ mandates or opportunities in

the market. This reinforces the need for the totality of investment costs to be considered in the context of investment performance.

Un-invoiced costs are estimated to be £18.8million for year 2016-2017.

- Transactions costs are expected to reduce over time as investment portfolios have been reorganised and the new portfolios generally trade less;
- Fees deducted from capital are expected to increase with an increasing allocation to private debt.

5.3 The proposed budget continues to include £10 million contingency to be utilised in the specific event of significant departures from the internal investment team compelling the outsourcing of the investment management function.

## **Risk, policy, compliance and governance impact**

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

## **Equalities impact**

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

## **Sustainability impact**

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

## **Consultation and engagement**

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

9.2 Consultation and engagement via a number of sources has informed the service plan including:

- Customer insight including surveys and meetings;
- Feedback from the Fund's Customer Service Excellence assessment;
- Staff survey and staff meetings.

## Background reading/external references

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None

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## Links

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### Coalition pledges

**Council outcomes** CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed

### Single Outcome Agreement

**Appendices** Appendix 1 – Draft Lothian Pension Fund Service Plan 2016-2018



# Service Plan 2016 – 2018





## Introduction

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

Lothian Pension Fund is the second largest Local Government Pension Fund in Scotland with assets of approximately £5.0 billion, 100 employers with active members and over 70,000 members.

The Lothian Buses Pension Fund holds assets of £0.5 billion and 3,900 members, while Scottish Homes Pension Fund investments amount to £0.14 billion with 1,800 members.

## How the Fund is run

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

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

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

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

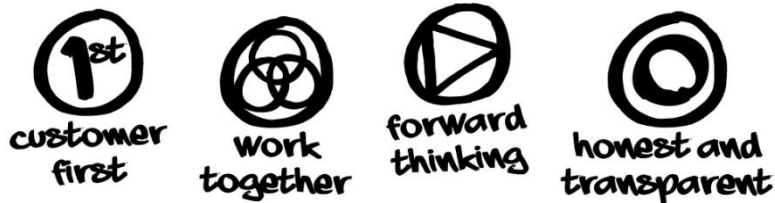
The Fund maintains a comprehensive website for easy access to all relevant pension information and this is found at [www.lpf.org.uk](http://www.lpf.org.uk). This includes the Annual Report & Accounts of the three pension funds.

## Policies

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

## Our Service

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



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

To enable us to achieve these objectives we must:

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

## Our Responsibilities

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

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

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

# Performance Indicators

	<b>2014/ 2015</b>	<b>2015/ 2016</b>	<b>2016/ 2017</b>	<b>2017/ 2018</b>
Maintain Customer Service Excellence Standard (CSE)	Retain award (Yes)	Retain award (Yes)	Retain	Retain
Overall satisfaction of employers, active members and pensioners measured by surveys	86% (89%)	87% (84.6%)*	88%	89%
Proportion of members receiving a benefit statement and by August	Over 95% (96%)	Over 96% (98%)	100%	100%
Performance and Risk of Lothian Pension Fund	Actual 9.5%pa. Benchmark 8.8%pa	*Actual 8.4%pa Benchmark 6.9%pa	Meet benchmark over rolling 5 year periods with lower risk with risk/return measures including performance in rising and falling markets	
Proportion of critical pensions administration work completed within standards	Greater than 90% (90%)	Greater than 90% (92.5%)*	Greater than 90%	Greater than 90%
Audit of annual report	Unqualified opinion (Yes)	Unqualified opinion		
Percentage by value of pension contributions received within 19 days of the end of the month to which they relate	98% (98%)	99% (98.6%)*	99%	99%
Data quality - compliance with best practice as defined by The Pensions Regulator	Fully compliant (Yes)	Fully compliant		
Monthly pension payroll paid on time	Yes (Yes)	Yes (Yes)*	Yes	Yes
Level of sickness absence	4.0% (2.1%)	4.0% (0.9%)*	4.0%	4.0%
Annual staff survey question to determine satisfaction with present job	65% (65%)	67% (73%)	75%	77%
All staff complete at least two days training per year	2 days (Yes)	Yes (on track)*	Yes	Yes

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

# Continuous improvement

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

<p><b>Political &amp; Regulatory</b></p>	<p>Governance changes were introduced in April 2015 with a new Pension Board and a national Scheme Advisory Board. In addition the Pensions Regulator now has regulatory oversight of public sector pension schemes</p> <p>The Local Government Pension Scheme (LGPS) in England &amp; Wales is reviewing options to implement investment pooling arrangements. A review of the structure of the LGPS in Scotland is expected to be undertaken.</p> <p>Members over age 55 are now able to transfer their LGPS benefits to defined contribution arrangements which allow immediate access to the cash transferred. The Fund is seeking authorisation from the Financial Conduct Authority.</p> <p>The abolishment of contracting out of the State Earnings Related Pension Scheme in April 2016 will mean increases in national insurance contributions for employers and members, as well as an onus on the Fund to reconcile members' contracting out with those of the government. The changes to benefits in the LGPS, pension taxation allowances and new pension freedoms make the administration more complex and more difficult for members to understand.</p>
<p><b>Economic</b></p>	<p>Continuing budgetary constraints across the public sector are expected to lead to further reductions in employee numbers. There is also a risk that members decide to opt-out of the Fund on grounds of affordability or lack of appreciation of the value of pension benefits. Together with the new pension freedom and pension auto-enrolment, these could impact on the Fund's membership and liabilities.</p> <p>Economic growth in most parts of the world appears to be stuttering and yields on government bonds continue to move to historic lows.</p> <p>The results of the 2014 actuarial valuation and employer covenant analysis have highlighted the need for different funding and investment options for certain employers. With increased pressure on employer contributions, there continues to be a need to improve efficiency and reduce costs.</p>
<p><b>Customer Insight</b></p>	<p>The Fund has a wide range of internal and external customers. We use a variety of engagement techniques to develop our understanding of different customer groups and our staff. Their needs, experiences of our service and their perception of the Fund help us to continually improve and become more efficient and effective.</p>
<p><b>Technology</b></p>	<p>Advances in information technology facilitating on-line self-services and data transfer for both scheme members and employers.</p>
<p><b>Environmental</b></p>	<p>The Fund continues to strive to be an active shareholder to enhance the long-term value of our investments.</p>
<p><b>Scrutiny &amp; Benchmarking</b></p>	<p>The Fund uses feedback from scrutiny of our services to inform developments. Such scrutiny includes internal and external audit, cost benchmarking and external awards (Customer Service Excellence and Investors in People).</p>
<p><b>Risk Management</b></p>	<p>The Fund is committed to a strong control environment to ensure that risks are identified, understood, managed and monitored appropriately. The risks faced by the Fund change over time and ongoing management of risk is crucial.</p>



## Customer First

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

Our Customer Service Excellence award demonstrates that we consistently strive to meet our customers' needs. In 2016 we will be working with the Pension Administration Standards Association to further improve our service.

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

The general lack of awareness of our members of the value of their pension benefits, and the contributions made by their employer, remains a concern. With increases in national insurance contributions in April 2016 it is important to ensure the scheme is appreciated as a valuable part of an employee's remuneration.

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

Action	Description
<p><b>Develop and improve customer insight</b></p>	<ul style="list-style-type: none"> <li>– Develop and refresh our insight of our customers to ensure we capture changing needs.</li> <li>– Develop our understanding of the ways customers contact us. Continue to regularly engage with all customer groups using a variety of techniques including mystery shopping and transactional surveys.</li> <li>– Improve analysis of consultations to ensure it remains integral to our service.</li> </ul>
<p>Develop and improve customer awareness</p>	<ul style="list-style-type: none"> <li>– Develop communications for members on the value of the scheme.</li> <li>– Develop communications with employers on funding and investment ahead of the 2017 actuarial valuation.</li> <li>– Improve external communications and understanding of investment strategy.</li> </ul>
<p><b>Improve timeliness and quality of customer service</b></p>	<ul style="list-style-type: none"> <li>– Complete roll-out of “employer on-line” system.</li> <li>– Partnership accountability – continue to monitor and publish performance against service standards to ensure we have an effective and accountable partnership with employers.</li> <li>– Enhance members’ first point of contact with the Fund.</li> <li>– Review resourcing of changes in employer admission status.</li> </ul>
<p>Develop and improve our information and access</p>	<ul style="list-style-type: none"> <li>– Improved access to services via member on-line system.</li> <li>– Monitor the Fund’s trail of social media for communicating with stakeholders.</li> <li>– Review and update the Fund’s new website based on feedback from employers and members.</li> <li>– Retender pension administration software services.</li> </ul>



## Forward Thinking

With the changes to the Local Government Pension Scheme, reducing pension taxation relief and new pensions freedom, pension administration is becoming more complex for both the Fund and employers. By striving to continually improve our performance, the Fund will be position to meet these challenges.

The results of the 2014 actuarial valuation and employer covenant analysis have highlighted the need for different funding and investment options for certain employers.

The Local Government Pension Scheme (LGPS) in England & Wales is expected to implement investment pooling arrangements. The Fund will continue to take a proactive approach to investment collaboration, building on its exoerience of working with Falkirk Pension Fund, and work with other LGPS funds to explore collaborative/pooled arrangements.

<b>Action</b>	<b>Description</b>
<b>Monitor financial and economic pressures and scheme maturity</b>	<ul style="list-style-type: none"> <li>– Manage the risks of the participating employers including updates of admission agreements.</li> <li>– Implement different funding and investment options for certain employers in Lothian Pension Fund with new unitisation approach.</li> <li>– Continue to monitor membership and cash flow.</li> </ul>
Provide an efficient, accurate and effective service	<ul style="list-style-type: none"> <li>– Improve systems skills and data analysis, particularly performance statistics and data quality measures.</li> <li>– Reconcile members’ contracting out records (GMPs) with those of the government.</li> <li>– Put in place Service Level Agreements for key services provided by City of Edinburgh Council.</li> <li>– Continue to explore further efficiencies.</li> </ul>
<b>Shared services</b>	<ul style="list-style-type: none"> <li>– Explore opportunities for further investment collaboration and pooling.</li> </ul>



## Honest & Transparent

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

All public sector pension schemes are now subject to greater scrutiny by the Pensions Regulator and a Scheme Advisory Board. The Fund also has a Pension Board, made up of employers and members.

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

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

Action	Description
<p><b>Ensure effective Governance</b></p>	<ul style="list-style-type: none"> <li>– Continue to embed the new Pension Board in to the Fund’s governance.</li> <li>– Continue to improve the Fund’s approach to training for the Pensions Committee and Pension Board.</li> <li>– Monitor and respond to the requirements of the Scheme Advsiory Board.</li> <li>– Participate in the review of the structure of the LGPS in Scotland.</li> </ul>
<p>Risk is managed effectively</p>	<ul style="list-style-type: none"> <li>– Progress with application for authorisation from Financial Conduct Authority to improve investment controls.</li> <li>– Continue to review and update procedure manuals.</li> <li>– Continue to develop integration of environmental, social and governance research into investment decision making.</li> <li>– Progress with updates of employer admission agreements.</li> </ul>

## Working Together



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

As a relatively small team of 55, there are risks associated if the Fund were to experience high staff turnover, particularly in key positions requiring specialist knowledge. Specialist investment staff are now employed via a special purpose vehicle to facilitate relevant and appropriate terms and conditions. Consideration will be given to a phase two where all the pension fund staff would be transferred to the special purpose vehicle.

Feedback from the 2015 staff survey highlighted that staff could be more involved in changes that affect their work and that more regular feedback on performance would be beneficial.

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



## Our Budget

The budget for 2016-17 and indicative figures for 2017-2018 are as follows:

	Projected 2015/16 £000	Budget 2015/16 £000	Movement £000	Budget 2016/17 £000	Movement £000	Indicative Budget 2017/18 £000
Employees	2,253	2,489	417	2,906	89	2,995
Property Costs	190	188	7	195	2	197
Plant and Transport	35	37	4	41	0	41
Supplies and Services	1,037	1,095	100	1,195	-1	1,194
Third Party Payments	751	1,286	89	1,375	3	1,378
Investment Managers Fees	7,800	8,100	-980	7,120	552	7,672
Support Costs	315	276	24	300	0	300
Capital Funding	91	80	7	87	0	87
<b>Gross Expenditure (Invoiced)</b>	<b>12,472</b>	<b>13,551</b>	<b>-332</b>	<b>13,219</b>	<b>645</b>	<b>13,864</b>
Receipts	-153	-157	-20	-177	-5	-182
Income - Other	-1,050	-1,500	700	-800	0	-800
<b>Total Income</b>	<b>-1,203</b>	<b>-1,657</b>	<b>680</b>	<b>-977</b>	<b>-5</b>	<b>-982</b>
<b>Net Expenditure (Invoiced)</b>	<b>11,269</b>	<b>11,894</b>	<b>348</b>	<b>12,242</b>	<b>640</b>	<b>12,882</b>
Property Operational Costs	1,000	1,000	0	1,000	0	1,000
Investment fees deducted from Capital	15,224	15,624	976	16,600	0	16,600
Transaction Costs	2,800	2,300	-1,100	1,200	0	1,200
<b>Indicative Net Expenditure (Uninvoiced)</b>	<b>19,024</b>	<b>18,924</b>	<b>-124</b>	<b>18,800</b>	<b>0</b>	<b>18,800</b>
<b>Total Indicative Expenditure</b>	<b>30,293</b>	<b>30,818</b>	<b>224</b>	<b>31,042</b>	<b>640</b>	<b>31,682</b>
<b>Pension Administration</b>	<b>1,855</b>	<b>2,041</b>	<b>20</b>	<b>2,061</b>	<b>22</b>	<b>2,083</b>
<b>Investment Management</b>	<b>28,438</b>	<b>28,777</b>	<b>204</b>	<b>28,981</b>	<b>618</b>	<b>29,599</b>
<b>Investment Managers Fee Contingency</b>	<b>0</b>	<b>10,000</b>	<b>0</b>	<b>10,000</b>	<b>0</b>	<b>10,000</b>

## Our Budget continued

The budget for 2016-17 and indicative figures for 2017-2018 and are as follows:

### Capital Expenditure

	<b>Projected</b>	<b>Budget</b>		<b>Budget</b>		<b>Indicative</b>
	<b>2015/16</b>	<b>2015/16</b>	<b>Movement</b>	<b>2016/17</b>	<b>Movement</b>	<b>Budget</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>2017/18</b>
						<b>£000</b>
Loan Facility - LPFE	n/a	250	-250	0	0	0
- LPFI	n/a	75	0	75	-75	0
LPFI Share Capital	n/a	36	0	36	-36	0
<b>Total Capital Expenditure</b>	<b>34</b>	<b>361</b>	<b>-250</b>	<b>111</b>	<b>-36</b>	<b>0</b>

# Pensions Committee

2.00 p.m., Tuesday, 15 March 2016

## Employers Participating in the Lothian Pension Fund and updates to the Funding Strategy Statement

Item number	5.12
Report number	
Executive/routine	
Wards	All

### Executive summary

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This report provides updates on:

- Employers who are currently looking to join the Fund;
- Employers leaving the Fund;
- Other current matters affecting employers participating in the Fund; and
- The Fund's Funding Strategy Statement to reflect decisions made by the Pensions Committee in November 2015.

### Links

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Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

## Employers Participating in the Lothian Pension Fund and updates to the Funding Strategy Statement

### Recommendations

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- 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 changes to the employers participating in Lothian Pension Fund.
- 1.3 That Committee approves the change to the Funding Strategy Statement.

### Background

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- 2.1 Responsibilities of both the City of Edinburgh Council, as administering authority of the Fund, and the participating employers are set out in the Funding Strategy statement and the Pensions Administration Strategy.
- 2.2 The Funding Strategy Statement includes the 'Admission Policy' (for employers joining the Fund), the 'Policy on Employers leaving the Fund' (cessation policy) and the 'Charging Policy' outlining when charges will be levied by the Fund.
- 2.3 The Pensions Administration Strategy sets out standards for exchange of information, including the requirement for the employer to keep the Fund informed about planned changes to their pension provision, including bulk transfers of staff and any outsourcing.

### Main report

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#### Employers joining the Fund

- 3.1 As previously advised to Committee, the City of Edinburgh Council has entered into a contract with CGI IT UK Limited (CGI). From 1 April 2016, CGI will provide ICT services for the Council. CGI has applied for admission to the Local Government Pension Scheme. At present, the number of staff involved is still to be confirmed. As required by the Scheme Regulations, the City of Edinburgh Council will act as guarantor.
- 3.2 We have been advised that CGI is likely to outsource part of the contract to another organisation, Dacoll Limited. A further admission agreement will be agreed with Dacoll for the staff involved and again, the City of Edinburgh Council will act as guarantor.

- 3.3 Transferring staff will have the option to transfer their previous pension rights accrued in the BT pension scheme. As required under the Scheme regulations, the transfers will be carried out on a bulk basis and the Fund's actuary will work with the BT actuary to agree transfer terms.

#### **Employers leaving the Fund**

- 3.4 As previously reported to Committee, cessation valuations have been carried out by the Fund's Actuary in respect of several employers who left the Fund last year.
- 3.5 Almond Housing Association gave notice to leave the Fund on 30 September 2015. Full payment of the cessation deficit has now been received.
- 3.6 Following the dissolution of the Forth Estuary Transport Authority on 31 May 2015, employees transferred to Amey Services Ltd ('Amey'). From 1 June 2015, Amey become an admitted body in order to provide continuity of pension conditions for these members. The Scottish Government has agreed to act as guarantor for Amey. Legacy pension liabilities (ie deferred and pensioner members) will be the responsibility of the Scottish Government. Full payment of the cessation deficit is expected by the end of the 2015/16 financial year.
- 3.7 Midlothian Council entered into a contract with BAM Construction in 2002 to provide janitorial services for schools in the Dalkeith area. BAM were admitted to the Fund in 2003. The Fund's admission agreement with BAM Construction Ltd ended following the retirement of the last active member on 1 September 2015. An invoice has been raised and full payment of the cessation deficit is expected shortly.
- 3.8 As previously advised to Committee, Pilton Community Health Project left the Fund on 1 April 2015. A cessation valuation has been carried out. Further information is included in item B1.1 on the agenda. A cessation valuation has also been carried out in respect of Age Concern, a former Fund employer. Further information is included in item B1.1.
- 3.9 The Fund has been advised by both the Broomhouse Centre and the National Mining Museum that their last active members will be retiring within the next couple of months. As both employers are closed to new entrants, a cessation valuation will be carried out for each organisation. An update will be provided to Committee at a later date.
- 3.10 As part of the Funding Strategy appeals submitted in 2015, six employers advised that they were considering leaving the Fund. Further information is included in item B1.1.

#### **Other changes**

- 3.11 Barony Housing Association has advised that it will enter into a partnership with Wheatley Housing Group. Barony will continue as a separate legal entity and will remain the employer of the staff who are currently members of Lothian Pension Fund. The Fund has carried out appropriate due diligence in consultation with legal advisers and has established that this change will

strengthens Barony's covenant and will thus provide greater protection for the Fund. As Barony was originally admitted to the Fund in 1980, a revised admission agreement has been prepared to ensure consistency with current legislation and documentation.

- 3.12 Edinburgh Cyrenians Trust is changing to a Scottish Charitable Incorporated Organisation from 1 April 2016. A new admission agreement has been prepared to reflect this change in legal status, including commitment that the new entity has responsibility for previous pension liabilities.
- 3.13 The Fund is still awaiting further information from the Department of Work & Pensions regarding employees of the City of Edinburgh Council, East Lothian Council and West Lothian Council who transferred to the Civil Service Pension Scheme in 2014. These transfers were part of a UK-wide exercise to introduce a Single Fraud Investigation Service. Since the last update to Committee, the Fund has responded to further data queries from the Government Actuary's Department, however no further information regarding the terms of the bulk transfer has been received.

#### **Updates to the Funding Strategy Statement**

- 3.14 At the November 2015 meeting of Pensions Committee, several changes to the Fund's Funding Strategy Statement were agreed. These changes have now been incorporated into the Funding Strategy Statement and the amended document has been published on the Fund's website.

### **Measures of success**

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- 4.1 Employers continue to take decisions in full knowledge of Local Government Pension Scheme (LGPS) Regulations and with awareness of policies put in place by the Fund to protect the Fund as a whole.

### **Financial impact**

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- 5.1 There is no financial impact arising directly from this report. However proactive monitoring of employers participating in the Fund and appropriate admission agreements for employers help to protect the financial position of the Fund and other contributing employers.

### **Risk, policy, compliance and governance impact**

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- 6.1 Ongoing monitoring and engagement, together with robust policies on admission and cessation help to mitigate the risks of employer actions having an adverse impact on the Fund. Risks are also regularly reviewed via the Lothian Pension Fund risk register.

## Equalities impact

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7.1 There is no equalities impact as a result of this report.

## Sustainability impact

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8.1 There is no sustainability impact arising from this report

## Consultation and engagement

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- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.
- 9.2 The Fund engages with participating employers on a regular basis via monthly bulletins highlighting relevant issues and employer events held throughout the year. The Fund continues to remind employers of the importance of keeping the Fund informed of any changes that could have an impact on their pension arrangements.
- 9.3 Changes to relevant regulations and policies and the implications of these changes are communicated to employers, with consultation exercises carried out where appropriate.

## Background reading/external references

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None

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## Links

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### Coalition pledges

**Council outcomes** CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed

**Single Outcome Agreement**

**Appendices**

# Pensions Committee

2.00 p.m., Tuesday, 15 March 2016

## Risk Management Summary

Item number	5.13
Report number	
Executive/routine	
Wards	All

### Executive summary

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In line with the pension funds' ongoing risk management procedures, this paper provides an overview of the risk analysis for Q4 2015/16 for consideration by the Committee.

### Links

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Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement



## Risk Management Summary

### Recommendations

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- 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 Quarterly Risk Overview.

### Background

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- 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

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- 3.1 The Operational Risk Register has been issued to the conveners of the Pensions Committee and the Pensions Audit-Sub Committee and the Independent Professional Observer.
- 3.2 The Quarterly Risk Overview, as at 12 February 2016, is set out in the appendix to this report for consideration.

### Measures of success

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- 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**

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

## **Risk, policy, compliance and governance impact**

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

## **Equalities impact**

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- 7.1 None

## **Sustainability impact**

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- 8.1 None

## **Consultation and engagement**

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

## **Background reading/external references**

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None

## **Hugh Dunn**

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## Links

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**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 12 February 2016

## QUARTERLY RISK OVERVIEW

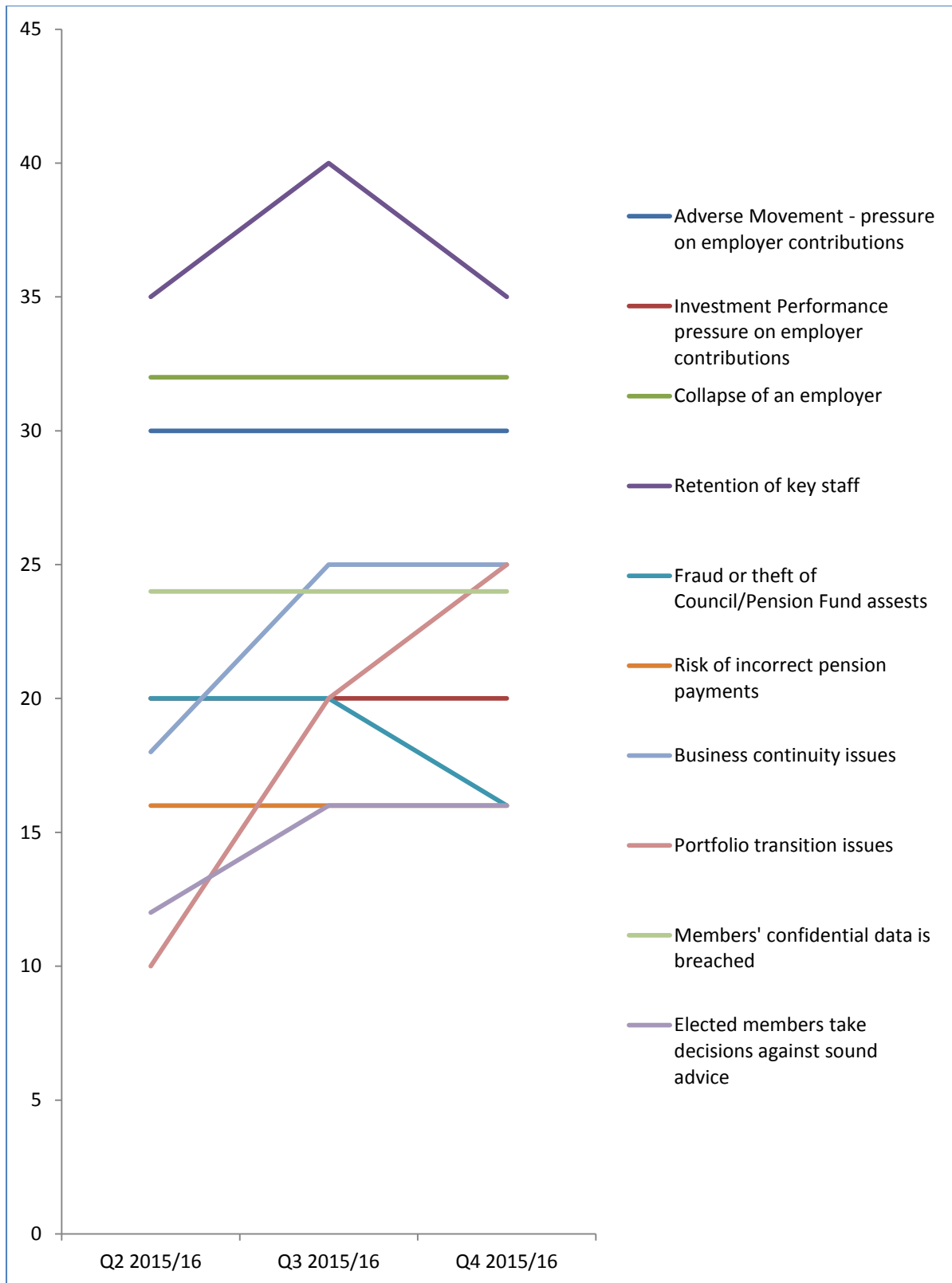
12 February 2016

### UPDATE ON MOST NOTABLE RISKS

Risk & Reference Number	Update	Trend/RAG
<b>Adverse Investment performance leading to pressure on employer contribution (1)</b>	<p>Implementation of the new lower volatility investment strategy proceeds to plan and early indications are that they have continued to perform comparatively well in the recent stock market downturn.</p> <p>A review of the Lothian Buses Pension Fund strategy is also progressing in conjunction with the Investment Strategy Panel, with ongoing liaison with the City of Edinburgh Council's finance team and the senior management of Lothian Buses.</p>	<p>Static</p> 
<b>Adverse movement against non-investment funding assumptions leading to pressure on employer contributions (2)</b>	<p>The 2014 actuarial valuation is complete and experience against funding assumptions and employer contributions has been assessed. The Funding Strategy Statement (FSS) has been revised.</p> <p>Work is ongoing to implement the new unitisation system which will provide improved tracking of employer assets and liabilities, and different investment strategies.</p>	<p>Static</p> 
<b>Collapse/restructuring of an employer body leading to pressure on other employers (3)</b>	<p>The revised funding approach for employers close to exiting the Fund reduces the overall risk to the Fund and the other employers.</p> <p>The Fund continues to engage with a group of smaller employers regarding the potentially adverse financial impact of the revised funding strategy and to implement the outcomes from the appeals process and the Pension Committee decision in this regard. Where appropriate, the Fund will be pursuing guarantees and securities from the employers in order to further mitigate this risk.</p> <p>This risk will continue to be closely monitored over the coming months in the context of the overall Fund. In particular, the Fund will monitor and assess (i) the impact of the arrangements agreed with those employers participating in the appeals process, (ii) any guidance from the Scheme Advisory Board or Scottish Government.</p>	<p>Static</p> 
<b>Recruitment and retention of key staff (4)</b>	<p>This risk has reduced marginally in recognition of the progress being made in introducing revised terms and conditions and bespoke HR policies and procedures appropriate for the investment business LPF is engaged in. The risk does continue to remain high during the final stages of implementation and as LPF's management team continue to monitor the immediate impact of these changes. Also, and notwithstanding the recent market downturn, we continue to see a steady improvement in UK economic and market conditions in the private sector. It is anticipated that the risk may reduce further once revised terms and conditions have been fully implemented by LPFE Limited and the new structure is settled.</p>	<p>Decrease</p> 

Risk & Reference Number	Update	Trend/RAG
<b>Regulatory Breach (20)</b>	<p>The Fund is continuing to monitor the changing regulatory landscape for investment and pensions business within the UK and its potential impact on its internal investment operations. Recent focus has been on the MiFID II regulations and the proposed new Investment Management Regulations for the LGPS in England &amp; Wales.</p> <p>The Fund also continues to monitor its limited use of derivative instruments closely so as to ensure that it continues to apply best practice compliance in this area and develop its back-office function and custodian and manager arrangements accordingly.</p>	<p><b>Static</b></p> 
<b>Business continuity issues (11)</b>	<p>The Council's new IT service provision from CGI will begin in April 2016, but we await details as to the service specification in order to assess the likely impact on its core systems. Some system changes, including the financial system, are scheduled for October 2016.</p> <p>Given the Fund's reliance on internal and complex third party hosted IT systems, and the adverse effect that any outage or issues may have on internal business operations and the external member experience, the risk has been retained at its current level.</p>	<p><b>Static</b></p> 
<b>Acting out-with proper authority/delegations (23)</b>	<p>At the time of writing, sub-delegation and signing authorities to take into account the recent changes within the City of Edinburgh Council are being updated.</p> <p>The Fund is also looking to input into the next round of changes to the Scheme of Delegation to address certain governance matters specific to the Fund.</p>	<p><b>Decrease</b></p> 
<b>Over-reliance on single service provider for core functions (31)</b>	<p>The Fund continues to monitor the position in relation to its core providers and is presently reviewing new entrants to certain service provision markets relevant to its operations.</p>	<p><b>Static</b></p> 
<b>Claim or liability arising from any shared service arrangement between local authorities (27)</b>	<p>The Fund is engaging with Falkirk Council on its reporting and monitoring protocols to ensure that commercially sensitive information is not inappropriately disclosed.</p>	<p><b>Static</b></p> 

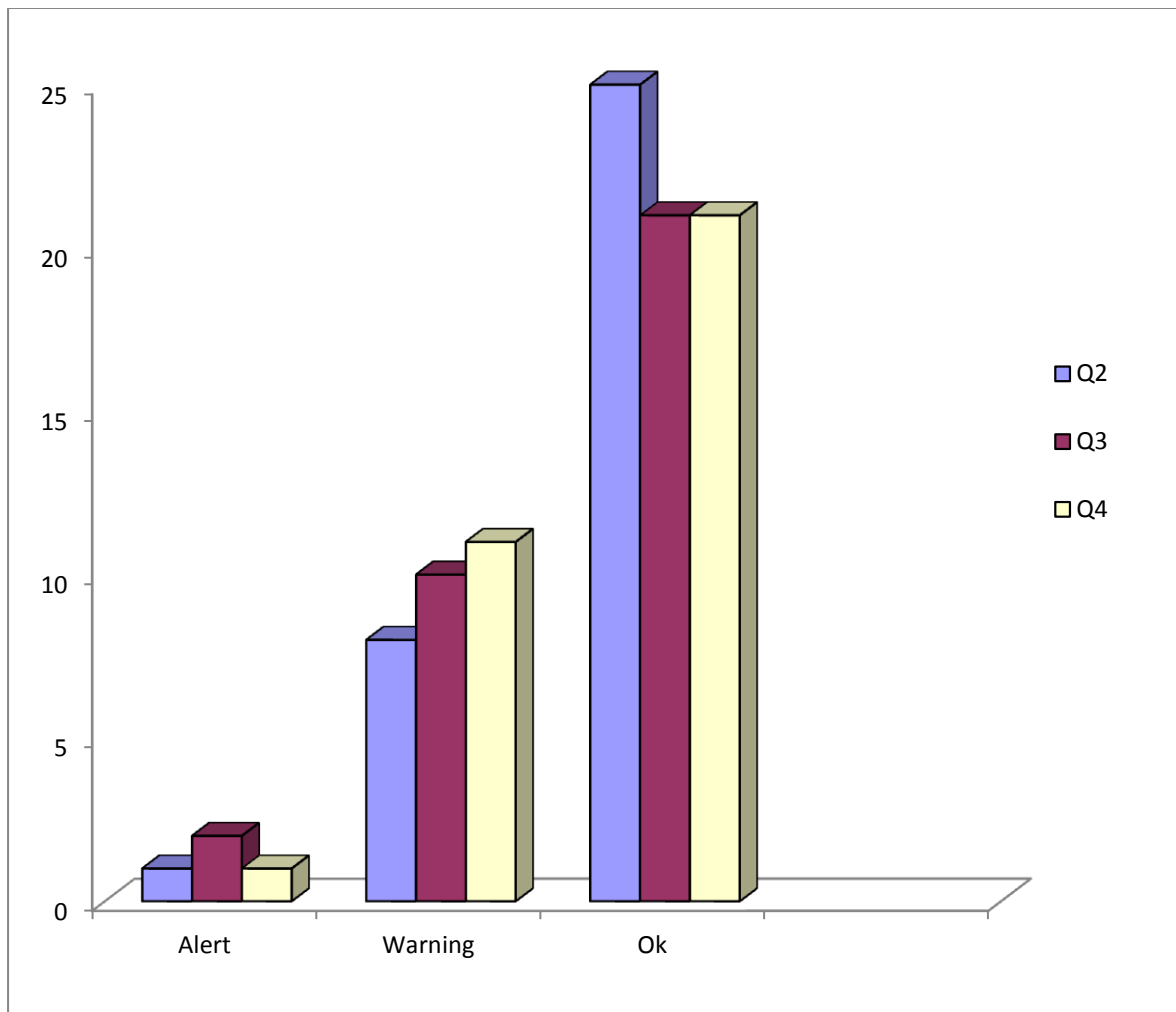
**NOTABLE RISKS: PROGRESSION OF CURRENT RISK (ACCOUNTING FOR CONTROLS) IN LAST THREE QUARTERS**



**OTHER KEY POINTS**

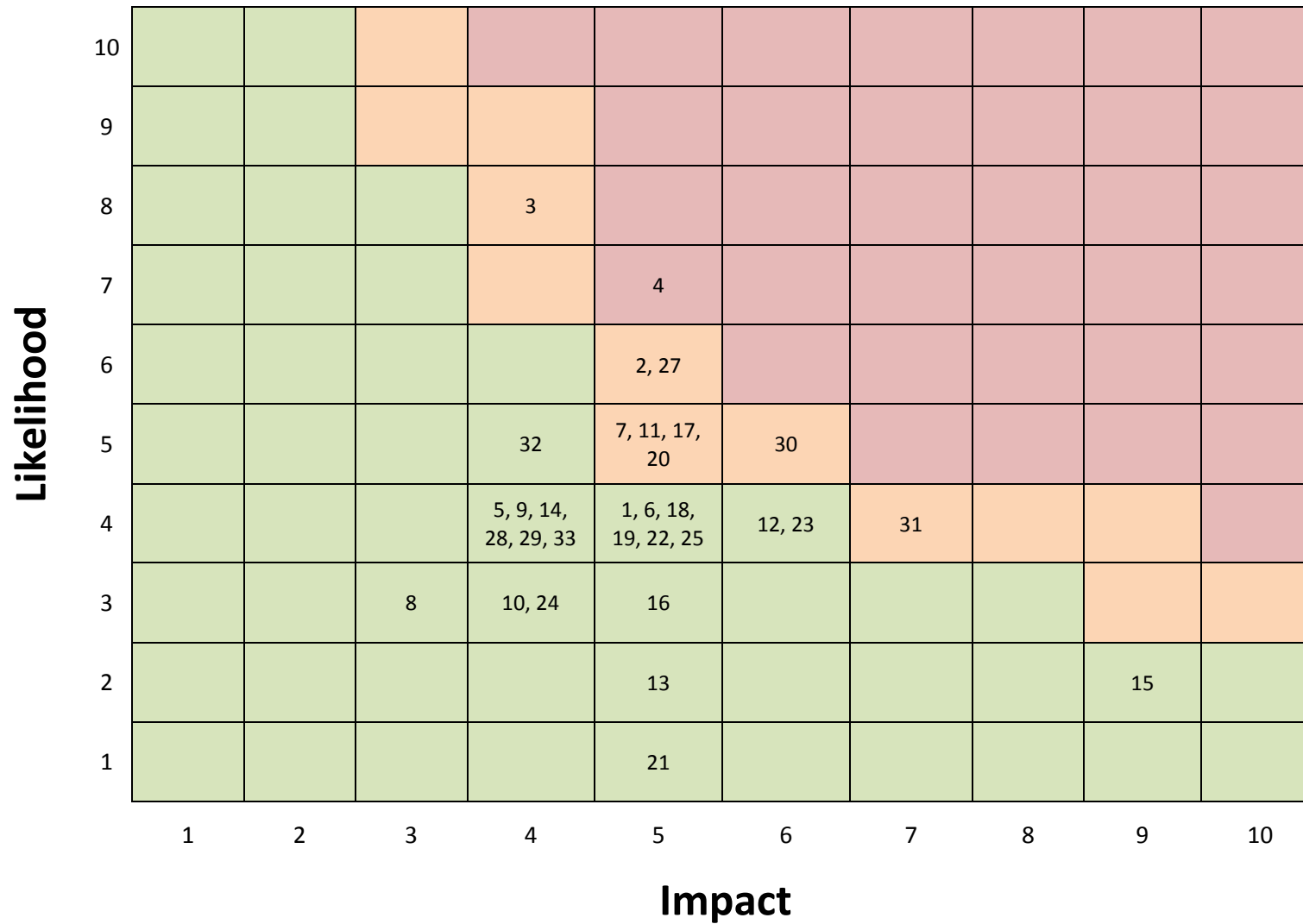
	<b>Comments</b>
<b>New significant risks</b>	None. We do however note that the pending portfolio transition has caused the associated risk to increase in the short term. (17)
<b>Other new risks</b>	None.
<b>New controls</b>	<p>Following a successful pilot earlier in the year, a UK bank account validation service is now in place to mitigate against the risk of customer fraud. (5)</p> <p>A new fax machine with separate phone line has been installed to mitigate against business and IT continuity risk during network/communications outages. (7,11)</p> <p>Industry standard arrangements have been entered into by the Fund in relation to the in-house management of foreign exchange derivatives, to ensure that the Northern Trust Company (a US bank with a UK arm) continues to comply with its US regulatory obligations in relation to Dodd Frank. The means through which the investment team cover foreign exchange risk are currently under review.(20)</p>
<b>Eliminated risks</b>	None.
<b>Notable initiatives / actions</b>	<p>Visits to other pension funds have been scheduled to explore approach to management of employer covenant in order to increase LPF's awareness and expertise in this area and to help consider the management of this risk in the future. (3)</p> <p>Engaging with Audit Scotland on potential changes to the CIPFA accounting standards for investment costs to ensure appropriate transparency standards and the scheme as a whole does not suffer undue reputational damage through taking a backward step in this regard.</p> <p>Efforts on improving data quality reorganised to mitigate against the associated risks of LPF acting on the basis of poor or incorrect membership data. (2)</p> <p>Ongoing review to ascertain the best means of providing Pension Board members with quick and user friendly access to Committee papers (whether through the use of iPads or by couriering papers). (10)</p> <p>Investment team continue to review research unbundling and ongoing cost analysis. (30)</p> <p>Recruitment of Legal &amp; Compliance support ongoing. (32)</p> <p>Continuing to liaise with the City of Edinburgh Council's insurer for clarity on the position around the personal liability of Pension Board members. (10)</p>
<b>Material Litigation</b>	None.

## All Risks: Status Overview

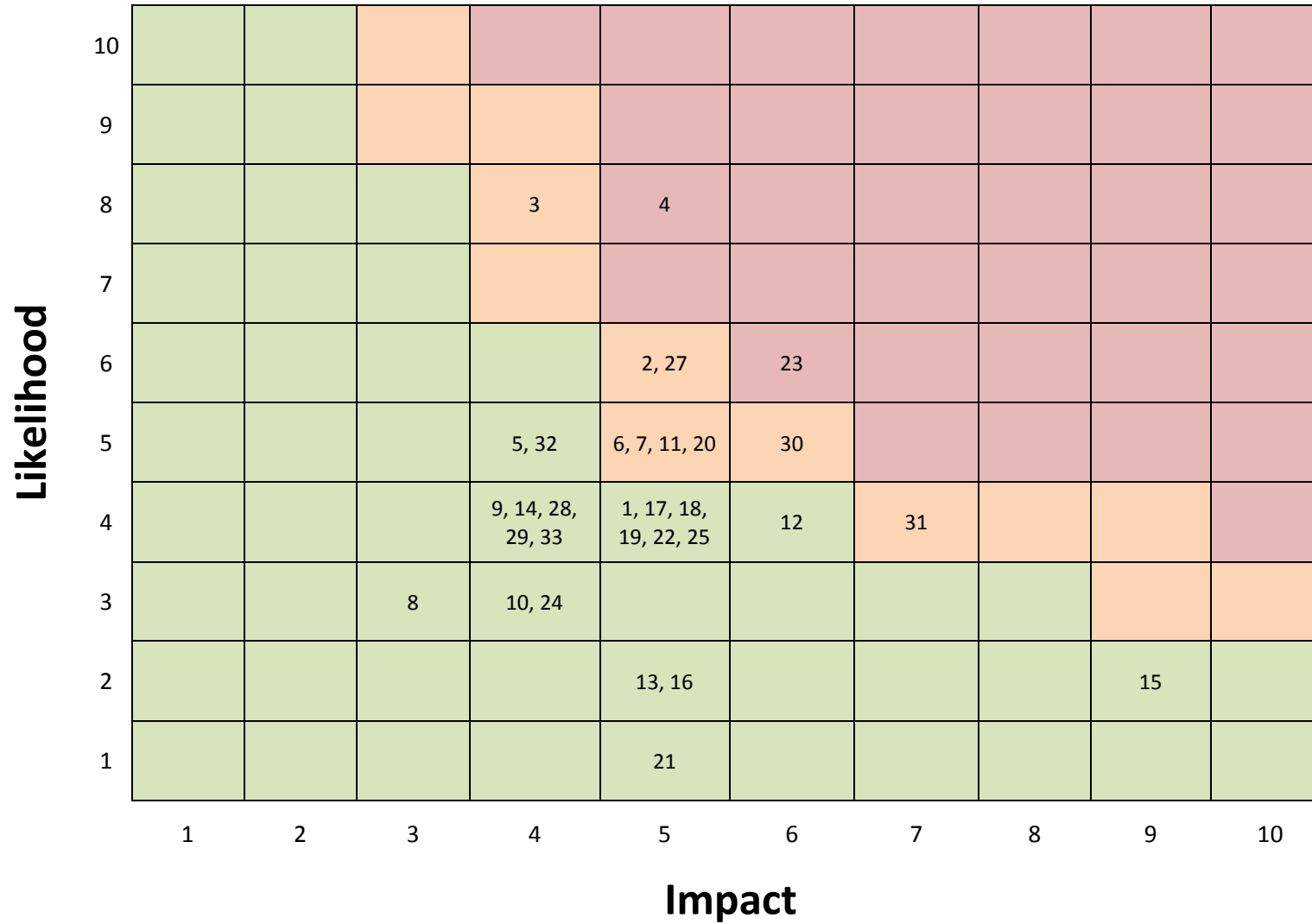




**Q4 2015/16 All Risks: Impact and Likelihood Overview**



Q3 2015/16 All Risks: Impact and Likelihood Overview



## Key: Risks by Number

- Adverse Investment Performance - pressure on employer
- 1** contributions
- Adverse Movement of non-investment funding
- 2** 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** *Not in use*
- 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