Notice of meeting and agenda

Pensions Committee

2.00pm, Monday 27 June 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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THE CITY OF EDINBURGH COUNCIL

1. Order of business

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

2. Declaration of interests

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

3. Deputations

3.1 If any.

4. Minute

4.1 Minute of the Pensions Committee of 15 March 2016 – Submitted for approval as a correct record (circulated)

5. Reports

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

5.2 Considerations and matters to be raised by the Pension Board regarding any items on the agenda

5.3 Agenda Planning – report by the Acting Executive Director of Resources (circulated)

5.4 Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund Annual Report 2016 (and Financial Statements) Unaudited – report by the Acting Executive Director of Resources (circulated)

5.5 Scheme Advisory Board – Fiduciary Duty - report by the Acting Executive Director of Resources (to follow)

5.6 Statement of Investment Principles – report by the Acting Executive Director of Resources (circulated)

5.7 Investment Strategy Panel Activity – report by the Acting Executive Director of Resources (circulated)

5.8 Annual Investment Update – Lothian Pension Fund – report by the Acting Executive Director of Resources (circulated)

5.9 Annual Investment Update – Lothian Buses Pension Fund – report by the Acting Executive Director of Resources (circulated)

5.10 Annual Investment Update – Scottish Homes Pension Fund – report by the Acting Executive Director of Resources (circulated)

5.11 Risk Management Summary – report by the Acting Executive Director of Resources (circulated)

6. Motions

6.1 If any

Kirsty-Louise Campbell
Interim Head of Strategy and Insight

Committee Members

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

Information about the Pensions Committee

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

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

Further information

If you have any questions about the agenda or meeting arrangements, please contact Stuart McLean, Committee Services, City of Edinburgh Council, City Chambers, High Street, Edinburgh EH1 1YJ, Tel 0131 529 4106, e-mail stuart.mclean@edinburgh.gov.uk.

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

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

Item 4.1 Minutes

Pensions Committee

2.00pm, Tuesday 15 March 2016

Present

Councillor Rankin (Convener), John Anzani, Councillor Maureen Child, Richard Lamont, Councillor Orr and Councillor Rose

Pensions Board Members Present:

Eric Adair, Jim Anderson, Thomas Carr-Pollock, Darren May, John Rodgers and Rucelle Soutar.

Minutes

Decision

1) To approve the minute of the Pensions Committee of 16 December 2016 as a correct record.
2) To note Sarah Smart's appointment as a non-executive director on the board of the Pensions Regulator (TPR)

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

Decision

To note that no issues were raised by the Pensions Board regarding any items of the agenda.

3. Agenda Planning

Details were provided of potential reports for future meetings of the Pensions Committee and Pensions Audit Sub Committee.

Decision.

To note the agenda planning document.

(Reference – report by the Acting Executive Director of Resources, submitted.)

4. External Audit – Annual Audit Plan 2015-16

Audit Scotland, the external auditor, had outlined its planned programme of work to support the statutory audit in 2015/16.

A representative from Audit Scotland attended for this item.

Decision

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

2) To note that suitable provision had been made in the approved budget 2015-16 for the audit fee.

3) To note that progress against the Annual Audit Plan 2015-16 would be reported to future meetings of the Pensions Audit Sub-Committee and the Pensions Committee.

(Reference – report by the Acting Executive Director of Resources, submitted.)

5. Investment Strategy Review - Lothian Buses Pension Fund

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. Approval was sought for a revised investment strategy which aims to reduce risk further, over the next 5 years.

Decision

1) To note the outcome of the review of investment strategy for the Lothian Buses Pension Fund undertaken by the Investment Strategy Panel.

2) To approve the revised investment strategy for the Lothian Buses Pension Fund.

3) To agree 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. (Reference – report by the Acting Executive Director of Resources, submitted.)

6. Investment Strategy Review - Scottish Homes Pension Fund

Details were provided on the review of the investment strategy of the Scottish Homes Pension Fund. The resulting proposals had been submitted to the Scottish Government for discussion.

Decision

1) To note progress on the review of the Scottish Homes Pension Fund investment and funding strategy which proposes:

   - To change the agreement which governs the funding and investment for the Fund.
   - To remove 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.
   - To introduce a more flexible, income focussed investment strategy to reduce the current requirement for regular asset sales.
   - To provide a longer-term projection of Scottish Government contributions at the time of the actuarial valuation.

2) To approve that the Acting 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.

(Reference – report by the Acting Executive Director of Resources, submitted.)

7. Governance Update

Details were provided on the rotation of the Pension Board chair and training activities over 2015/16.

Decision

1) To note Eric Adair's contribution as the first chair of the Pension Board.

2) To note that Jim Anderson was the newly appointed chair of the Pension Board effective from 1 April 2016 to 31 March 2017. To note the training hours over 2015/16.

(Reference – report by the Acting Executive Director of Resources, submitted.)

8. Appointments – Pensions Audit Sub-Committee

Appointments were sought for the membership of the Pensions Audit Sub-Committee.

Decision

1) To appoint Councillors Cook, Orr and Rose 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.

2) To appoint Councillor Rose as Convener of the Pensions Audit Sub-Committee.

(Reference – report by the Chief Executive)

9. Internal Audit – Annual Audit Plan 2016-17

Details were provided of the planned Internal Audit activities for the financial year 2016/17 which had been developed using a risk based methodology to ensure that assurance activity is focussed on the key areas of risk faced by the Fund.

Decision

To note the planned audit activity for the year 2016/17

(Reference – report by the Chief Internal Auditor)

10. Appointment of Providers

Details were provided on the appointment of providers for services to the pension fund and approval was sought to extend the contracts with Hermes Equity Ownership (for stewardship services) and State Street (for investment services to the Scottish Homes Pension Fund)

Decision

1) To note the appointment of the providers for the pension funds.

2) To agree to the extension of the contract with Hermes Equity Ownership until March 2017.

3) To agree the extension of the contract with State Street to March 2017.

(Reference – report by the Acting Executive Director of Resources, submitted.)

11. 2015-2018 Service Plan Update

Details were provided 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 and Transparent, Working Together; and Forward Thinking.

Decision

To note the progress of the Fund against the 2015 – 2018 Service Plan.

(Reference – report by the Acting Executive Director of Resources, submitted.)

12. 2016-2018 Service Plan and Budget

Approval was sought for the Service Plan 2016-18 and the budget for 2016-17. The Service Plan included details of the pension fund's key challenges.

Decision

1) To approve the two-year Service Plan for 2016-2018.

2) To approve the budget for 2016-2017.

3) To note the indicative budget for 2017-2018.

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

Details were provided of Employers who are currently looking to join the Fund, those leaving the Fund, current matters affecting employers participating in the Fund and The Fund's revised Funding Strategy Statement.

Decision

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

2) To note the change to the Funding Strategy Statement.

(Reference – report by the Acting Executive Director of Resources, submitted.)

14. Risk Management Summary

An overview of the pension funds' risk analysis for quarter 4 of 2015/16 was provided.

Decision

To notes the Quarterly Risk Overview

(Reference – report by the Acting Executive Director of Resources, submitted.)

15. Resolution to consider in private

The Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the following items of business on the grounds that they involved the disclosure of exempt information as defined in Paragraph 6 of Schedule 7(A) of the Act.

16. Employers cessation and update on appeals against Funding Strategy, Actuarial Valuation 2014

Details were provided of cessation valuations recently carried out in respect of employers that had left the Fund and steps taken in relation to repayment of cessation debt.

Decision

1) To note that following the November 2015 meeting of the Pensions Committee, actuarial advice had been taken and that a revised 'Rates and adjustments certificate' had been issued by the Fund Actuary and circulated to employers.

2) To note that appropriate follow-up actions had been undertaken by Lothian Pension Fund as agreed at the November 2015 meeting.

3) To note that the Fund would pursue securitisation of assets to improve employer covenant.

(Reference – Pensions Committee 16 November 2015 (item 4); report by the Acting Executive Director of Resources, submitted.)

17. Investment Workshop

Details were provided the UK Governments policy of effective collaboration of LGPS funds in England and Wales regarding the pooling of their investments. Approval was sought to explore the potential for investment collaboration.

Decision

Detailed in the Confidential Schedule, signed by the Convener, with reference to this minute.

(Reference – report by the Acting Executive Director of Resources, submitted.)

Pensions Committee

2.00 p.m., Monday, 27 June 2016

Agenda Planning

Item number	5.3
Report number	
Executive/routine	
Wards	All

Executive summary

This document provides Committee with an overview of the agendas for future meetings of the Pensions Committee and Pensions 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 Pensions Committee and the Pensions Audit Sub Committee in addition to those set out herein.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Report

Agenda Planning

Recommendations

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

1.2 That the Committee notes the agenda planning document.

Background

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

Main report

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

September 2016

Pensions Committee	Audit Sub Committee
• Referrals / recommendations from Pensions Audit-Sub Committee • Considerations and matters to be raised by the Pension Board regarding any items on the agenda • LPF Annual Report & Accounts (Audited) • ISA 260 Audit Report • Annual Report by External Auditor • Employers Participating in Lothian Pension Fund • Service Plan Update • Risk management summary	• LPF Annual Report & Accounts (Audited) • Annual Report by External Auditor • Internal Audit Reports • ISA 260 Audit Report • Pensions Data Quality • Delegated authorities – Write offs • Fraud Prevention • Risk management summary

December 2016

Pensions Committee	Audit Sub Committee
• Referrals / recommendations from Pensions Audit-Sub Committee • Considerations and matters to be raised by the Pension Board regarding any items on the agenda • Benchmarking • Stewardship • Service Plan Update • Risk management summary	• EU Tax Claims & Income Recovery • Investment Income Review-Cross-Border withholding tax • Investment Controls & Compliance • Internal Audit Reports • Risk management in-depth review (if required)

Future Pensions Committee and Audit Sub Committee dates:

Pensions Committee	Pensions Audit Sub Committee
• Wednesday, 28 September, 2pm Dunedin Room, City Chambers • Tuesday 6 December, 2pm Dunedin Room, City Chambers • Wednesday 15 March 2017, 2pm Dunedin Room, City Chambers • Wednesday 28 June 2017, 2pm Dunedin Room, City Chambers	• Tuesday 27 September 2016, 2pm Dunedin Room, City Chambers • Monday 5 December 2016, 2pm Dunedin Room, City Chambers • Tuesday 27 June 2017, 2pm Dunedin Room, City Chambers

Measures of success

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

Financial impact

5.1 None.

Risk, policy, compliance and governance impact

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

Equalities impact

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

Sustainability impact

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

Consultation and engagement

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

Background reading/external references

None

Hugh Dunn

Acting Executive Director of Resources

Contact: Struan Fairbairn, Chief Risk Officer

E-mail: struan.fairbairn@edinburgh.gov.uk | Tel: 0131 529 4689

Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed
Single Outcome Agreement	
Appendices	Appendix 1 – Scheme of Committee Papers

Appendix 1

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
	Budget (Service Plan every 2 years)		
	Governance Update		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 Updates - 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
	Annual Report by External Auditor	Annual Report by External Auditor	December (or September if available)
	Benchmarking	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)	N/A	
	Discretions (death grants etc.)	Audit reports	
	N/A	Internal Audit Reports	
	Regulatory Update	N/A	
	Investment Strategy Reviews (at least every 3 years)	N/A	
	N/A	Risk management (in depth review)	

Pensions Committee

2.00 p.m., Monday, 27 June 2016

Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund Annual Report 2016 (and Financial Statements) Unaudited

Item number	5.4
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to present the unaudited Annual Report for the year ended 31 March 2016 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund.

A copy of the unaudited Pension Funds' Annual Report for the year to 31 March 2016 is attached as Appendix 1. The Accounts show that the Lothian Pension Fund valuation increased from £5,106m to £5,434m and Lothian Buses Pension Fund increased from £386m to £394m. Reflecting the mature profile of its liabilities, the Scottish Homes Pension Fund decreased from £155m to £150m.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

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Report

Lothian Pension Fund Annual Report (& Accounts) Unaudited

Recommendations

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

1.2 Note the unaudited Annual Report for the year ended 31 March 2016 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund.

1.3 Refer this report, for information, to the City of Edinburgh Council, in its role as administering authority of the Pension Funds.

Background

Statutory provisions and accounting guidance

2.1 The Scottish Government has issued statutory accounting guidance, which requires that Local Government Pension Scheme (LGPS) financial statements be published within an Annual Report. From 2010/11 onwards, the LGPS Annual Report should be published separately from the Authority's own financial statements and there should be a separate audit report.

2.2 On 11 May 2015, "Local Government Finance Circular No.6/2015" was issued to provide non-statutory guidance on the requirements of The Local Authority Accounts (Scotland) Regulations 2014. These introduced a new statutory requirement for the Financial Statements to include a Management Commentary and an Annual Governance Statement. Similar requirements are contained in The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008.

2.3 In July 2014, CIPFA published guidance "Accounting for Local Government Pension Scheme Management Costs", which promoted greater transparency of investment management fees. These principles were adopted as best practice in the presentation of the unaudited Annual Report 2015.

2.4 Local authorities are required to account for pension funds in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). The Code is based on approved accounting standards issued by the International Accounting Standards Board and interpretations of the International Financial Reporting Interpretations Committee, except where these are inconsistent with specific statutory requirements. The Code also draws on approved accounting standards issued by the International Public Sector Accounting Standards Board and the UK Financial Reporting Council where these provide additional guidance. The Code now requires that preparers have regard to CIPFA guidance "Accounting for Local Government Pension Scheme Management Costs".

2.5 In March 2016, CIPFA revised and updated this guidance. Whilst the underlying principle of transparency of investment cost remains unchanged, there has been a degree of relaxation to full cost disclosure. Specifically, for complex "Fund of Fund" structures, the new guidance states that "Investment costs incurred by a separate legal entity, or in respect of investment decisions over which the pension fund has no control, should not be included in the (Pension) Fund Account......If pension funds wish to provide information about the total cost of Fund of Fund investments, this should be included as part of the Investments section in the Annual Report".

2.6 The financial statements of Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, however, do include full transparency of all investment management fees.

2.7 With the investment staffing vehicle, LPFE Limited, commencing trading on 1 May 2015, consolidated financial statements have been prepared for Lothian Pension Fund for the year ended 31 March 2016. These consolidated financial statements combine those of the Fund (the parent entity) and its controlled entity (LPFE Limited) as defined in International Accounting Standard (IAS) 27.

2.8 The Local Government (Scotland) Act 1973 stipulates that unaudited financial statements must be presented to the Council and the Controller of Audit within three months of the financial year end, that is 30 June. It is within the Pensions Committee's remit to consider the unaudited Annual Report for the pension funds. As per Audit Scotland guidance, the Annual Report should be referred to Council on for the purpose of noting. The next Council meeting is on 30 June 2016.

Main report

Unaudited Lothian Pension Funds Annual Report

3.1 A copy of the unaudited Annual Report for the year to 31 March 2016 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund is attached as Appendix 1.

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

3.2.1 Section 95 of the Local Government (Scotland) Act 1973 states that "every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the authority has responsibility for the administration of those affairs". The Acting Executive Director of Resources serves as the

Section 95 Officer for all of the City of Edinburgh Council's accounting arrangements, including those of the Pension Funds, however, this Section 95 responsibility has been delegated to the Chief Finance Officer, Lothian Pension Fund.

3.2.2 The Accounts show that the Lothian Pension Fund valuation increased from £5,106m to £5,434m and the Lothian Buses Pension Fund increased from £386m to £394m. Reflecting the mature profile of its liabilities, the Scottish Homes Pension Fund decreased from £155m to £150m.

3.2.3 The Annual Report includes an Annual Governance Statement which sets out details of how the Funds are governed and the internal controls that are in place to manage risk. This mirrors the requirement to have a similar statement within the Financial Statements of the Council. This also encompasses a Governance Compliance Statement, which is a requirement of the LGPS Regulations. Its purpose is to record the extent to which the constitutional governance arrangements comply with best practice guidance issued by the Scottish Public Pensions Agency.

3.2.4 Related to the Annual Governance Statement is the Statement of Responsibilities for the Statement of Accounts. This sets out the respective responsibilities of the Administering Authority and those delegated to the Chief Finance Officer, Lothian Pension Fund.

3.2.5 Each of the three funds has a separate Actuarial Statement provided by the Actuary which provides information on the triennial valuation as at 31 March 2014 and the contributions determined for the following three years.

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

a. City of Edinburgh Council should note the unaudited accounts at its meeting on 30 June 2016.
b. In order to meet the statutory timetable, the Pensions Audit Sub-Committee of 27 September 2016 and thereafter the Pensions Committee, at its meeting on 28 September 2016, will consider the following reports:
    i. International Standard on Auditing (ISA) 260 Audit Report, which covers all significant issues arising from the audit of the accounts;
    ii. the Annual Report by the External Auditor which summarises all significant matters arising from the audit and overall conclusions about the management of key risks; and
    iii. the Audited Annual Report 2016.
c. It is anticipated that City of Edinburgh Council should note the audited accounts at its meeting on 27 October 2016.

Measures of success

4.1 The prime objective of the Council, as administering authority of the Lothian Pension Fund, Lothian Buses Pensions Fund and Scottish Homes Pension Fund, is to ensure an unqualified audit opinion of the Annual Report 2016. This will be determined in due course.

Financial impact

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

Risk, policy, compliance and governance impact

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

Equalities impact

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

Sustainability impact

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

Consultation and engagement

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

Background reading/external references

None

Hugh Dunn

Acting Executive Director of Resources

Contact: John Burns, Chief Finance Officer

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Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed
Single Outcome Agreement	
Appendices	Appendix 1: Unaudited Annual Report 2016 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund; Appendix 2: Lothian Pension Funds – Annual Statement by Chief Internal Auditor; Appendix 3: City of Edinburgh Council – Statement on the system of internal financial control by Acting Executive Director of Resources; Appendix 4: Lothian Pension Finds – Statement on the system of internal financial control by Chief Finance Officer, Lothian Pension Fund;

Appendix 1

Lothian PENSION FUND

Unaudited Annual Report and Financial Statements 2015/16

Lothian Pension Fund
Lothian Buses Pension Fund
Scottish Homes Pension Fund

Contents

Foreword

As Convener of the Pensions Committee with responsibility for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, I am pleased to introduce the 2015/16 Annual Report and Financial Statements.

We are witnessing one of the most challenging periods in modern times within the pensions arena. The wide reaching and radical reforms - to the State Pension and all public service pensions schemes, alongside the introduction of auto enrolment and flexible access to pensions savings under the 'Freedom and Choice' initiative - will have an impact for generations to come.

We aim to ensure that those 70,000 people who are members of our scheme have confidence that we are managing it effectively and efficiently on their behalf.

Good governance should be at the heart of any pension fund and changes required by the Public Sector Pensions Act 2013 are shining a greater light on governance across all public sector schemes. We welcome this. The Scottish LGPS Scheme Advisory Board has been established to advise Scottish ministers on changes which may be require to the LGPS and I am privileged to be a member of that Board. Locally we established our Pension Board, its members being employer and member representatives, on 1 April 2015. The Board has played an active role in the Funds' governance.

Unusually within the public sector, the LGPS is a funded scheme. Over the last year, the Lothian Pension Fund's assets have increased by £328million, with investments returning 6.5% over the last year. It is pleasing to see that our low-cost, lower-risk investment strategy is providing protection in volatile investment markets. The Funds also paid £165million of pension benefits to our members, primarily into the local economy where most of our members live.

I would like to take this opportunity to record my thanks to colleagues on the Pensions Committee, Pension Board, our advisors, employers and the Lothian Pension Fund team.

Councillor Alasdair Rankin
Pensions Committee Convener
The City of Edinburgh Council

Report by the Convener of the Pensions Audit Sub-Committee

The role of the Pensions Audit Sub-Committee is to assess the control of the Funds to ensure effective and efficient operations and to make appropriate recommendations to the Pensions Committee. It consists of three members of the Pensions Committee and it draws on appropriate specialist knowledge, understanding and expertise to scrutinise the operation of the pension funds. Two members of the Pension Board, one member representative and one employer representative, and the independent professional observer also attend.

Over the 2015/16 year, the Sub-Committee met three times and considered the 2014/15 accounts including the external audit of these accounts. It also reviewed findings from internal audits, fraud prevention, recovery of income tax on investment income and the service from the Funds' investment custodian.

I believe the Audit Sub-Committee plays a valuable role in the governance of the pension funds and adds value to members and employers.

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

Report by the Chair of the Pension Board

As required by regulations, a Pension Board was established on 1 April 2015 to help ensure that the operation of the pension funds is in accordance with the applicable law and regulation.

The Board is made up of employer and member representatives and replaced the Consultative Panel which was similarly constructed. While the Board has additional regulatory powers and hence has needed to be operated more formally, I am pleased that the Board has worked with the pension funds in an equally transparent and collaborative manner. The Board is very grateful for work of all the Fund staff whose skills and dedication have again produced a positive position for the funds.

The Board attends all meetings of the Pensions Committee and Audit Sub-Committee and actively participates in the Funds' governance. Members of the Board have also undertaken training to understand their role, general pensions issues and the operations of the pension Funds.

As required by the constitution, the chair of the Pension Board rotates annually between employer and member representatives. Jim Anderson, a member from Scottish Water nominated by UNISON, was selected by the Board to take on the role from 1 April 2016 and I know the Board will continue to support the pension funds in a constructive manner in the future.

Eric Adair
Finance Director of EDI (an admitted body in Lothian Pension Fund) and Chair of the Pension Board

Report by the Independent Professional Observer

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

During the year the Pensions Committee and Pension Board worked collaboratively and with constructive challenge to ensure that the new governance arrangements bedded in well and added value to the efficient oversight of the pension funds. As well as overseeing the normal day to day management of the funds, the Committee and Board have considered a number of emerging issues in relation to funding and investment, including the monitoring of the financial strength of employers and consideration of climate change exposure within the investment portfolio.

The level of debate within and between the Pensions Committee and Pension Board continues to be of a very high quality, and members continue to demonstrate high levels of engagement in searching for continuous incremental improvements to the overall governance standards of funds.

Sarah Smart
Independent Professional Observer

Introduction

Funding and investments

Uncertainty over economic growth, particularly in emerging markets, brought volatility to investment markets over 2015/16. Lothian Pension Fund's innovative strategy, targeting stable, income generating global equities, has delivered strong returns in these uncertain markets, returning +6.5% over the year despite equities falling in most regions.

Infrastructure investment has received much publicity over the past year as the UK and Scottish governments look to encourage Local Government Pension Schemes to increase their investment in this area. Lothian Pension Fund has built up a large and diverse infrastructure portfolio over a number of years, developing its reputation, network and execution capabilities to secure access to investment opportunities within this market niche.

An experienced team manages the majority of investments internally, with strong oversight and support from the Investment Strategy Panel. Not only is an internal team better aligned with the Funds' interests, but employers and members benefit from lower costs. A new corporate structure was established to facilitate further development of the in-house investment team and generate efficiencies for stakeholders. A limited company wholly owned by the pension fund, provides staff resources to the pension fund and facilitates recruitment and retention of specialist staff. In addition, a regulated investment company, LPFI Limited, has applied to the Financial Conduct Authority for authorisation. The company will enable us to collaborate more effectively with other institutional investors on infrastructure and other alternative investments to benefit from economies of scale.

Scheme changes

Significant changes were made to the Local Government Pension Scheme on 1 April 2015. The Fund participated in an ambitious joint communications programme covering all Scottish Funds to inform members of these changes and the Fund's communications officer played a key role. The initiative produced a dedicated website, video and pension modeller. In addition, the Fund provided its own members with newsletters and e-newsletters and produced posters and a comprehensive toolkit for employers. Approximately 2,500 members attended over 50 roadshows. Communications reinforced the message that the scheme remains a valuable part of remuneration.

Customers

Efforts to speed up the transfer of membership data from employers to the Fund continued. As well as helping us to provide a better service to members, it improves accuracy which is required to administer the new career average pension scheme.

Employers in the Lothian Pension Fund continue to face organisational changes and there is increased pressure on employer contributions. The results of the 2014 actuarial valuation and employer covenant analysis highlighted the need for different funding and investment options for certain employers. Consideration of appeals from some employers demonstrated that we are committed to ensuring commitments to the Fund are honoured whilst adopting as flexible an approach as possible to funding.

We had over 80,000 visits to our website, www.lpf.org.uk, over the year and over 19,000 members are registered to use the My Pension Online service. We recently used the online facility during a large-scale voluntary early release programme allowing members to see their potential pension benefits before expressing an interest. This facility significantly reduced work for both the employer and Fund.

Awards

During the year, the Funds, once again demonstrated their commitment to customers by retaining the Customer Service Excellence award. In order to further develop our service, we have joined the Pension Administration Standards Association, the first local government pension fund to do so. We also won two awards at the Local Government Investment Awards 2015, Fund of the Year (over £5billion) for Lothian Pension Fund and Fund of the Year (under £750million) for Lothian Buses Pension Fund.

Challenges

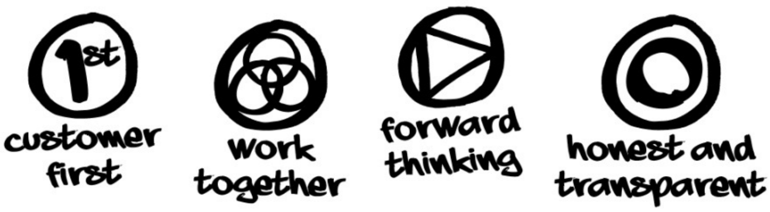
The changes to the pension scheme, pension taxation allowances and new pension freedoms make the administration of the Local Government Pension Scheme more complex and more difficult for members to understand. We will continue to develop communications, including different communications channels, strive for efficiencies and use industry standards to improve our service.

Continuing budgetary constraints across the public sector are expected to lead to further reductions in employee numbers and an increasing number of admitted bodies seeking to exit Lothian Pension Fund. 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 membership, its liabilities and cashflow.

Economic growth in most parts of the world appears to be stuttering and yields on government bonds continue to move to historic lows. Collaboration could offer efficiencies and improved governance, particularly with the Fund's internal investment team. The Fund will continue to take a proactive approach to collaboration, assisted by authorisation from the Financial Conduct Authority.

There has always been interest from members and specific campaign groups in investments and over recent years this has increased significantly. There is a need to continue to be open and transparent with each Fund investments and communicating its investment strategy. The Funds must act in the best interests of members and employers and this remains paramount in all decision making.

To ensure we meet these challenges we have 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.

Hugh Dunn
Acting Executive Director of Resources
The City of Edinburgh Council
27 June 2016

Clare Scott
Chief Executive
Lothian Pension Fund
27 June 2016

Governance

Pension Committee and Pension Board

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

Pensions Committee and Pensions Audit Sub-Committee

The City of Edinburgh Council, in its role as administering authority, delegates pension matters to the Pensions Committee and Pensions Audit Sub-Committee whose members act as 'quasi trustees'. The Pensions Committee held five meetings during the year and the Pensions Audit Sub-Committee met three times. Membership of the Committees from 1 April 2015 to 31 March 2016 was as follows:

Membership

Pensions Committee

Councillor Alasdair Rankin (Convener)
Councillor Maureen Child
Councillor Jim Orr
Councillor Bill Cook
Councillor Cameron Rose
John Anzani (elected member representative, Midlothian Council)
Richard Lamont (employer representative, Visit Scotland)

Pensions Audit Sub-Committee

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

The Pension Board

The Public Services Pensions Act 2013 and the Local Government Pension Scheme (Governance) (Scotland) Regulations 2014 came into force on 1 April 2015. This resulted in the Consultative Panel being disbanded on 31 March 2015 and being replaced by a new Pension Board on 1 April 2015.

The role of the Pension Board is to help ensure that the operation of the Funds is in accordance with the applicable law and regulation. The Board attends all Pensions Committee meetings and has appointed two representatives to attend Pensions Audit Sub-Committee meetings. The membership comprises of ten members, five representatives appointed from the employer bodies and five members appointed by trade unions representing the membership of the Funds.

The Pension Board membership for the period 1 April 2015 to 31 March 2016 was as follows:

Employer representatives

Eric Adair (Chair)	EDI Group
Darren May	Scottish Water
Linda McDonald	Handicabs
Simon Belfer*	Napier University
Rucelle Soutar	The Royal Edinburgh Military Tattoo

Member representatives

Graeme Turnbull	UCATT
John Rodgers	UNITE
Thomas Carr Pollock	GMB
Catrina Warren*	Unison
Jim Anderson	Unison

(*Pension Board member appointed to attend the Pensions Audit Sub-Committee meetings.)

Pensions Committee and Pension Board training

The Committee and Board members must attend no less than 21 hours of training per year as outlined in the Funds' training policy which is available on our website at www.lpf.org.uk. All new members of the Pensions Committee and Pension Board attended induction training. Other training covered key areas including pension legislation, investment, accounting, auditing standards and actuarial practices. All members of the Committee and Board achieved the required training hours during 2015/16. Committee members collectively attended 293 hours of training over the year. Pension Board members undertook 314 training hours.

Scheme Advisory Board

The Public Service Pensions Act 2013 requires a Scheme Advisory Board for the Local Government Pension Scheme in Scotland and this was established on 1 April 2015. Its main function is to advise Scottish ministers, when requested, on the desirability of changes to the Scheme. They can also provide advice to scheme managers and pension boards in relation to effective and efficient administration and management of the Scheme.

The membership of the Board comprises of seven member representatives and seven employer representatives and a Joint Secretary is appointed in support of each of the Member and Employer groups. Councillor Rankin has been appointed a member of the Scheme Advisory Board. Officers of Lothian Pension Fund have also been called upon to advise the Board and its Joint Secretaries.

Lothian Pension Fund staff

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

In February 2015, two limited companies (LPFE Limited and LPFI Limited) were established to facilitate the development of the internal investment capabilities and improve governance as well as delivering efficiencies for the administration of the Funds. Both companies are wholly owned and controlled by the City of Edinburgh Council as the administering authority of the Funds.

LPFI Limited has been established to support the investment programme of the in-house investment team by providing operational and other efficiencies; carrying out business from a vehicle authorised by the Financial Conduct Authority (FCA). Authorisation from the FCA is pending and is expected in the summer of 2016.

The employment of the internal investment team was transferred to LPFE Limited in May 2015. Revised terms and conditions of employment have been put in place, closer to those of comparable employers.

Over the year, senior officers were:

Alastair Maclean, Director of Corporate Governance, The City of Edinburgh Council (to 31 December 2015)
Hugh Dunn, Acting Executive Director of Resources, The City of Edinburgh Council (from 1 January 2016)
Clare Scott, Chief Executive of Lothian Pension Fund
Bruce Miller, Chief Investment Officer of Lothian Pension Fund
Struan Fairbairn, Chief Risk Officer of Lothian Pension Fund
John Burns, Chief Finance Officer of Lothian Pension Fund
Esmond Hamilton, Financial Controller of Lothian Pension Fund.

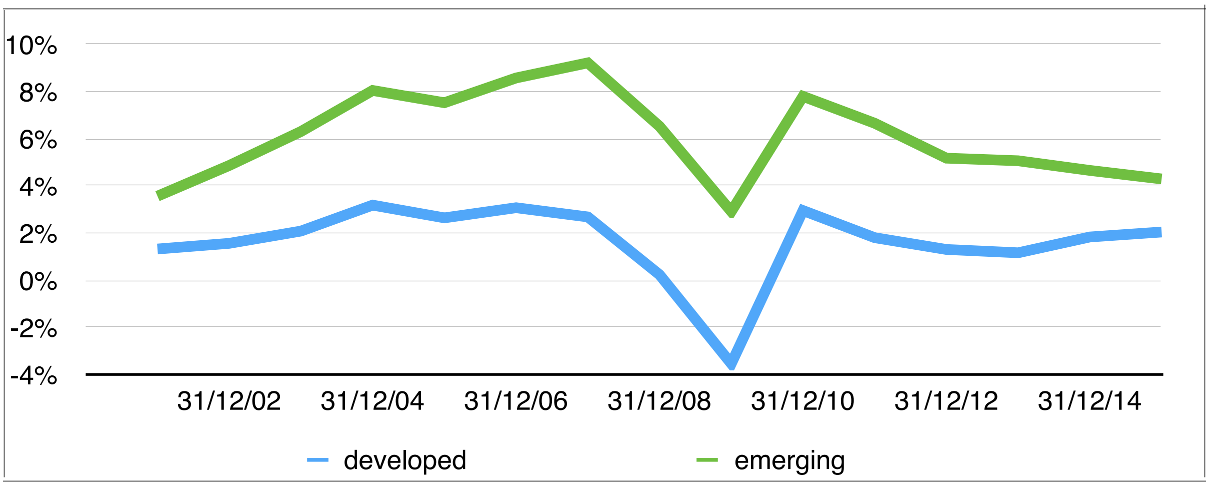
Investment Strategy Panel

The Pensions Committee sets the overall investment strategy with the implementation of that strategy, including investment monitoring, delegated to the Executive Director of Resources who takes advice from the Investment Strategy Panel. The Investment Strategy Panel meets quarterly and comprises the Executive Director of Resources of the City of Edinburgh Council and the Chief Executive, Chief Financial Officer and Chief Investment Officer of Lothian Pension Fund along with three external advisers. The external advisers are Gordon Bagot, Scott Jamieson and KPMG, represented by David O'Hara.

Investment markets

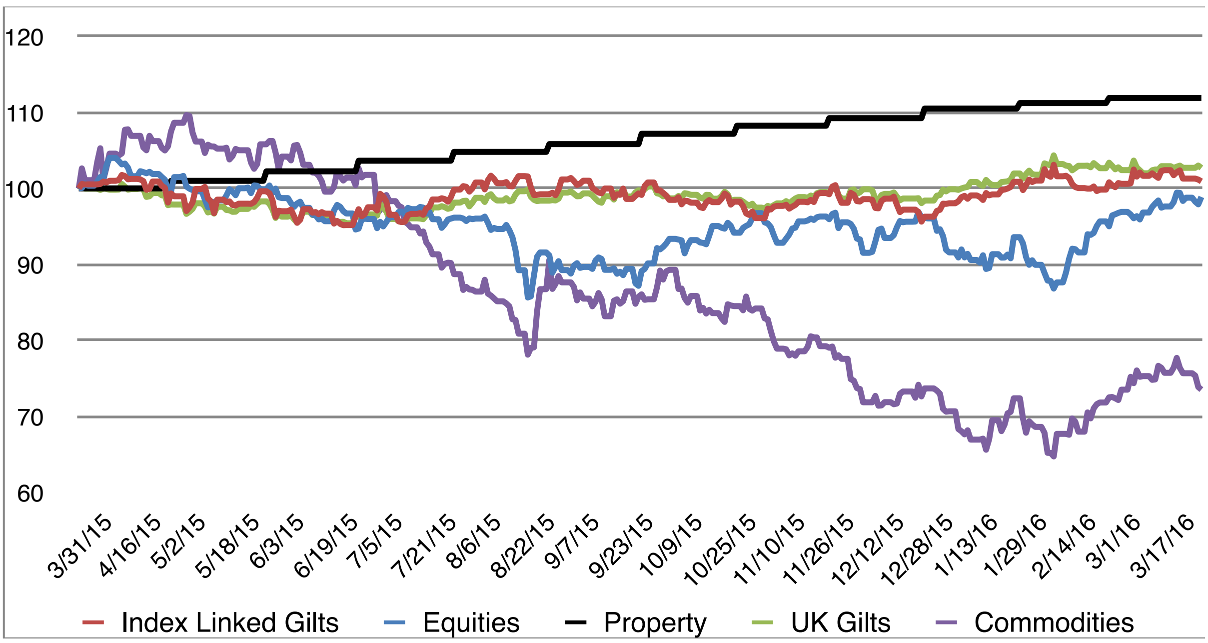
UK economic growth moderated somewhat in 2015, slowing from 2.9% in 2014 to 2.4% in 2015. The recovery in the labour market continued with unemployment falling to a 10 year low of 5%. Despite this, wage growth has remained subdued, with average earnings staying around 2%. The big surprise of 2015 was inflation falling below zero as oil and other commodity prices continued their slump. Other global economies showed quite diverse growth rates. Growth in developed economies have broadly returned to levels prior to the 2007/08 global financial crisis, around 2%. Growth in emerging markets on the other hand, has reduced significantly over recent years. Brazil and Russia are in recession and growth in China has slowed markedly.

Divergence between Developed Market and Emerging Market Economic Growth



Asset markets gave relatively lacklustre but volatile returns during 2015/16. Equity market returns were mainly negative, with only the US giving a positive return to UK investors, of 3%. The UK, Eurozone and Japan all gave returns of between -4% and -7% to a UK investor. The worst performing equity markets were those of the emerging markets, with Brazil and China returning -9% and -16% respectively in Sterling terms. The UK index-linked government bond market produced a modest positive return of 2%. Property returns were strongly positive, giving a return of +11%.

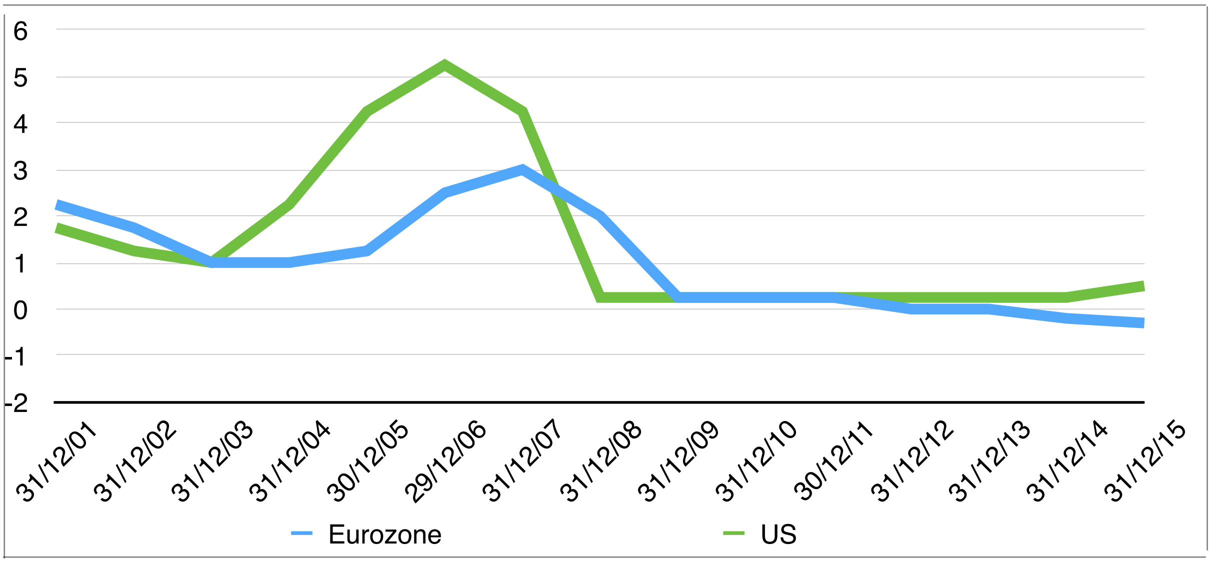
One Year Asset Class Returns – Major Markets (rebased to 100)



The outlook for asset markets relies on developed markets continuing to grow and for emerging markets to recover. In the US, the Federal Reserve has felt confident enough in the growth outlook to raise rates by 0.25%, the first monetary tightening in 9 years. Only a very slow and gradual further increase in interest rates is expected, due to low US inflation and the weakness of the global economy. Both Eurozone and Japan have continued to ease monetary policy in the face of domestic economic weakness and falling inflation. Further easing in both areas is expected in 2016. Growth expectation in the UK is between the US and Eurozone. Brexit fears have weighed on the currency and investment intentions. UK monetary policy has been unchanged for over 7 years.

Higher US rates, lower European rates

The outcome of the Brexit referendum, the speed of interest rate rises in the US and the performance of emerging economies will have a major impact on global assets. Longer term, asset returns are likely to remain low as global growth, inflation and interest rates all remain subdued.



Management commentary

Investment strategies

Over 2015/16, both Lothian Pension Fund and Lothian Buses Pension Fund reduced their equity allocations and continued to make new commitments to alternative assets, including timber and infrastructure investments in Scotland, UK and overseas. Investments in index-linked government bonds were modestly increased.

Scottish Homes Pension Fund adjusted its asset allocation in response to changes in its funding level during the year, and between 31 March 2015 and 31 March 2016, it increased its equity allocation and decreased its bond allocation due to a small decrease in the funding level.

Strategies are implemented utilising our experienced internal team of investment professionals. The guiding principle is to use strong internal investment capabilities to their maximum potential and to retain external managers for specialist mandates.

Over the past 6-7 years, the internal team has expanded with very positive effects on costs and capabilities. This is reflected in two structural shifts. Firstly, the percentage of Lothian Pension Fund's listed equity assets managed internally has risen from 23% to more than 85% and the majority of publicly traded bond assets are also managed internally. Secondly, the Fund has altered the construction of the listed equity assets, increasing the global mandates from 32% to more than 85%. Despite these large changes in the Fund, equity returns have been ahead of benchmark by 1.5% per year over the last five years and this has been achieved with lower risk than the benchmark.

Lothian Pension Fund and Lothian Buses Pension Fund also invest in private markets, selecting specialist managers to access a wide range of opportunities that are not available in the public markets. Over the past 10 years, the investment team has built a portfolio of private market assets in equity, debt, real estate, timber and especially in infrastructure, which is the largest proportion of the private market assets held and are described in more detail below.

The review of investment strategies for all three Funds during 2012 resulted in five year plans (2012-17) to achieve a reduction in investment risk. The investment strategies were again reviewed during 2015, taking into account the results of the 2014 actuarial valuations.

For Lothian Pension Fund, the Pensions Committee agreed that there was no reason to change its long term strategic allocation of assets as agreed in the 2012-17 investment strategy. The Fund will continue to implement that strategy over 2016 and 2017.

For Lothian Buses Pension Fund, the review of strategy has greater implications. In March 2016, the Pensions Committee agreed a revised long term strategy allocation for the five year period 2016-21. This makes meaningful changes to asset allocation over that timeframe reflecting the requirement for greater funding stability as the Fund matures. In addition, as Lothian Buses Pension Fund is defined in regulations as a sub-fund of Lothian Pension Fund, the Pensions Committee agreed that the option for it to be merged into Lothian Pension Fund would be explored in consultation with stakeholders.

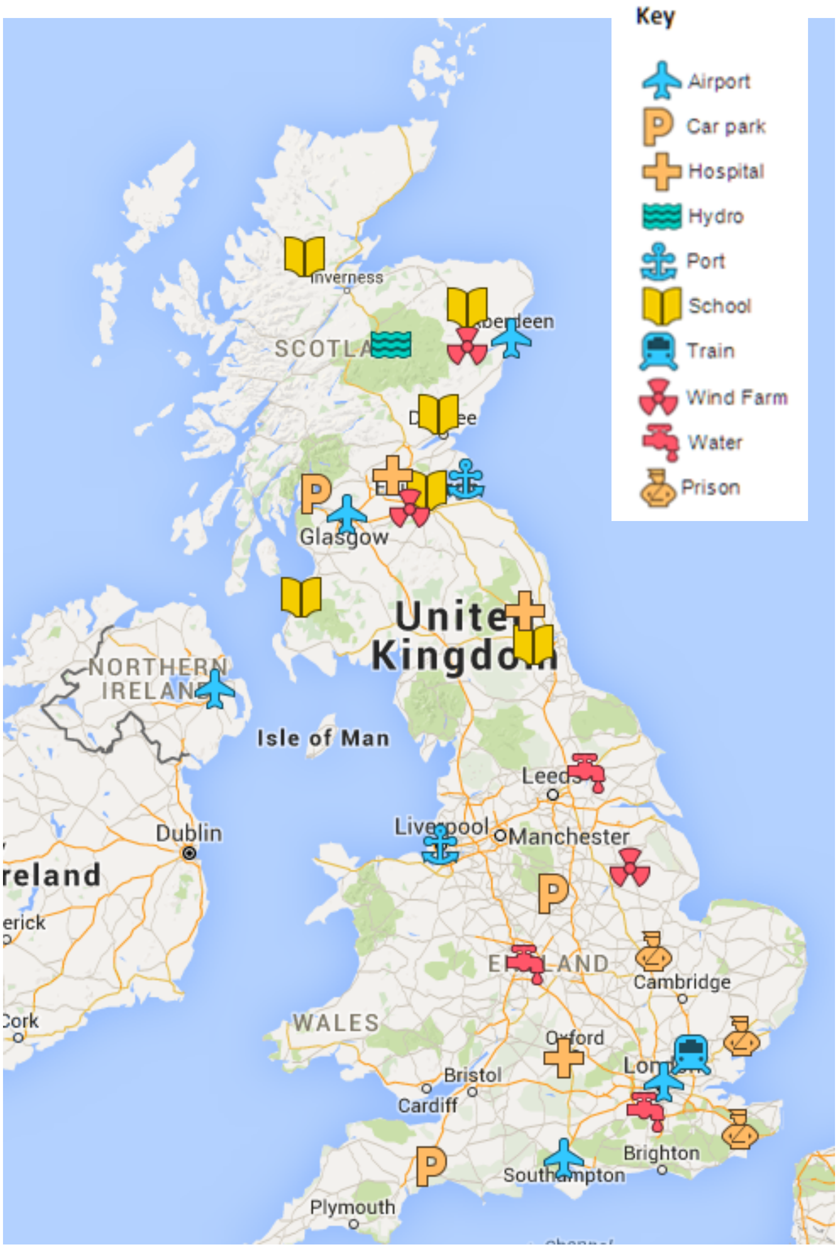
For Scottish Homes Pension Fund, the review concluded that a less prescriptive investment and funding strategy would allow a higher-yielding investment strategy and a more flexible approach to setting contributions. The current investment strategy adjusts asset allocation based on the evolution of the funding level. It is a bond-focused strategy, which generates an annual income yield of less than 2%, and so the Fund is required to sell assets on a regular basis to pay pensions. Proposals have been put forward to the Scottish Government to change and update its funding agreement and it has agreed to consider alternatives to the existing funding approach. Until options are explored further, Scottish Homes Pension Fund will continue to implement the existing investment strategy.

Infrastructure investment

Infrastructure investment has received much publicity over the past year as the UK and Scottish governments encourage Local Government Pension Schemes to increase their investment in this area. Infrastructure investments may offer the potential to generate attractive risk-adjusted returns based on cash flows that are often linked to inflation and can play a diversifying role in the Funds' strategies.

Lothian Pension Fund operates a dedicated multi-strategy real assets team to manage its infrastructure allocation. Over the last decade, it has developed its reputation, network and execution capabilities to secure access to investment opportunities within this market niche. Our experienced team appraises, models and invests in primary and secondary funds as well as co-investments to achieve its target allocation in a cost effective manner. An important element of the implementation strategy is to work with managers to ensure execution certainty and to understand transaction fees fully.

Infrastructure investments represented 8% of the value of the Lothian Pension Fund at 31 March 2016, one of the largest and most diversified allocations compared with other UK Local Government Pension Funds.
Lothian Buses Pension Fund investments in infrastructure accounted for 6% at 31 March 2016. Of the £439million invested in infrastructure, 55% is invested in a diverse range of projects in the UK. The map below shows some of the infrastructure projects.



During 2015/16, Lothian Pension Fund completed one primary fund investment, acquired five secondary fund interests at material discounts to net asset value and invested in four co-investment and/or single asset investment vehicles. Approximately £182million has been invested over the year in UK, European and infrastructure assets, including UK hydro, wind, solar, gas distribution and the Thames Tideway Tunnel.

Over the last year, we have collaborated with Falkirk Council Pension Fund on five infrastructure investments. A staff secondment arrangement shares internal staff costs between the funds, supports Falkirk's strategy to increase its allocation to UK infrastructure and gives them access to opportunities that would not have otherwise been available.

Financial Conduct Authority approval (once obtained) will enable us to more effectively collaborate in this sector, and for Lothian to benefit from scale in the market whilst further supporting other institutional pension funds in accessing infrastructure markets.

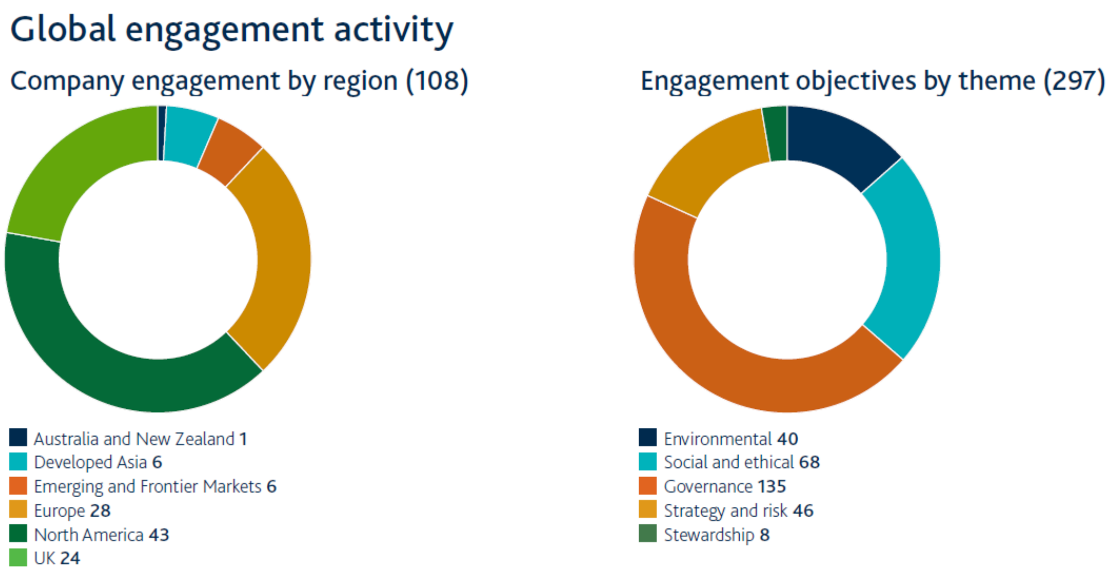
Responsible investment

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

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

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

Over the year, we voted at shareholder meetings of more than 600 companies in which we were invested. We voted on over 9,000 resolutions and opposed over 600 of them. Hermes Equity Ownership Services engaged on our behalf with companies across the world on topics such as board structure, executive compensation, climate change and community relations. We supported the "Aiming for A" coalition which seeks transparency over climate change risks and opportunities in mining companies and we co-filed a shareholder resolution at Rio Tinto.



Councillor Cameron Rose, a member of the Pensions Committee, is Vice Chair of the Local Authority Pension Fund Forum (LAPFF), which promotes the investment interests of local authority pension funds and seeks to maximise their influence as shareholders. In his LAPFF role, Councillor Rose meets with boards of companies and attends company Annual General Meetings to represent shareholders' interests.

Financial performance

Administrative expenses

A summary of the Division's administrative expenditure for 2015/16, against the budget approved by Pensions Committee, is shown in the table below.

The budget focuses on controllable expenditures and therefore excludes all benefit payments and transfers of pensions from the Fund. Similarly, income does not include contributions receivable and pension transfers to the Fund. The total net cost outturn of £11,118k against budgeted of £11,894k represented an underspending of £776k (6.5%) for the pension fund. The key budget variances serving to generate this underspending were:-

- Other third party payments - £633k underspend. This saving arose primarily from investment broker research costs continuing to be paid via commission, rather than being invoiced directly. The budget also included provision for preliminary expenses incurred in exploring potential investments but not concluding in an asset purchase. In the event, no such outlays were written off and the budget of £200k was not utilised. Miscellaneous other costs amounted to £67k in excess of budget.

- Employees - £319k underspend. This arose from savings in unfilled posts and also the timing of recruitment.

- Supplies and services - £226k underspend. Savings were realised across a range of budgets within this cost classification. These included lower than anticipated outlays for investment legal fees, £60k; investment asset system costs, £45k; establishment of wholly-owned companies, LPFE Limited and LPFI Limited, including application to Financial Conduct Authority for the latter, £30k, printing and postage expenditures, £25k. Miscellaneous other savings totalled £66k.

- Investment management fees - £191k underspend. This saving arose from greater use of in-house investment management expertise, with three external fund mandates being terminated and assets transferred. This occurred late in the financial year and therefore realised savings were proportionately lower. Investment management fees are also linked to asset performance. Investment returns remained lower than the prudent assumption of an 8% return used to derive the budgeted fee expenditure. Savings of £450k, however, were offset by additional fee outlays in pursuit of infrastructure investments.

- Income - £586k lower receipts than budgeted. Securities lending commission fell significantly short of budget. This reflected the generally lower than anticipated volume of securities lending activity in investment markets, particularly in the United States, and also reflected changes to the underlying asset holdings. Specifically, 50% of stock lending commission received by the Division in the previous year had been derived from a single stock. The income from this stock proved less reliable in the first quarter of this year and was sold, on investment grounds, during the second quarter.

	Approved budget	Actual outturn	Actual variance
	£000	£000	£000
Employees	2,489	2,170	(319)
Property	188	194	6
Plant and Transport	37	32	(5)
Supplies and Services	1,095	869	(226)
Investment Managers Fees - Invoiced	8,100	7,909	(191)
Other Third Party Payments	1,286	653	(633)
Capital funding - Depreciation	80	83	3
Direct Expenditure	13,275	11,910	(1,365)
Support Costs	276	279	3
Income	(1,657)	(1,071)	586
Total net controllable cost to the Funds	11,894	11,118	(776)

	Actual outturn
	£000
Actual outturn on budgeted items above	11,118
Add back securities lending revenue included in income above	892
Investment property administration costs	497
Investment transaction costs	2,260
Investment management fees deducted from capital	23,126
Securities lending management fee	255
IAS19 LPFE retirement benefits	180
LPFE deferred tax on retirement benefits	(36)
LPFE corporation tax losses utilised by CEC group	(5)
Total cost to the Funds (inclusive of full investment management fees)	38,287
Per Fund Accounts	
Lothian Pension Fund	36,286
Lothian Buses Pension Fund	1,779
Scottish Homes Pension Fund	222
Total	38,287

Funding and cash-flow

Cashflow to and from a pension fund is very dependent upon the profile of its membership. Specifically, a maturing membership, where the proportion of active to deferred and pensioner members is reducing, will result in a relative reduction in contributions received, together with additional outlays on payments to pensioners.

For Lothian Pension Fund, a significant early retirement initiative from the largest employer, the City of Edinburgh Council, resulted in a marginal decrease in the total active membership (-0.6%) over the year. The impact on funding was that net additions from dealing with members, although remaining positive at £11.4million, fell by £7.9million (40.9%). The impact of higher lump sum and pension payments was offset by the policy of the Fund that any pension strain cost associated with early retirement is paid in full immediately on the member's retirement.

As a fund which is closed to new entrants, the income and expenditures of Lothian Buses Pension Fund reflect this relative maturity. As at 31 March 2016, outlays from dealing with members remained in excess of receipts by £1.3million. This represents a change of £0.5million on the position as at 31 March 2015, where net outlays totalled £1.8million. Primarily, this resulted from the phased increase in contributions from the employer, £0.4million, as agreed at the 2014 actuarial valuation.

Scottish Homes Pension Fund is a mature fund with no active members. As a result, pension outlays are met from investment income and asset sales, supplemented by funding from the Scottish Government. Net pension outlays were £7.0million, an increase of £0.2million (3.0%) on the previous year.

Membership statistics for the three Funds and funding statements from the Actuary are provided at the Fund accounts section.

Investment cost benchmarking

Investment strategy focuses on risk adjusted returns net of costs. Investment data is provided to CEM, an independent benchmarking expert for global pension funds. CEM calculates a benchmark for the Lothian Pension Fund based on fund size and asset mix, which are key drivers of investment costs.

Reflecting the Fund's commitment to internal management, including the ability to implement transitions, investment costs are below that of CEM's benchmark of global peers. The latest analysis shows Lothian Pension Fund's investment costs at 0.39% are significantly lower than CEM's benchmark cost of 0.50% an equivalent saving of approximately £5million a year.

Investment management cost transparency

Local authorities are required to account for pension funds in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). The Code is based on approved accounting standards issued by the International Accounting Standards Board and interpretations of the International Financial Reporting Interpretations Committee, except where these are inconsistent with specific statutory requirements. The Code also draws on approved accounting standards issued by the International Public Sector Accounting Standards Board and the UK Financial Reporting Council where these provide additional guidance. The Code now requires that preparers have regard to CIPFA guidance "Accounting for Local Government Pension Scheme Management Costs"

CIPFA published guidance "Accounting for Local Government Pension Scheme Management Costs" in July 2014, which promoted greater transparency of investment management fees. These principles were adopted as best practice in the presentation of the Lothian Pension Fund audited Annual Report 2015. In March 2016, CIPFA revised its guidance including the following -"Investment costs incurred by a separate legal entity, or in respect of investment decisions over which the pension fund has no control, should not be included in the Fund Account."

The revised guidance changes the disclosure of fees for fund of funds investment arrangements. A "fund of funds" is an investment holding a portfolio of other investment funds rather than investing directly in stocks/securities. Typically fees are due to the "fund of funds" manager as well as to the managers of the underlying funds they are invested in. Generally, under the revised guidance from CIPFA this second layer of fees would not be disclosed with just the fees from the "fund of funds" manager disclosed.

In the preparation of Lothian Pension Fund's 2014/15 Annual Report the Fund made efforts to be completely transparent on the totality of costs incurred for managing its investment assets. The Fund's disclosures included all layers of fees.

The Fund believes that full transparency of investment costs is crucial to providing a full understanding to the most significant cost of managing a pension fund. Accordingly, the Fund has maintained this principle in this years financial statements and continued to disclose all investment cost in the financial statement for the year and therefore is not compliant with the revised CIPFA guidance. However, the Fund feels that the principle of full investment management cost transparency should be maintained. The table below demonstrates the difference in reporting between CIPFA's recommendations and full transparency in investment costs for 2015/16.

	Investment Management expenses in compliance with CIPFA	Investment Management expenses per 2015/16 financial statements	Variance from full disclosure
	£000	£000	£000
Lothian Pension Fund	27,625	34,400	6,775
Lothian Buses Pension Fund	1,309	1,677	368
Scottish Homes Pension Fund	169	169	0
TOTAL	29,103	36,246	7,143

Risk management

The Funds are committed to a strong control environment to ensure that risks are identified, understood, managed and monitored appropriately. The risks faced by the Funds change over time and ongoing management of risk is crucial. The Funds also have a compliance policy and each manager is responsible for ensuring compliance within their area of responsibility.

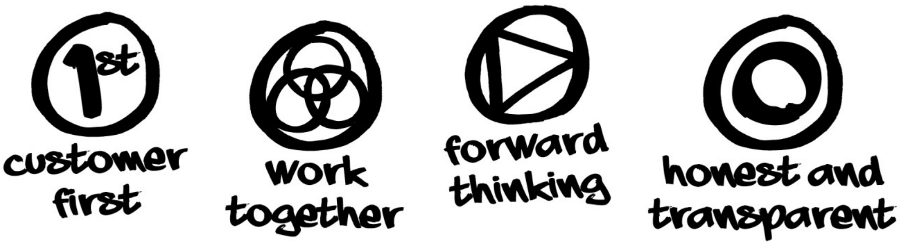
As at 31 March 2016, the most significant risks (after taking account of risk reduction controls), as assessed using a score out of 10 by the Investment and Pensions Service Management Team, were as follows:

Description	Impact	Likelihood	Risk score
Adverse investment performance leading to pressure on employer contributions	5	4	20
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions	5	6	30
Collapse/restructuring of an employer body leading to pressure on other employers	4	8	32
Recruitment and retention of key staff	5	7	35

Performance

The Fund has a strong commitment to customer service. We continually develop our services to ensure the best possible service for customers whilst recognising potential demands of the future. Our vision, objectives and key actions are shown in our service plan along with how we measure their success. Our progress is reported regularly to the Pensions Committee and Pension Board.

To ensure we meet this aim we have set the following objectives for our service:



In 2015/16, we have delivered the following achievements:

- Implemented LGPS2015 scheme changes, the most significant changes to the Scheme since it began
- Established a new Pension Board and embedded it into the Funds' governance
- Set up two new companies LPFE Limited and LPFI Limited and transferred investment staff to LPFE Limited
- Submitted an application to the Financial Conduct Authority for the registration of LPFI Limited
- Established a new data quality team and developed enhanced performance measures to monitor membership data
- Participated in discussions being undertaken by LGPS funds in England and Wales on investment pooling
- Commenced implementation of investment unitisation system
- Commenced work to undertake Guaranteed Minimum Pension (GMP) reconciliation with HMRC
- Continued to provide a shared service to Falkirk Pension Fund.

Performance against key objectives

We put our customers first and aim to provide the very best service.

	Target	Actual
Maintain Customer Service Excellence Standard	Retain	Retained
Overall satisfaction of employers, active members and pensioners with our services as measured by surveys	87%	86%
Proportion of active members receiving a benefit statement by 31 August 2015	96%	98%

Customer Service Excellence

To maintain our commitment to customer service, we use the Customer Service Excellence (CSE) framework which ensures we are continuously making improvements. We are assessed annually by an external assessor and at our assessment in February 2016, we retained the CSE award for another year. We also gaining an additional Compliance Plus award bringing the number held to five for areas such as complaint handling and working with employers.

In 2016, the assessor said, "All told a very sound submission from what is clearly a very customer focussed organisation."

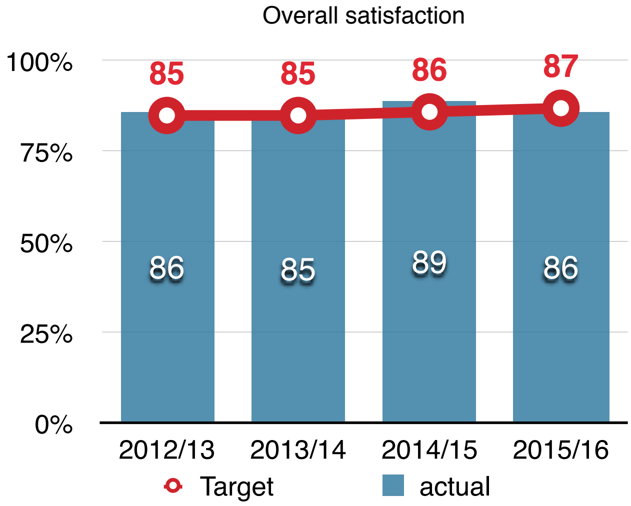
Customer satisfaction

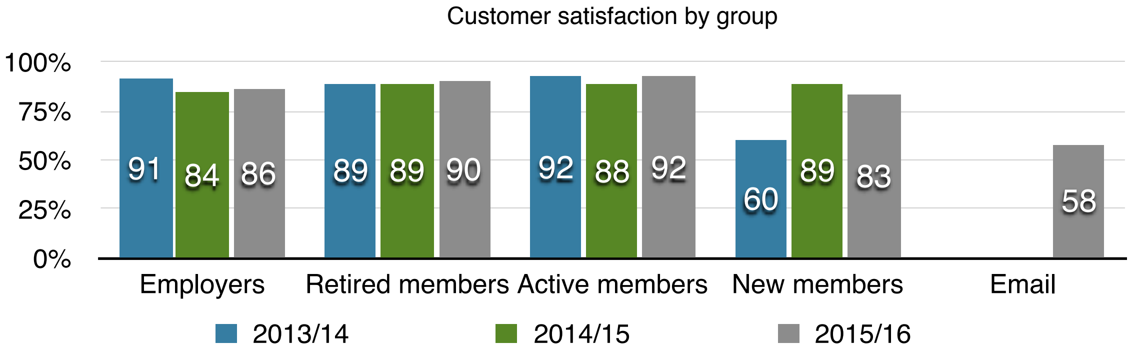
Our overall customer satisfaction over the year was 86%, just below the target of 87%. The chart on the left shows actual satisfaction against target since 2012/13.

The chart below shows customer satisfaction broken down by customer groups.

The year 2015/16 was the first time we have measured the satisfaction of those receiving services via email. As a result of feedback received, improvements have been implemented over the year to email service including quicker and more-focussed responses.

These have resulted in increased satisfaction over the course of the year, from 49% in the first quarter to 74% in the last quarter.





Complaints

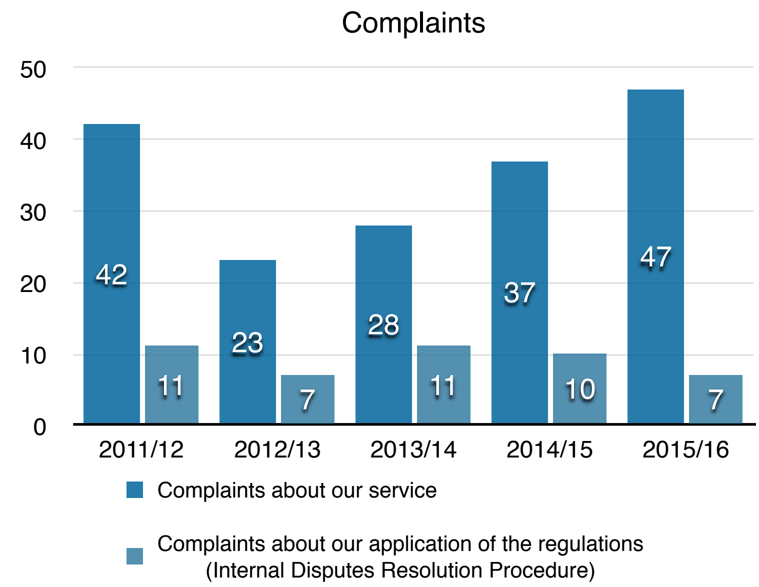
We monitor the complaints we receive on a monthly basis. We respond promptly to any complaints, investigate them and learn from them to improve the service. We categorise our complaints in two ways:

Complaints about our service
Complaints about our application of the regulations

The graph shows the number of complaints in each of the categories. These represent less than 0.2% percentage of the procedures (over 23,000) we carried out in 2015/16. The most common cause of complaint during 2015/16 was the delay in processing requests for transfers out of the Funds.

Following changes to the Scheme on 1 April 2015 there was a delay in updating the pension administration software used by all Scottish LGPS Funds. Increased public awareness of the new Freedom and Choice available from 6 April 2015 increased the number of requests for transfers and this compounded the problem. As soon as the software was updated in September, resource was immediately focussed on dealing with the requests.

Another theme identified was that members did not understand the complex scheme rules on trivial commutation (taking a small pension as a one-off cash lump sum where the payment extinguishes rights to benefits under the scheme). We used feedback to improve our retirement communications and now explain the triviality rules and the tax implications.



Annual benefit statements and data quality

We issued 98% of benefit statements by 31 August 2015. High quality data is essential to provide an excellent service to our members and for the provision of benefit statements and to meet The Pension Regulator's target of all members receiving their benefit forecast by 31 August. During the year more than 85 employers submitted monthly contribution data, leading to cleaner membership data, quicker services to members and fewer queries at the end of the year.

Along with our employer web portal, introduced to assist with the transfer of data, we have adopted other initiatives to improve member information. These include participation in specialist longevity and data analyses through "Club Vita", a service provided by the Funds' Actuary. We also carry out quarterly checks with the General Register Office and participate in the National Fraud Initiative. In 2014, we carried out a matching exercise for deferred members where we have lost touch with them. The project is currently being followed up with contact being made where a possible match has been found.

Following the end of contracting-out of the Second State Pension (S2P) on 5 April 2016, pension schemes need to reconcile the GMP values they hold for members with those calculated by HMRC. Schemes will be obliged to pay whatever GMPs are attributed to them, even those that may be incorrectly calculated or have been transferred out. An initial assessment shows 54% matching HMRC records and reconciliation is underway for the remaining records.

work together

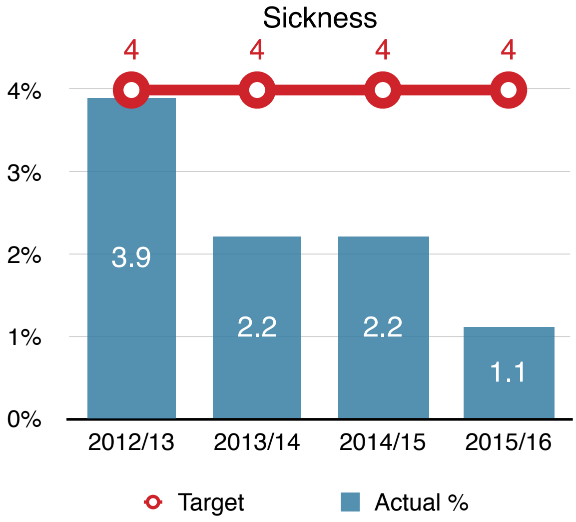
Our people are at the very heart of our business and we work together to deliver our service.

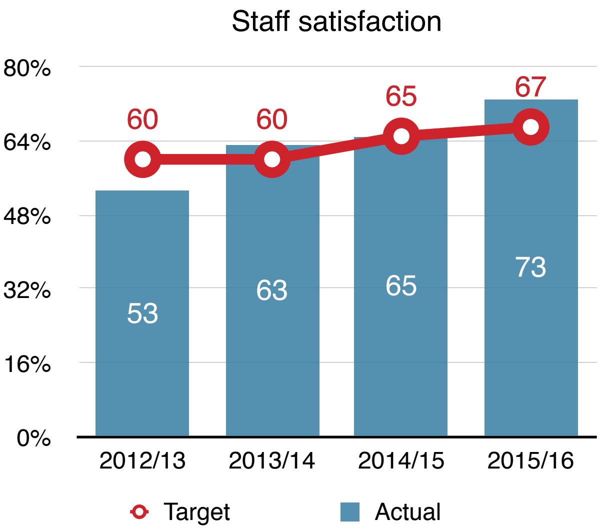
	Target	Actual
All staff complete at least two days training	Yes	Yes
Level of sickness absence	4%	1.1%
Staff survey satisfaction	67%	73%

Key indicators for staff in 2015/16 were overall staff satisfaction, sickness absence levels and training hours completed. All targets were achieved.

Over the last financial year, staff participated in regular training. As well as attendance at external seminars and training for qualifications, we held in-house sessions covering topics such as investments, annual accounts and funding.

The sickness absence rate was very low again at 1.1%.





Overall job satisfaction is measured during the annual staff survey. Overall satisfaction has continued to increase from 65% to 73% in 2015/16. This year's survey also saw the highest response rate with 49 out of 54 staff responding to the survey.

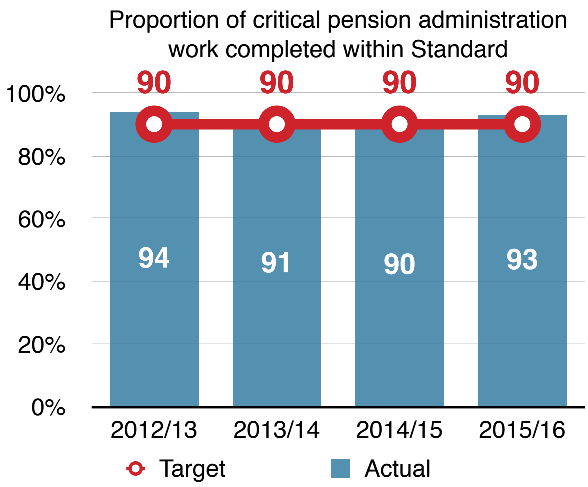
forward thinking

We strive to improve our services by thinking ahead and developing new solutions.

	Target	Actual
Proportion of critical pensions administration work completed within standards	Greater than 90%	93%

Our in-house pension administration team provides a dedicated service for the three pension Funds. We monitor the time taken to complete our procedures. Key procedures include processing of retirement and dependent benefits, providing information for new members, transfers and retirement quotes.

The Scheme changes from April 2015 have seen administration becoming more complex for both the Fund and employers. We continue to review our processes to improve our performance so that the Fund is in a position to meet new challenges. Despite the challenging environment, 93% of key procedures in 2015/16 completed in target.



In order to ensure we receive the necessary data from employers to administer pensions, we reviewed and updated our Pensions Administration Strategy to take into account recent regulatory changes and to further enhance data quality and service standards.

The Pensions Administration Strategy sets out the roles and responsibilities of both the Fund and employers and specifies the level of services the parties will provide to each other.

The Pensions Committee agreed to pass on costs of poor performance from employers, and the revised Strategy now includes reference to charges in four key areas:

- Late payment of contributions
- Late submission of membership information at the end of the year
- Failure to provide the Fund with information required to provide members with pensions savings statements
- Failure to provide details of member contributions on a monthly basis.

These areas are particularly important to ensure compliance with legislation, including accurate data to administer the new career average pension scheme and the new requirement to provide members with a pension forecast by 31 August each year. Charges for late payment of contributions are as stated in the Scheme regulations whilst other charges have been set to reflect the additional time spent in resolving queries and pursuing late information.

The Fund monitors employer performance against the standards set out in the Pension Administration Strategy. Results are reported to employers by way of an annual performance report and more frequently for larger employers.

Overall employer performance for 2015/16 is shown below, with 2014/15 shown for comparison purposes.

		2014/15			2015/16		
Case type	**Target (working days)**	**Number received**	**Number within target**	**% within target**	**Number received**	**Number within target**	**% within target**
New members	20	4,741	3,631	**77%**	4,653	4,074	**88%**
Leavers	20	2,430	1,189	**49%**	2,377	1,207	**51%**
Retirements	20	931	373	**40%**	1,156	398	**34%**
Deaths in Service	10	29	7	**24%**	40	11	**28%**

In 2015/16, the proportion of new member, leaver and death in service cases where the information was received from employers within target timescales has improved from 2014/15. However, information continues to be received later than target for a significant proportion of these cases.

In contrast the provision of information for retirements within target timescales has worsened over the year. In part this was due to one of the largest employers carrying out a large-scale early retirement exercise. Of the retirements within 2015/16, 77% were due to members retiring early or on redundancy or efficiency grounds. 10% of the retirements were due to ill health.

honest and transparent

We are committed to supporting a culture of honesty and transparency.

	Target	Actual
Audit of annual report	Unqualified opinion	Yes
Monthly pension payroll paid on time	Yes	Yes
Contributions received within 19 days of the end of the month to which they relate	99.0%	98.9%
Data quality - compliance with best practice as defined by The Pensions Regulator	Fully compliant	Yes

Our annual report and accounts are audited by Audit Scotland and has received an unqualified audit opinion since the Fund began providing its own annual report. The Funds also paid over £165million of pension benefits to our members, primarily into the local economy where most of our members live.

We also measure the payment of employer contributions which are to be paid by the 19th day of the month to which they relate. 98.9% of employer contributions were received in the timescale against the target was 99%. Of the £2.0m paid late, £1.4m represented three payments from two employers. The employers who paid late are listed in the Funding section.

Pension record keeping standards are also measured against The Pension Regulator's best practice guidance and appropriate assurance has been attained for the second year since introduction.

Common data	**Target**	**Actual**
New data (Post June 2010)	100%	100%
Old data (pre June 2010)	95%	96%
Conditional and numerical data		
Fund specific measurement including date of joining, pensionable remuneration, date of leaving and reasons for leaving etc.	98%	98%

Funding Strategy Statement

The Funding Strategy Statement sets out how we balance the potentially conflicting aims of affordability and stability of employers' pension contributions whilst taking a prudent long-term view of funding pension liabilities. The Funding Strategy Statement was revised at the 2014 Actuarial Valuation and further revised in November 2015. It can be viewed on our website at www.lpf.org.uk/publications. The Statement covers the funding strategies of each of the three Funds.

Employer appeals

The revised Funding Strategy Statement included a change for those employers with less than five active members and/or those who were within two valuation periods (6 years) of leaving Lothian Pension Fund. Such employers were invested in lower-risk investments, i.e. index-linked government bonds, with employer contribution rates set accordingly. This was in order to address the previous inconsistency between the actuarial and cessation valuations, raise awareness of pension deficits and reduce risk of employers being unable to pay deficits when the last member leaves.

Following representation from employers at Pensions Committee in March 2015, those affected were given leave to appeal their new contribution rates on affordability grounds. Of the 27 employers affected, 14 appeals were received.

The appeals were considered by the Pensions Committee at a special meeting in November 2015 and decisions were agreed for each of the employers. A revised rates and adjustments certificate with revised contribution rates was prepared by the Actuary. The Funding Strategy Statement was amended to include reference to these determinations and to clarify other issues raised by employers during the appeals process.

Unitisation of assets

Lothian Pension Fund is seeking to enhance the transparency of the fund assets attributable to each employer and, to that end, has procured a system of investment unitisation (asset tracking). This enables investment assets for each employer to be tracked on a monthly basis, with the cash flow of an employer resulting in either a purchase or sale of units. The aim is to implement this change at the coming actuarial valuation, as at 31 March 2017, and data has been loaded to the system retrospectively in readiness. Another benefit of the system is that it also facilitates the future provision of more tailored strategies to employers.

Tailored employer investment strategies

Lothian Pension Fund is seeking to provide more tailored investment strategies to individual employers from the next actuarial valuation in 2017. A system has been purchased that will enable tracking investment assets for each employer on a monthly basis with the cash flow of an employer resulting in either a purchase or sale of units.

Any new investment strategy would supplement the present high-level asset classes of equities, index-linked gilts and alternatives for the majority of employers, together with the wholly index-linked gilts funding for those employers closest to exit.

Employer contributions – late payments

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

We monitor this requirement via our key performance indicators to ensure compliance with the Act. The target for 2015/16 year was 99.0% pension contributions paid in time. 98.9% of contributions by value were paid on time.

Of the 1,180 payments made to the Fund in 2015/16, in total 71 were paid later than the target of the 19th of the month. The number of late payments for each employer is provided overleaf.

Employer	Number of late payments
Centre for the Moving Image	1
Children's Hearing Scotland	2
Citadel Youth Centre	4
Dawn Construction	2
Edinburgh Cyrenians Trust	3
Edinburgh Festival Society	1
Edinburgh World Heritage Trust	1
Edinburgh Leisure	1
ELCAP	1
Enjoy East Lothian	1
Festival City Theatres Trust	2
Forth & Oban	1
Four Square	8
Granton Information Centre	2
Homeless Action Scotland [1]	7
Fire Training College	1
Link In	1
Lothian Buses	1
Museums Galleries Scotland	5
National Mining Museum	1
Open Door Accommodation Project	1
Pilton Equalities Project	2
Police Scotland	2
Royal Edinburgh Military Tattoo	1
Scotland's Learning Partnership [1]	5
Scottish Fire & Rescue Service	2
Skanska	1
SSERC Ltd	1
Stepping Out Project	3
Victim Support Scotland	4
West Granton Community Trust	1
West Lothian College	1
Young Scot Enterprise	1
TOTAL	**71**

[1] includes contributions paid in part

Lothian Pension Fund

Membership records

Status	Membership at 31 March 2013	Membership at 31 March 2014	Membership at 31 March 2015	Membership at 31 March 2016
Active	28,869	30,622	32,273	32,079
Deferred	16,600	16,482	15,916	17,444
Pensioners	20,484	19,972	20,636	21,371
Dependants	4,064	3,770	3,810	3,849
Total	**70,017**	**70,846**	**72,635**	**74,743**

Investment Strategy

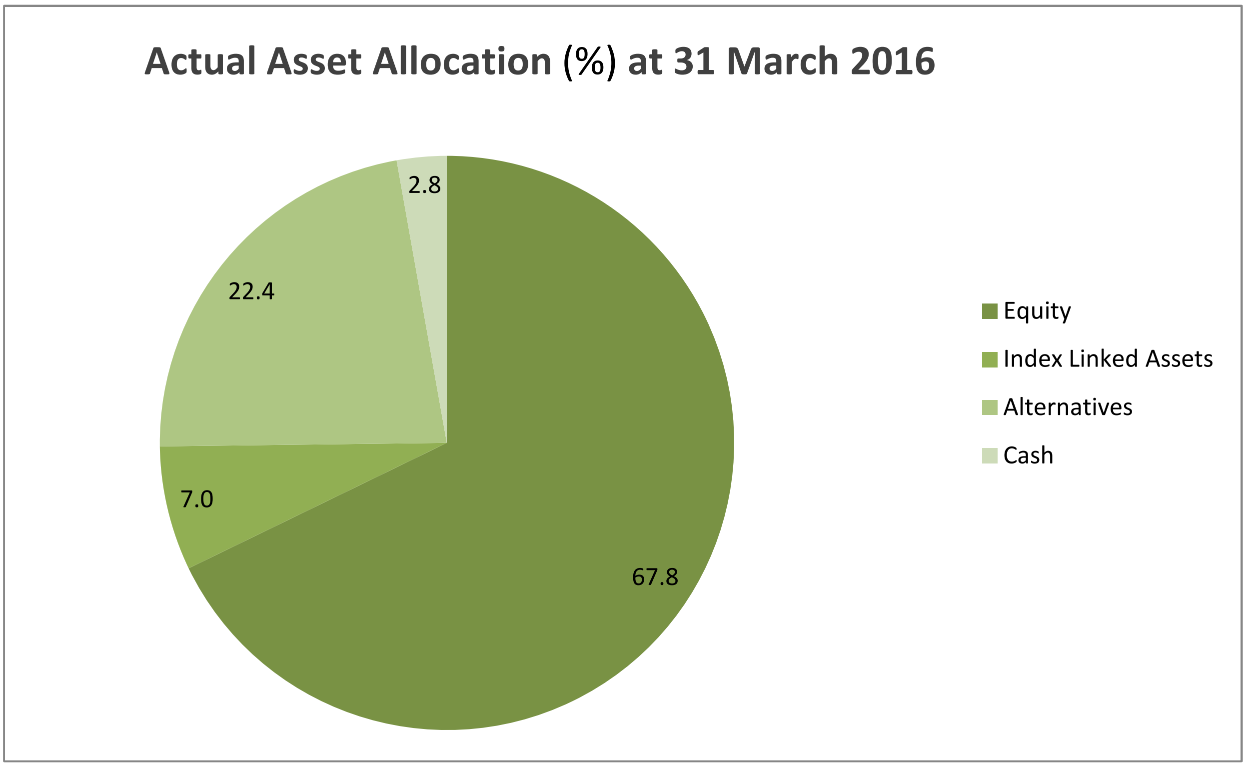
Following completion of the 2014 Actuarial Valuation, the Investment Strategy Panel and Pensions Committee reviewed the Fund's investment strategy in light of developments in pension fund membership, expected cash flow, funding level, investment risk and returns.

Lothian Pension Fund manages two investment strategies, which provides employers with access to an appropriate level of risk dependent on their individual characteristics (covenant strength, funding position, liability profile and time horizon). Most employer liabilities are funded in Strategy 1, which invests in a diversified portfolio of assets that are expected to generate positive real returns over the long term, but which will be volatile over shorter periods. Employers accounting for less than 1% of the Fund's liabilities are funded on a 'gilts' basis in Strategy 2, which invests in a portfolio of index-linked gilts to minimise risk for these employers.

Following completion of the 2014 Actuarial Valuation, the Fund’s Investment Strategy was reviewed. The Pensions Committee agreed in December 2015 that the Investment Strategy 2012-17 remained appropriate for the vast majority of employer liabilities. This strategy, Strategy 1, reduces the allocation to equities (including private equity) from 71.5% at the end of 2012 to 65% by the end of 2017 and increases the allocation to index-linked gilts and alternatives. (Alternatives include property, infrastructure, timber and fixed income assets, such as corporate bonds and other debt investments.) The strategy recognises a gradually changing risk profile for the Fund, but retains significant exposure to investments, such as index-linked gilts and equities, which have a history of protecting or enhancing purchasing power after the effects of inflation have been taken into account.

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

Strategy 1	Strategic Allocation 31/03/2016 %	Long term Strategy 2012 - 2017 %	Permitted ranges %
Equities	67	65	50 - 75
Index Linked Assets	7	7	0 - 20
Alternatives	25	28	20 - 35
Cash	1	0	0 - 10
Total	**100**	**100**	**n/a**



The implementation of the Investment Strategy 2012-17 continued to proceed at a measured pace over 2015/16 as investment opportunities became available and as research on opportunities was completed. Progress towards the long term strategy allocation involves the interim strategy allocation and the actual asset allocation changing gradually over time. The pace of change can be accelerated or slowed depending on asset prices, the availability of alternative investments and research conclusions on new investment opportunities.

The most significant changes to the Fund over 2015/16 were the terminations of three external equity managers (one active global equity mandate and two active emerging market mandates) with the assets transitioned into internally managed, lower risk, global equity mandates. Approximately 88% of the Fund's equities are now managed internally with the majority of these in low cost, low turnover strategies, which are expected to enhance the Fund's risk-adjusted returns over the long term. The Fund continues to outsource investment management services for specialist mandates, which complement the portfolio strategies employed internally.

Investment performance

The objectives of the Fund are:

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

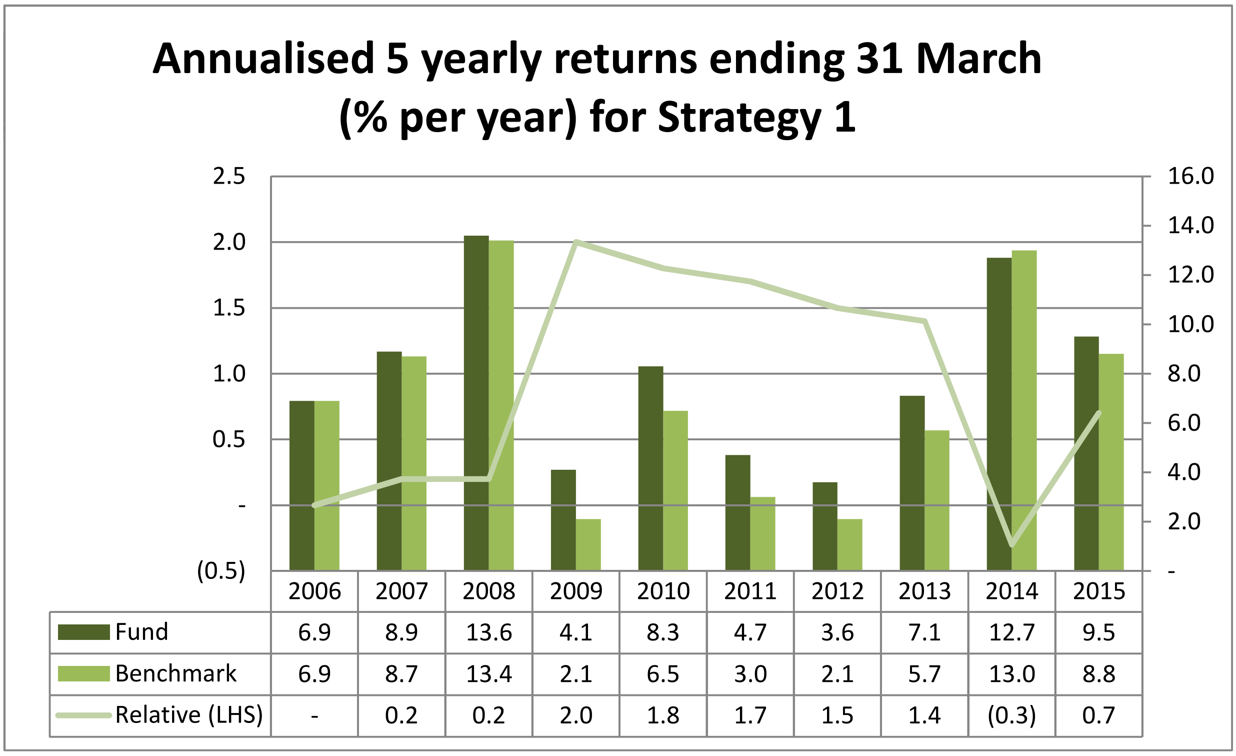
The Fund has achieved returns in excess of the strategic allocation over the last year and over the longer term timeframes shown in the table. The benchmark return shown in the table is the strategic allocation and comprises equity, index-linked gilts and cash indices as well as an inflation-linked index for the alternatives allocation.

Returns relative to the benchmark over a one year period need to be placed in the context that there are no ideal benchmarks for many of the assets held in the Fund, especially the Alternatives. The Fund's benchmark for Alternatives is inflation plus 3.5% per annum, which makes sense over the long term as the Fund's liabilities are linked to inflation. However, over shorter periods, there is less information content in the relative returns of the Fund because the development of asset prices is much more volatile than that of UK retail or consumer prices. The Investment Strategy Panel assesses the underlying risks of the portfolios that make up the asset allocation to ensure that these are consistent with the long term objectives of the Fund.

The strong performance relative to the benchmark over 2015/16 was largely attributable to equities (especially the large internally managed global portfolios) and the alternative investments, driven primarily by double digit return from the property and infrastructure portfolios, which benefited from the purchase of infrastructure assets at attractive valuations.

Annualised returns to 31 March 2015 (% per year)	1 year	5 year	10 years
Lothian Pension Fund	6.5	9.1	6.9
Benchmark	0.2	7.1	5.1
Actuarial Valuation Assumptions - Strategy 1 *	5.0	5.7	5.9
- Strategy 2 *	3.5	5.4	5.8
Retail Price Index (RPI)	1.6	2.3	3.0
Consumer Price Index (CPI)	0.5	1.7	2.4
National Average Earnings	1.9	1.6	2.2

*estimated



Lothian Pension Fund

Fund Account for year ended 31 March 2016

Restated* 2014/15 £000		Note	Lothian Pension Fund Parent 2015/16 £000	Lothian Pension Fund Group 2015/16 £000
	Income			
142,437	Contributions from employers	**5**	159,872	159,872
42,343	Contributions from members	**6**	42,800	42,800
6,452	Transfers from other schemes	**7**	2,780	2,780
191,232			**205,452**	**205,452**
	Less: expenditure			
128,701	Pension payments including increases	**8**	133,624	133,624
31,456	Lump sum retirement payments	**9**	46,315	46,315
3,593	Lump sum death benefits	**10**	5,336	5,336
423	Refunds to members leaving service		519	519
407	Premiums to State Scheme		417	417
5,580	Transfers to other schemes	**11**	6,075	6,075
1,780	Administrative expenses	**12a**	1,743	1,766
171,940			**194,029**	**194,052**
19,292	**Net additions from dealing with members**		**11,423**	**11,400**
	Returns on investments			
122,876	Investment income	**13**	134,113	134,113
613,941	Change in market value of investments	**15, 21b**	216,646	216,646
(27,413)	Investment management expenses	**12b**	(34,400)	(34,520)
709,404	**Net returns on investments**		**316,359**	**316,239**
728,696	**Net increase in the Fund during the year**		**327,782**	**327,639**
4,377,536	**Net assets of the Fund at 1 April 2015**		5,106,232	5,106,232
5,106,232	**Net assets of the Fund at 31 March 2016**		**5,434,014**	**5,433,871**

* The results for the year ended 31 March 2015 have been restated to reflect a change in the accounting policy on securities lending revenue and the related management charges. The effect is to increase both investment income and investment management expenses by £472k. There is no change in the net return on investement. See note 2 for details.

Lothian Pension Fund

Net Assets Statement as at 31 March 2016

31 March 2015 £000		Note	Lothian Pension Fund Parent 31 March 2016 £000	Lothian Pension Fund Group 31 March 2016 £000
	Investments			
5,077,632	Assets		5,413,590	5,413,590
(5,048)	Liabilities		(14,627)	(14,627)
5,072,584	**Net investment assets**	**14**	**5,398,963**	**5,398,963**
	Fixed assets			
365	Computer systems		332	332
365			**332**	**332**
	Non current assets			
-	Debtors	**25**	451	451
-	Deferred tax	**30b**	-	36
-			**451**	**487**
	Current assets			
6,352	The City of Edinburgh Council	**29**	4,287	4,287
36,350	Cash balances	**22, 29**	41,327	41,331
9,769	Debtors	**26**	12,670	12,703
52,471			**58,284**	**58,321**
	Non current liabilities			
-	Retirement benefit obligation	**31**	-	(180)
-			**-**	**(180)**
	Current liabilities			
(19,188)	Creditors	**27**	(24,016)	(24,052)
(19,188)			**(24,016)**	**(24,052)**
5,106,232	**Net assets of the Fund at 31 March 2016**		**5,434,014**	**5,433,871**

JOHN BURNS FCMA CGMA
Chief Finance Officer, Lothian Pension Fund
27 June 2016

Notes to the net asset statement

The financial statements summarise the transactions of the Fund during the year and its net assets at the year end. They do not take account of the obligations to pay pensions and benefits which fall due after the end of the year. The actuarial position of the Fund, which does take account of such obligations, is discussed in the Actuarial Valuation section of this report and these financial statements should be read in conjunction with that information. In addition, as required by International Accounting Standard (IAS)26, the Actuarial Present Value of Promised Retirement Benefits is disclosed in the notes to these financial statements.

Notes to the Accounts

1 Statement of Accounting Policies

The statement of accounting policies for all Funds' can be found on page 112.

2 Prior year adjustment

During the year, the Fund has changed its accounting policy in respect to securities lending revenue that has required the restatement of the 2014/15 results.

Previously securities lending revenue was recognised net of fees, as management charges were deducted at source. The new treatment recognises the gross income from securities lending and impacts both the investment income of the Fund and investment management expenses.

	2014/15 Restated £000	Adjustment £000
Investment income	122,876	472
Investment management expenses	(27,413)	(472)

3 Lothian Pension Fund Group

Basis of consolidation, presentation of financial statements and notes

Commencing with the year ended 31 March 2016, Consolidated Financial Statements have been prepared for Lothian Pension Fund. The Financial Statements of Lothian Buses Pension Fund and Scottish Homes Pension Fund continue to be prepared on a single entity basis.

The Consolidated Financial Statements for Lothian Pension Fund are prepared by combining the Financial Statements of the Fund (the parent entity) and its controlled entity (LPFE Limited) as defined in accounting standard IAS27 - Consolidated and Separate Financial Statements. Consistent accounting policies are employed in the preparation and presentation of the Consolidated Financial Statements. All inter-entity balances and transactions between entities, including any unrealised profits or losses, have been eliminated on consolidation.

Because LPFE limited activities are focussed of the provision of seconded staff, its consolidation has a limited impact on the figures included in the Fund Account and Net Assets Statement of Lothian Pension Fund. An additional column has been added in both the Fund Account and Net Assets Statement, with the figures prior to consolidation being identified as "Parent" and after consolidation as "Group". In the notes to the accounts, where there is a difference between the parent and group figures they are identified as either "Parent " or "Group".

As LPFE Limited commenced trading on 1 May 2015, the prior year comparative figures consist only of the results of Lothian Pension Fund.

Notes to the Accounts

3 Lothian Pension Fund Group (cont)

Notes relevant to LPFE Limited and the consolidation

The following notes provides more information in respect of LPFE Limited:

Note	Description
29	Related parties Describes the loan facility agreement that provides the working capital of the Company and the staff services agreement.
30a	Consolidated Lothian Pension Fund group - LPFE Limited - Corporation Tax utilised by CEC group Describes the tax loss of the Company utilised by another member of the City of Edinburgh Corporation Tax Group. The tax loss of the Company is transferred to another company in the Tax Group in exchange for a cash amount.
30b	Consolidated Lothian Pension Fund group - LPFE Limited - deferred tax Describes the deferred tax non-current asset of the Company. See 2 f) ii) in the Statement of Accounting Policies and General notes for more information.
30c	Consolidated Lothian Pension Fund group - LPFE Limited - share capital Describes the share capital of the Company.
31	Retirement benefits obligation - group Provides the information on the retirement benefits obligation of the Company as required under IAS19 - Employee Benefits. See 2 q) ii) in the Statement of Accounting Policies and General notes for more information.

4 Events after the Reporting Date

There have been no events since 31 March 2016, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

5 Contributions from employers

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

By category	2014/15 £000	2015/16 £000
Future service rate	111,692	133,035
Past service deficit	24,698	7,357
Strain costs	5,131	9,984
Cessation contributions	916	9,496
	142,437	159,872

By employer type		
Administering Authority	55,795	63,459
Other Scheduled Bodies	67,980	77,198
Community Admission Bodies	18,411	18,784
Transferee Admission Bodies	251	431
	142,437	159,872

Notes to the Accounts

5 Contributions from employers (cont)

Employer contributions, as calculated by the Fund Actuary, comprise two elements:

- An estimate of the cost of benefits accruing in the future, referred to as the “future service rate”, which is expressed as a percentage of payroll and;
- an adjustment for the solvency of the Fund based on the benefits already accrued. If there is a surplus, there may be a contribution reduction; if there is a deficit there may be a contribution increase. For all employers, contributions to cover any Past Service Deficit are expressed as a fixed monetary sum, rather than as a percentage of payroll and are payable on a monthly basis that is one twelfth of the annual total.

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

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

6 Contributions from members

By employer type	2014/15 £000	2015/16 £000
Administering Authority	16,544	16,389
Other Scheduled Bodies	19,751	20,226
Community Admission Bodies	5,988	6,074
Transferee Admission Bodies	60	111
	42,343	42,800

7 Transfers in from other pension schemes

	2014/15 £000	2015/16 £000
Group transfers	703	-
Individual transfers	5,749	2,780
	6,452	2,780

8 Pensions payable

By employer type	2014/15 £000	2015/16 £000
Administering Authority	60,636	65,447
Other Scheduled Bodies	56,688	56,115
Community Admission Bodies	11,234	11,902
Transferee Admission Bodies	143	160
	128,701	133,624

8 Pensions payable (cont)

Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998 [Section 31] allows employers to pay additional pensions on a voluntary basis.

As is typical within the Local Government Pension Schemes (LGPS), arrangements exist whereby additional teachers pensions and employee pensions are paid with the payment of funded pensions. In order that such are not regarded as “unauthorised payments” by HMRC these pension payments are met by the administering authority through a general fund bank account and recharged to the body or service which granted the benefits.

As “unfunded payments” are discretionary benefits, they are not relevant to the sums disclosed in the Fund accounts. As such Lothian Pension Fund provides payment and billing services to certain employers on a no charge agency agreement basis.

9 Lump sum retirement benefits payable

By employer type	2014/15 £000	2015/16 £000
Administering Authority	12,330	27,160
Other Scheduled Bodies	15,783	15,336
Community Admission Bodies	3,301	3,685
Transferee Admission Bodies	42	134
	31,456	46,315

10 Lump sum death benefits payable

By employer type	2014/15 £000	2015/16 £000
Administering Authority	1,191	2,745
Other Scheduled Bodies	2,020	1,964
Community Admission Bodies	382	627
Transferee Admission Bodies	-	-
	3,593	5,336

11 Transfers out to other pension schemes

	2014/15 £000	2015/16 £000
Group transfers	-	-
Individual transfers	5,580	6,075
	5,580	6,075

Notes to the Accounts

12a Administrative expenses

	LPF 2014/15 £000	LPF Parent 2015/16 £000	LPF Group Group 2015/16 £000
Employee Costs	985	992	994
The City of Edinburgh Council - other support costs	134	133	133
System costs	208	228	228
Actuarial fees	89	50	50
External audit fees	44	44	44
Legal fees	3	15	15
Printing and postage	94	77	77
Depreciation	67	57	57
Office costs	88	108	108
Sundry costs less sundry income	68	39	39
IAS19 retirement benefit adjustments - see note 31	-	-	27
Deferred tax on retirement benefit obligation - see note 30b	-	-	(6)
Corporation tax losses utilised by CEC group - see note 30a	-	-	-
	1,780	1,743	1,766

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

12b Investment management expenses

	LPF 2014/15 £000	LPF Parent 2015/16 £000	LPF Group Group 2015/16 £000
External management fees -			
invoiced	7,113	7,123	7,123
deducted from capital (direct investment)	9,519	15,603	15,603
deducted from capital (indirect investment)	5,755	6,775	6,775
Securities lending fees	472	212	212
Transaction costs	1,971	2,201	2,201
Property operational costs	648	497	497
Employee costs	841	961	963
Custody fees	375	304	304
Engagement and voting fees	71	76	76
Performance measurement fees	50	46	46
Consultancy fees	70	78	78
System costs	141	185	185
Legal fees	107	103	103
The City of Edinburgh Council - other support costs	161	124	124
Depreciation	-	7	7
Office costs	57	71	71
Sundry costs less sundry income	62	34	34
IAS19 retirement benefit adjustments - see note 31	-	-	153
Deferred tax on retirement benefit obligation - see note 30b	-	-	(30)
Corporation tax losses utilised by CEC group - see note 30a	-	-	(5)
	27,413	34,400	34,520

Notes to the Accounts

12b Investment management expenses (cont)

Investment costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are allocated based on the value of the Funds as at the year end.

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales (see note 15 - Reconciliation of movements in investments and derivatives).

It should be noted that Lothian Pension Funds disclosure on investment management fees goes further than CIPFA's LGPS Management Cost revised guidance on cost transparency. Consistent with previous years, the Fund recognises fees deducted from investments not within its direct control (such as fund of fund fees) to give a full picture of its investment management costs. Further details can be found on page 16. This further disclosure highlights an extra £6.8m in costs (2015 £5.8m)

The external investment management fees (deducted from capital) above include £12m (£7.9m direct, £4.1m indirect) in respect of performance-related fees. (2014/15 £2.3m direct, £3.0m indirect).

12c Total management expenses

	LPF 2014/15 £000	LPF Parent 2015/16 £000	LPF Group Group 2015/16 £000
Administrative costs	1,550	1,570	1,582
Investment management expenses	25,951	32,814	32,900
Oversight and governance costs	1,692	1,759	1,804
	29,193	36,143	36,286

In accordance with CIPFA, the above analysis looks at the combined administration and investment management expenses in note 12a and b and splits out the costs to include a third heading covering oversight and governance expenditure.

13 Investment income

	2014/15 £000	2015/16 £000
Income from fixed interest securities	4,857	3,898
Dividends from equities	88,527	94,637
Unquoted private equity and infrastructure	7,924	13,581
Income from pooled investment vehicles	861	1,026
Gross rents from properties	18,754	20,914
Interest on cash deposits	1,130	1,237
Stock lending and sundries	2,933	1,142
	124,986	136,435
Irrecoverable withholding tax	(2,110)	(2,322)
	122,876	134,113

14 Net investment assets

Investment Assets	Region	31 March 2015 £000	31 March 2016 £000
Fixed interest securities			
Public sector fixed interest	Overseas	288,651	153,740
Public sector index linked gilts quoted	UK	125,679	380,290
		414,330	534,030
Equities			
Quoted	UK	609,702	561,064
Quoted	Overseas	2,658,273	2,887,886
		3,267,975	3,448,950
Pooled investment vehicles			
Private equity, infrastructure, private debt & timber	UK	127,587	165,547
Private equity, infrastructure, private debt & timber	Overseas	436,583	550,617
Property	UK	55,035	82,453
Other	UK	13,835	17,275
		633,040	815,892
Properties			
Direct property	UK	316,169	356,281
		316,169	356,281
Derivatives			
Derivatives - forward foreign exchange		29,879	-
		29,879	-
Cash deposits			
Deposits		400,497	227,409
		400,497	227,409
Other investment assets			
Due from broker		4,585	18,648
Dividends and other income due		11,157	12,380
		15,742	31,028
		5,077,632	5,413,590
Investment liabilities			
Derivatives			
Derivatives - forward foreign exchange		(79)	(13,183)
		(79)	(13,183)
Other financial liabilities			
Due to broker		(4,969)	(1,444)
		(4,969)	(1,444)
Total investment liabilities		(5,048)	(14,627)
Net investment assets		5,072,584	5,398,963

Notes to the Accounts

15 Reconciliation of movement in investments and derivatives

	Market value at 31 March 2015 £000	Purchases at cost & derivative payments £000	Sale & derivative receipts £000	Change in market value £000	Market value at 31 March 2016 £000
Fixed interest	414,330	308,910	(202,855)	13,645	534,030
Equities	3,267,975	1,256,575	(1,143,580)	67,979	3,448,949
Pooled investment vehicles	633,040	141,787	(81,080)	122,146	815,893
Property	316,169	25,153	(2,295)	17,253	356,280
Derivatives - futures	-	5	87	(92)	-
Derivatives - forward foreign exchange	29,800	4,316	(40,895)	(6,404)	(13,183)
	4,661,314	1,736,746	(1,470,618)	214,527	5,141,969
Other financial assets / liabilities					
Margin balances	-			-	-
Cash deposits	400,497			1,751	227,409
Broker balances	(384)			368	17,205
Dividend due etc	11,157			-	12,380
	411,270			2,119	256,994
Net financial assets	5,072,584			216,646	5,398,963

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

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

	Market value at 31 March 2014 £000	Purchases at cost & derivative payments £000	Sale & derivative receipts £000	Change in market value £000	Market value at 31 March 2015 £000
Fixed interest	318,215	325,346	(313,907)	84,676	414,330
Equities	2,866,444	878,347	(860,763)	383,947	3,267,975
Pooled investment vehicles	598,687	76,731	(103,020)	60,642	633,040
Property	270,753	11,375	(2,143)	36,184	316,169
Derivatives - futures	213	(99)	(521)	407	-
Derivatives - forward foreign exchange	9,709	3,281	(26,068)	44,878	29,800
	4,064,021	1,294,981	(1,306,422)	610,734	4,661,314
Other financial assets / liabilities					
Margin balances	894			-	-
Cash deposits	257,749			3,190	400,497
Broker balances	6,579			17	(384)
Dividend due etc	14,067			-	11,157
	279,289			3,207	411,270
Net financial assets	4,343,310			613,941	5,072,584

Notes to the Accounts

16 Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2016

Contract settlement within	Currency bought	Currency sold	Local currency bought 000	Local currency sold 000	Asset value £000	Liability value £000
Up to one month	GBP	AUD	97,473	45,533	-	(6,609)
Up to one month	GBP	CAD	157,811	79,124	-	(5,761)
One to six months	GBP	EUR	24,750	19,062	-	(576)
One to six months	USD	AUD	1,037	762	-	(19)
One to six months	USD	CHF	10,038	10,253	-	(218)

	Asset value £000	Liability value £000
Open forward currency contracts at 31 March 2016	-	(13,183)
Net forward currency contracts at 31 March 2016		(13,183)
Prior year comparative		
Open forward currency contracts at 31 March 2015	29,879	(79)
Net forward currency contracts at 31 March 2015		29,800

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

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

17 Investment managers and mandates

Manager	Mandate	Market value at 31 March 2015 £000	% of total 31 March 2015 %	Market value at 31 March 2016 £000	% of total 31 March 2016 %
In-house	UK all cap equities	101,918	2.0	106,884	2.0
In-house	UK mid cap equities	103,346	2.0	105,980	2.0
Total UK equities		205,264	4.0	212,864	4.0
In-house	European ex UK equities	102,665	2.0	105,479	2.0
In-house	US equities	118,528	2.3	117,119	2.2
Mondrian	Emerging markets	104,048	2.1	-	-
UBS	Emerging markets	121,954	2.4	-	-
Total regional overseas equities		447,195	8.8	222,598	4.2

17 Investment managers and mandates (cont)

Manager	Mandate	Market value at 31 March 2015 £000	% of total 31 March 2015 %	Market value at 31 March 2016 £000	% of total 31 March 2016 %
In-house	Global high dividend	675,666	13.3	759,254	14.1
In-house	Global low volatility	886,891	17.5	966,835	17.8
In-house	Global value	333,310	6.6	824,967	15.2
Cantillon	Global equities	265,575	5.2	-	-
Harris	Global equities	205,125	4.0	186,652	3.5
Nordea	Global equities	203,667	4.0	223,912	4.1
Total global equities		2,570,234	50.7	2,961,620	54.7
In-house	Currency hedge	29,251	0.6	(12,370)	(0.2)
Total currency overlay		29,251	0.6	(12,370)	(0.2)
Total listed equities		3,251,944	64.1	3,384,712	62.7
In-house	Private equity unquoted	186,536	3.7	168,904	3.1
In-house	Private equity quoted	57,866	1.1	57,145	1.1
Total private equity		244,402	4.8	226,049	4.2
Total equity		3,496,346	68.9	3,610,761	66.9
In-house	Index linked gilts	296,300	5.8	357,163	6.6
In-house	Gold	15,897	0.3	17,020	0.3
Total inflation linked bonds and gold		312,197	6.2	374,183	6.9
In-house	Property	47,241	0.9	50,003	0.9
Standard Life	Property	382,694	7.5	422,452	7.8
Total property		429,935	8.5	472,455	8.7
In-house	Infrastructure unquoted	251,099	5.0	384,028	7.1
In-house	Infrastructure quoted	29,932	0.6	30,060	0.6
In-house	Timber	101,826	2.0	125,313	2.3
Total other real assets		382,857	7.5	539,401	10.0
In-house	Secured loans	13,927	0.3	13,770	0.3
In-house	Treasury bills	129,614	2.6	134,399	2.5
In-house	Private debt	-	0.0	37,918	0.7
Total other bonds		143,541	2.8	186,087	3.5
In-house	Cash	294,537	5.8	137,886	2.6
In-house	Transitions	13,171	0.3	32,905	0.6
Total cash and sundries		307,708	6.1	170,791	3.2
Strategy One financial assets		5,072,584	100.0	5,353,678	99.2
In-house	Mature employer gilts	-	-	45,285	0.8
Strategy Two financial assets		-	-	45,285	0.8
Net financial assets		5,072,584	100.0	5,398,963	100.0

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

Fixed interest	Market value at 31 March 2015 £000	% of asset class 31 March 2015	Market value at 31 March 2016 £000	% of asset class 31 March 2016
US Treasury Bill 0.375% 31/05/16	-	-	133,396	25.0
UK Gov 0.125% Index Linked 2044	-	-	47,630	8.9
UK Gov 1.25% Index Linked 2055	23,934	5.8	41,499	7.8
UK Gov 0.125% Index Linked 22/03/68	-	-	36,048	6.8
UK Gov 0.125% Index Linked 22/03/58	-	-	34,099	6.4
UK Gov 1.125% Index Linked 22/11/37	23,300	5.6	29,311	5.5
US Treasury Bill 1.25% 31/10/19	68,626	16.6	-	-
US Treasury Bill 1% 30/11/19	57,054	13.8	-	-
UK Gov 0.5% Index Linked 22/03/50	21,458	5.2	-	-
Pooled funds				
Stafford Elm Inc	42,650	6.5	45,094	5.5
Macquarie Infrastructure A & B LP	-	-	43,748	5.4
Property				
London, 119-125 Wardour St	24,750	7.8	28,050	7.9
Martlesham Heath, Retail Park	24,375	7.7	24,650	6.9
London, 100 St John Street	20,600	6.5	22,500	6.3
Sheffield, Bochum Parkway	19,600	6.2	19,850	5.6
Exeter, David Lloyd Leisure	17,575	5.6	17,875	5.0

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

19 Securities lending

During the year Lothian Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2016, £49.8m (2015 £92.1m) of securities were released to third parties. Collateral valued at 107.6% (2015 107.1%) of the market value of the securities on loan was held at that date.

Notes to the Accounts

20 Property holdings

	2014/15 £000	2015/16 £000
Opening balance	270,753	316,169
Additions	11,375	25,153
Disposals	(2,143)	(2,295)
Net change in market value	36,184	17,253
Closing balance	316,169	356,280

As at 31 March 2016, there were no restrictions on the realisability of the property or the remittance of income or sale proceeds. The Fund is not under any contractual obligations to purchase or construct any of these properties. However, at year end the Fund was due the final payment to the developer of Waterfront North Leisure Park, Walsall. This totalled £3.3m and was settled in April 2016. The Fund also has the responsibility of repairs and maintenance on any properties that are unlet.

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

	2014/15 £000	2015/16 £000
Within one year	19,140	22,018
Between one and five years	65,238	67,158
Later than five years	103,665	94,517
	188,043	183,693

21 Financial Instruments

21a Classification of financial instruments

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

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

21a Classification of financial instruments (cont)

Classification of financial instruments - parent

	31 March 2015			31 March 2016		
	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000
Investment assets						
Fixed interest	414,330	-	-	534,030	-	-
Equities	3,267,975	-	-	3,448,950	-	-
Pooled investments	633,040	-	-	815,892	-	-
Property Leases	9,497	-	-	7,905	-	-
Derivative contracts	29,879	-	-	-	-	-
Margin balances	-	-	-	-	-	-
Cash	-	400,497	-	-	227,409	-
Other balances	-	15,742	-	-	31,029	-
	4,354,721	416,239	-	4,806,777	258,438	-
Other assets						
City of Edinburgh Council	-	6,352	-	-	4,287	-
Cash	-	36,350	-	-	41,327	-
Debtors - current	-	9,769	-	-	12,670	-
Debtors - non-current	-	-	-	-	451	-
	-	52,471	-	-	58,735	-
Assets total	4,354,721	468,710	-	4,806,777	317,173	-
Financial liabilities						
Investment liabilities						
Derivative contracts	(78)	-	-	(13,183)	-	-
Other investment balances	(4,970)	-	-	(1,444)	-	-
	(5,048)	-	-	(14,627)	-	-
Other liabilities						
Creditors	-	-	(19,188)	-	-	(24,016)
Liabilities total	(5,048)	-	(19,188)	(14,627)	-	(24,016)
Total net assets	4,349,673	468,710	(19,188)	4,792,150	317,173	(24,016)

	31 March 2015	31 March 2016
Total net financial instruments	4,799,195	5,085,307
Amounts not classified as financial instruments	307,037	348,707
Total net assets - parent	5,106,232	5,434,014

Notes to the Accounts

21a Classification of financial instruments (cont)

Classification of financial instruments - adjustments to parent to arrive at group

	31 March 2015			31 March 2016		
	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000
Other assets						
Cash	-	-	-	-	4	-
Debtors - current	-	-	-	-	33	-
Debtors - non-current	-	-	-	-	36	-
	-	-	-	-	73	-
Assets total	-	-	-	-	73	-
Other liabilities						
Retire. benefit obligation	-	-	-	-	-	(180)
Creditors	-	-	-	-	-	(36)
Liabilities total	-	-	-	-	-	(216)
Total net assets	-	-	-	-	73	(216)

	31 March 2015	31 March 2016
Total adjustments to net financial instruments	-	(143)
Total net assets - group	5,106,232	5,433,871

21b Net gains and losses on financial instruments

	2014/15 £000	2015/16 £000
Designated as fair value through fund account	571,760	197,274
Loans and receivables	3,207	2,119
Financial liabilities at amortised cost	-	-
Total	574,967	199,393
Gains and losses on directly held freehold property	38,974	17,253
Change in market value of investments per fund account	613,941	216,646

21c Valuation of financial instruments carried at fair value

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

Level 1

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

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

21c Valuation of financial instruments carried at fair value

Level 2

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

Level 3

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

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

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

	31 March 2016			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets - parent				
Designated as fair value through fund account	3,491,275	534,030	781,472	4,806,777
Loans and receivables	317,173	-	-	317,173
Total financial assets	3,808,448	534,030	781,472	5,123,950
Financial liabilities - parent				
Designated as fair value through fund account	(14,627)	-	-	(14,627)
Financial liabilities at amortised cost	(24,016)	-	-	(24,016)
Total financial liabilities	(38,643)	-	-	(38,643)
Net financial assets - parent	3,769,805	534,030	781,472	5,085,307
Adjustments to parent to arrive at group				
Financial assets - loans and receivables	73	-	-	73
Financial liabilities at amortised cost	(216)	-	-	(216)
Net financial assets - parent	3,769,662	534,030	781,472	5,085,164

21c Valuation of financial instruments carried at fair value (cont)

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

22 Nature and extent of risk arising from financial instruments

Risk and risk management

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

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

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

Types of investment risk

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

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

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

22 Nature and extent of risk arising from financial instruments (cont)

The Fund manages these risks in a number of ways:

- assessing and establishing acceptable levels of market risk when setting overall investment strategy. Importantly, risk is considered relative to the liabilities of the Fund
- diversification of investments in terms of type of asset, investment styles, investment managers, geographical and industry sectors as well as individual securities
- taking stewardship responsibilities seriously and pursuing constructive engagement with the companies in which we invest
- monitoring market risk and market conditions to ensure risk remains within tolerable levels
- using equity futures contracts from time to time to manage market risk. Exchange traded options are not used by the Fund.

Sensitivity analysis

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

Asset type	Potential price movement (+ or -)
Equities - Developed Markets	20.5%
Equities - Emerging Markets	30.0%
Private Equity	30.0%
Timber and Gold	18.0%
Secured Loans	14.0%
Fixed Interest Gilts	6.7%
Index-Linked Gilts	10.8%
Infrastructure	18.0%
Property	13.0%
Cash	1.1%

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

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

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

22 Nature and extent of risk arising from financial instruments (cont)

	Value at 31 March 2016 £m	% of fund %	Potential Change +/- %	Value on increase £m	Value on decrease £m
Equities - Developed Markets	3,161	58.6	20.5	3,809.0	2,513.0
Equities - Emerging Markets	238	4.4	30.0	309.4	166.6
Private Equity	226	4.2	30.0	293.8	158.2
Timber and Gold	142	2.6	18.0	167.6	116.4
Secured Loan	52	1.0	14.0	59.3	44.7
Fixed Interest Gilts	134	2.5	6.7	143.0	125.0
Index-Linked Gilts	402	7.4	10.8	445.4	358.6
Infrastructure	414	7.7	18.0	488.5	339.5
Property	472	8.7	13.0	533.4	410.6
Cash and forward foreign exchange	158	2.9	1.1	159.7	156.3
Total [1]	5,399	100.0	18.7	6,409.1	4,388.9
Total [2]			15.7	6,246.6	4,551.4
Total [3]			15.7	6,246.6	n/a

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

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

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

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

However, because the purpose of a pension scheme is to make payments to scheme beneficiaries, the true risk of a pension scheme is not measured in absolute terms, but relative to its liabilities [3].

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

Credit risk

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

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

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

22 Nature and extent of risk arising from financial instruments (cont)

Cash deposits

At 31 March 2016, cash deposits represented £268.7m, 4.94% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2016	Balances at 31 March 2015 £000	Balances at 31 March 2016 £000
Held for investment purposes			
Northern Trust Global Investment Limited - liquidity funds	Aaa-mf	100,507	78,223
Northern Trust Company - cash deposits	Aa2	76,374	66,450
The City of Edinburgh Council - treasury management	See below	223,616	82,736
Total investment cash		400,497	227,409
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	36,350	41,327
Total cash - parent		436,847	268,736
Cash held by LPFE Limited			
Royal Bank of Scotland	A3	-	4
Total cash - group		436,847	268,736

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

	Moody's Credit Rating at 31 March 2016	Balances at 31 March 2015 £000	Balances at 31 March 2016 £000
Money market funds			
Deutsche Bank AG, London	Aaa-mf	38,167	117
Goldman Sachs	Aaa-mf	38,123	16,539
Bank call accounts			
Bank of Scotland	A1	24,567	8,123
Royal Bank of Scotland	A3	3,448	1,316
Santander UK	A1	23,840	10
Barclays Bank	A2	24,894	8,395
Svenska Handelsbanken	Aa2	38,765	8,562
HSBC Bank	Aa2	37,927	12
Commonwealth Bank of Australia	Aa2	10,079	-
Floating rate note			
Rabobank	Aa2	6,720	-
Building society fixed term deposits			
Nationwide Building Society	A1	6,719	-
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa1	-	24,726
UK Government Treasury Bills	Aa1	6,717	56,263
		259,966	124,063

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2016 was 'Aa1').

Notes to the Accounts

22 Nature and extent of risk arising from financial instruments (cont)

The Council has in place institutional restrictions on investments and counterparty criteria. These include -

(a) UK Government and other UK local Authorities with no limit, other public bodies up to £20 million per organisation.

(b) Money market funds (MMFs) no more than £30 million or 15% with any one Fund.

(c) Financial Institutions: Banks and Building Societies with multiple criteria based on a range of short and long term credit ratings, as well as any security, provided from maximum of £60 million / 20% of assets under management (AUM) for institutions with the highest criteria to £10 million / 5% of AUM for institutions with the lowest acceptable criteria.

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

Securities lending

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

Derivatives

The Fund transacts foreign currency derivatives over-the-counter and hence is exposed to credit risk in the event of a counterparty defaulting on the net payment or receipt that remains outstanding. This risk is minimised by the use of counterparties that are recognised financial intermediaries with acceptable credit ratings and by netting agreements. At 31 March 2016, the Fund owed £13.2m on over-the-counter foreign currency derivatives.

Refinancing risk

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

Liquidity risk

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

The majority (estimated to be approximately 79%) of the Fund’s investments could be converted to cash within three months in a normal trading environment.

23 Actuarial statement

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

24 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £6,266m (2015 £6,663m). This figure is used for statutory accounting purposes by Lothian Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end.

24 Actuarial present value of promised retirement benefits (cont)

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

	31 March 2015 % p.a.	31 March 2016 % p.a.
Inflation / pensions increase rate	2.4	2.2
Salary increase rate*	4.3	4.2
Discount rate	3.2	3.5

Longevity assumptions

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

	31 March 2015		31 March 2016	
	Males	Females	Males	Females
Current pensioners	22.1 years	23.7 years	22.1 years	23.7 years
Future pensioners (assumed to be currently 45)	24.2 years	26.3 years	24.2 years	26.3 years

Commutation assumption

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

25 Non current debtors

	LPF 31 March 2015 £000	LPF Parent 31 March 2016 £000	LPF Group 31 March 2016 £000
Contributions due - employers' cessation	-	451	451
	-	451	451

Analysis of non current debtor

	LPF 31 March 2015 £000	LPF Parent 31 March 2016 £000	LPF Group 31 March 2016 £000
Administering Authority	-	-	-
Other Scheduled Bodies	-	-	-
Community Admission Bodies	-	451	451
Transferee Admission Bodies	-	-	-
Other Local Authorities	-	-	-
Central Government Bodies	-	-	-
Other entities and individuals	-	-	-
	-	451	451

Notes to the Accounts

26 Debtors

	LPF 31 March 2015 £000	LPF Parent 31 March 2016 £000	LPF Group 31 March 2016 £000
Contributions due - employers	7,373	10,219	10,219
Contributions due - members	1,995	2,067	2,067
Benefits paid in advance or recoverable	-	-	-
Sundry debtors	160	109	137
Corporation tax losses utilised by CEC group	-	-	5
Prepayments	241	275	275
	9,769	12,670	12,703

Analysis of debtors

	LPF 31 March 2015 £000	LPF Parent 31 March 2016 £000	LPF Group 31 March 2016 £000
Administering Authority	305	6,987	6,992
Other Scheduled Bodies	6,671	3,526	3,526
Community Admission Bodies	2,624	1,812	1,812
Transferee Admission Bodies	27	26	26
Other Local Authorities	7	-	29
Central Government Bodies	-	-	-
Other entities and individuals	135	319	318
	9,769	12,670	12,703

27 Creditors

	LPF 31 March 2015 £000	LPF Parent 31 March 2016 £000	LPF Group 31 March 2016 £000
Benefits payable	3,793	8,375	8,375
VAT, PAYE and State Scheme premiums	1,210	1,399	1,495
Contributions in advance	11,899	11,845	11,845
Miscellaneous creditors and accrued expenses	2,137	2,083	2,121
Office - operating lease	149	216	216
LPFE Loan facility - see note 29	-	6	-
Intra group creditor - see note 29	-	92	-
	19,188	24,016	24,052

27 Creditors (cont)

Analysis of Creditors

	LPF 31 March 2015 £000	LPF Parent 31 March 2016 £000	LPF Group 31 March 2016 £000
Administering Authority	63	5,970	5,970
Other Scheduled Bodies	11,890	13,526	13,526
Community Admission Bodies	-	721	721
Transferee Admission Bodies	-	98	-
Central Government Bodies	1,247	1,399	1,495
Other entities and individuals	5,988	2,302	2,340
	19,188	24,016	24,052

28 Additional Voluntary Contributions

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

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

Total contributions during year for Lothian Pension fund	2014/15 £000	2015/16 £000
Standard Life	404	395
Prudential	1,369	1,593
	1,773	1,988

Total value at year end for Lothian Pension Fund	31 March 2015 £000	31 March 2016 £000
Standard Life	6,342	5,665
Prudential	3,158	3,863
	9,500	9,528

29 Related parties

The City of Edinburgh Council

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

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

29 Related parties (cont)

The Council is also the single largest employer of members of the Fund and contributed £63.5m to the Fund during the year (2014/15 £55.8m).

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

	31 March 2015 £000	31 March 2016 £000
Year end balance of holding account	6,352	4,287
	6,352	4,287

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2016, the fund had an average investment balance of £219.0m (2014/15 £204.1m). Interest earned was £1,032.5k (2014/15 £950.3k).

Year end balance on treasury management account	31 March 2015 £000	31 March 2016 £000
Held for investment purposes	223,616	82,736
Held for other purposes	36,350	41,327
	259,966	124,063

Office accommodation - 144 Morrison Street, Edinburgh

Investment and Pensions Division of the Council entered into an internal agreement with the Council for the provision of office accommodation at 144 Morrison Street in Edinburgh. The terms of the agreement are equivalent to those that would have been obtained had the accommodation been let on a commercial basis. In the accounts of the Fund the arrangement has been treated as a operational lease. The Investment and Pensions Division is committed to making the following future payments. City of Edinburgh Council sold the property on 31 March 2016, the lease with the new landlord is on the same terms as the internal agreement.

	31 March 2015 £000	31 March 2016 £000
Within one year	-	42
Between one and five years	272	345
After five years	1,379	992
	1,651	1,379
Recognised as an expense during the year	91	92

The above expense has been allocated across the three Funds, Lothian Pension Fund's share is £84.9k.

Governance

As at 31 March 2016, all members of the Pensions Committee, with the exception of Councillor Bill Cook and Richard Lamont, and all members of the Pensions Board, with the exception of Graham Turnbull, were active members of the Lothian Pension Fund or Lothian Buses Pension Fund.

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

Notes to the Accounts

29 Related parties (cont)

During the period from 1 April 2015 to the date of issuing of these accounts, a number of employees of the City of Edinburgh Council and its wholly owned subsidiary, LPFE Limited, held key positions in the financial management of the Lothian Pension Fund. With effect from 1 May 2015, all the employees listed below, with the exception of the Executive Director of Resources, were employed by LPFE Limited. These employees and their financial relationship with the Fund (expressed as cash-equivalent transfer values or CETV) are set out below:

Name	Position held	Accrued CETV as at 31 March 2015 £000	Accrued CETV as at 31 March 2016 £000
Hugh Dunn*	Acting Executive Director of Resources	734	755
Clare Scott	Chief Executive, Lothian Pension Fund	147	175
Bruce Miller	Chief Investment Officer, Lothian Pension Fund	139	185
Struan Fairbairn	Chief Legal & Risk Officer, Lothian Pension Fund	19	30
John Burns	Chief Finance Officer, Lothian Pension Fund	426	474
Esmond Hamilton	Financial Controller	138	161

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

There is no need to produce a remuneration report for 2015/16, as the Pension Fund did not directly employ any staff.

Staff are either employed by City of Edinburgh Council or LPFE Ltd, and their costs reimbursed by the Pension Fund. The Councillors, who are members of the Pensions Committee, are also remunerated by City of Edinburgh Council.

LPFE Limited - loan facility

LPFE Limited is wholly owned by the City of Edinburgh Council and has entered into a shareholder agreement with the Council to address governance matters. The company has a loan facility agreement with the City of Edinburgh Council for the purpose of the provision of short term working capital. The current agreement covers the period to 1 May 2020 and provides that interest is payable at 2% above the Royal Bank of Scotland base lending rate on the daily balance. In order to minimise the amount of interest payable, the company returns any cash not immediately required and this can result in short periods when the company has returned more cash than has been drawn. On such days the loan interest is negative, reducing the amount of interest payable.

Interest payable during the period was £968, of which £194 was due at the year end. At 31 March 2016, the balance on the loan facility was £6,157 due to LPFE Limited.

LPFE Limited - staffing services

Staffing services are provided to Lothian Pension Fund for the purposes of administering the Funds under a intra-group resourcing agreement. The agreement also provides for the running costs of the company to be covered as part of a service charge and anticipates the provision of staffing services to LPFI Limited (also wholly owned by the City of Edinburgh Council) on that entity beginning to trade. During the year to 31 March 2016, the Fund was invoiced £820k for the services of LPFE Limited staff, £92k of this remained payable at year end.

Notes to the Accounts

30a Consolidated Lothian Pension Fund group - LPFE Limited - Corporation Tax utilised by CEC group

	LPF Group 2015/16 £000
Tax credit for the period	5
	5

The credit for the period can be reconciled to the loss per the Financial Statements of LPFE Limited of £66k as follows:

	LPF Group 2015/16 £000
Loss for the year at the effective rate of corporation tax of 20%	(13)
Effect of:	
Expenses not deductible for tax purposes	8
Group relief utilised	5
Due from group entities for losses utilised	5
	5

30b Consolidated Lothian Pension Fund group - LPFE Limited - deferred tax

Movement in deferred tax asset (Non-current asset)

	LPF Group 2015/16 £000
At 1 April 2015	-
Credit for year to Fund Account	36
At 31 March 2016	36

Elements of closing deferred tax asset

	LPF Group 31 March 2016 £000
Pension liability	36
	36

30c Consolidated Lothian Pension Fund group - LPFE Limited - share capital

	31 March 2016 £
Allotted, called up and fully paid Ordinary shares of £1 each	1
	1

One ordinary share of £1 was issued to Lothian Pension Fund at par value on incorporation. Due to the low value this does not show on the Net Assets Statement.

31 Retirement benefits obligation - group

The retirement benefit obligation described in this note relates only to the is employees of LPFE Limited. This is because obligation in respect of the staff employed by the City of Edinburgh Council is disclosed in the City of Edinburgh Council's Financial Statements.

On 1 May 2015 LPFE Limited commenced trading and its staff transferred their employment from the City of Edinburgh Council to the Company on that date. On 1 May the Company also entered into appropriate admission arrangements with the City of Edinburgh Council with respect to the transferring individuals continuing to be members of the Lothian Pension Fund and in relation to its obligations as an employer in that Fund.

The present value of the defined benefit obligation, and related current service cost and past service cost, were measured using the Projected Unit Credit Method.

Fund assets

The LPFE Limited's share of the fair value of the Fund's assets which are not intended to be realised in the short term and may be subject to significant change before they are realised, were comprised as follows:

Asset		Fair value at 31 March 2016 £000	% of total 31 March 2016 %
Equity securities:	Consumer	319	15.0
	Manufacturing	247	12.0
	Energy and utilities	167	8.0
	Financial institutions	178	8.0
	Health and care	139	7.0
	Information technology	126	6.0
	Other	120	6.0
Debt securities:	UK Government	135	6.0
	Other	53	3.0
Private equity:	All	92	4.0
Real property	UK property	179	9.0
Investment funds and unit trusts:	Commodities	6	-
	Bonds	17	1.0
	Infrastructure	139	7.0
	Other	50	2.0
Cash and cash equivalents:	All	130	6.0
		2,097	100.0

Amounts recognised in the Net Assets Statement

	LPF Group 31 March 2016 £000
Fair value of Fund assets	2,097
Present value of Fund liabilities	(2,277)
	(180)

31 Retirement benefits obligation - group (cont)

Movement in the defined benefit obligation during the period

	LPF Group 2015/16 £000
At 1 May 2015	2,107
Current service cost	174
Interest cost on obligation	69
Fund participants contributions	54
Benefits paid	-
Actuarial losses arising from changes in financial assumptions	(378)
Actuarial losses arising from changes in demographic assumptions	-
Other actuarial losses	251
At 31 March 2016	2,277

Movement in the fair value of Fund assets during the period

	LPF Group 2015/16 £000
At 1 May 2015	1,826
Benefits paid	-
Interest income on Fund assets	60
Contributions by employer	121
Contributions by member	54
Contributions in respect of unfunded benefits	-
Unfunded benefits paid	-
Return on assets excluding amounts included in net interest	36
At 31 March 2016	2,097

Amounts recognised in the Fund Account

	LPF Group 2015/16 £000
Interest received on Fund assets	(60)
Interest cost on Fund liabilities	69
Current service costs	174
Transfer of opening retirement benefit obligation on 1 May 2015	(281)
Actuarial gains due to re-measurement of the defined benefit obligation	127
Return on Fund assets (excluding interest above)	36
	65

Principal actuarial assumptions used in this valuation

	1 May 2015* % p.a.	31 March 2016 % p.a.
Inflation / pensions increase rate	2.7	2.2
Salary increase rate	4.6	4.2
Discount rate	3.4	3.6

* Date of transfer of opening retirement benefit obligation.

31 Retirement benefits obligation - group (cont)

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice. Best estimate has been interpreted to mean that the proposed assumptions are ‘neutral’ – there is an equal chance of actual experience being better or worse than the assumptions proposed.

The financial assumptions used for reporting in the financial statements are the responsibility of the employer. These assumptions are largely prescribed at any point and reflect market conditions at the reporting date. Changes in market conditions that result in changes in the net discount rate can have a significant effect on the value of the liabilities reported.

A reduction in the net discount rate will increase the assessed value of liabilities as a higher value is placed on benefits paid in the future. A rise in the net discount rate will have an opposite effect of a similar magnitude. There is also uncertainty around life expectancy of the UK population – the value of current and future pension benefits will depend on how long they are assumed to be in payment.

Life expectancy is based on Fund specific statistical analysis with improvements in line with the CMI 2012 model assuming current rates of improvements have peaked and will converge to a long term rate of 1.25% p.a.

	31 March 2016	
	Males	Females
Current pensioners	22.1 years	23.7 years
Future pensioners	24.2 years	26.3 years

Expected employer contributions to the defined benefit plan for the year ended 31 March 2017 are £132,000, based on a pensionable payroll cost of £646,000.

32 Contractual commitments

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

	31 March 2015 £000	31 March 2016 £000
Outstanding investment commitments	146,403	160,891
	146,403	160,891

As disclosed in note 29 on related party transactions the Investment and Pensions Division has a commitment to make future payments equivalent to rent in respect office accommodation at 144 Morrison Street. Details of the future payments are provided in that note.

33 Contingent assets and liabilities

At 31 March 2016 the Fund had entered into negotiations for two infrastructure co-investments in which it is exposed to the potential risk of investment abort costs At 31 March 2016, Lothian Pension Fund's exposure is approximately £204.6k.

There were no material contingent assets at year end.

Notes to the Accounts

34 Impairment losses

During the year the Fund recognised an increase in impairment losses in respect of specific benefit over payments for which reimbursement has been requested of £14.5k. This increased the impairment to £46.4k at the year end.

Lothian Pension Fund

Actuarial Statement for 2015/16

This statement has been prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2014. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

Description of Funding Policy

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

- To ensure solvency of the Fund;
- to ensure the solvency of each individual employers' share of the Fund based on their expected term of participation in the Fund;
- to minimise the degree of short-term change in employer contribution rates;
- maximise the returns from investments within reasonable and considered risk parameters, and hence minimise the cost to the employer;
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment;
- to help employers manage their pension liabilities; and
- where practical and cost effective, to make allowance for the different characteristics of different employers and groups of employers.

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £4,379 million, were sufficient to meet 91% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £417 million.

Individual employers' contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the valuation report dated 31 March 2015.

Method

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

Assumptions

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

Actuarial Statement for 2015/16

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

Financial assumptions	31 March 2014 % p.a. Nominal	% p.a. Real
Discount rate	5.0%	2.3%
Pay increases*	5.0%	2.3%
Price inflation/Pension increases	2.7%	-

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

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

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

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

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

Experience over the period since April 2014

Experience has been worse than expected since the last formal valuation (excluding the effect of any membership movements). Real bond yields have fallen dramatically placing a higher value on liabilities. The effect of this has been only partially offset by the effect of strong asset returns. Funding levels are therefore likely to have worsened and deficits increased over the period.

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

Richard Warden FFA
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB

21 April 2016

List of active employers at 31 March 2016

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

SB - Scheduled bodies CAB - Community Admited Bodies TAB - Transferee Admitted Bodies

Lothian Buses Pension Fund

Membership records

Status	Membership at 31 March 2013	Membership at 31 March 2014	Membership at 31 March 2015	Membership at 31 March 2016
Active	1,335	1,268	1,196	1,130
Deferred	1,163	1,146	1,131	1,104
Pensioners	1,163	1,191	1,222	1,253
Dependants	310	320	332	350
Total	**3,971**	**3,925**	**3,881**	**3,837**

Investment Strategy

Over the course of 2015/16, the implementation of the Investment Strategy 2012-17 continued to proceed at a measured pace as investment opportunities became available and as research on opportunities was completed. Progress towards the long term strategy allocation involved the interim strategy allocation and the actual asset allocation changing gradually over time. The most significant changes to the actual allocation of the Fund over 2015/16 were the reduction in equities from 63% to 60% and the increase in other real assets (primarily infrastructure) from 6% to over 9%.

Following completion of the 2014 actuarial valuation, the Investment Strategy Panel and the Pensions Committee undertook an in depth review of Lothian Buses Pension Fund's investment strategy. The review was supported by asset liability modelling carried out by the Fund's investment adviser. The Panel reviewed developments in pension fund membership, expected cash flow, funding level, investment risk and returns and the employer covenant, the ability and willingness of the employer to pay contributions.

The review highlighted the potential future funding level volatility on the employing company's balance sheet and contributions. It afforded the opportunity to clarify the funding approach for this increasingly mature pension fund (it is closed to new entrants) in the event of the funding level worsening and also at the point when the last active member leaves the Fund. After discussions with the majority shareholder and company, Lothian Buses has agreed to continue paying deficit contributions (if required) after the last active member has left the Fund. With this clarity, the Fund is able to continue to adopt a long-term investment approach.

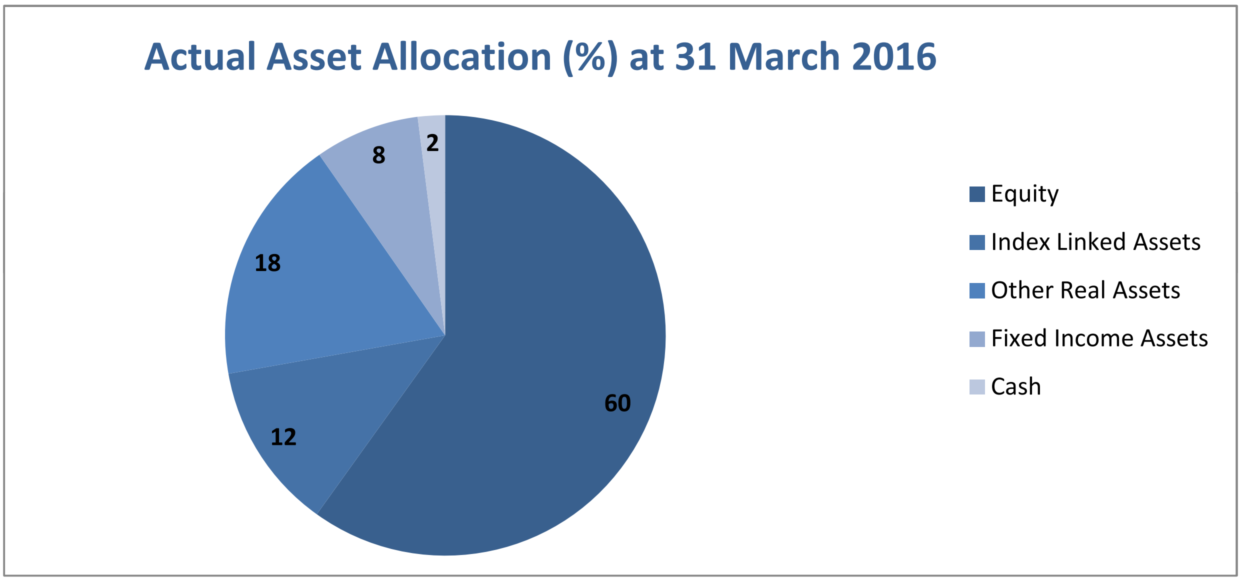
The Pensions Committee approved a revised Investment Strategy 2016-21 for Lothian Buses Pension Fund in March 2016. The main changes from the previous Investment Strategy are a reduction in equities from 55% to 40%, an increase in index-linked assets from 15% to 20% and the creation of a distinct fixed income asset class with an effective allocation increase from 12% to 22%, to be implemented by the end of 2021.

A significant allocation to equities is retained as they have higher long term return expectations than bonds as equity risk, as measured by short term volatility, is expected to diminish over the long term. Implementation of the strategy will include further de-risking within equities, lengthening the duration of the Fund's bond allocation to provide greater downside protection in the event of further reductions in interest rates (a key driver of liability values) and also investment in suitable fixed income assets.

The long term strategy for 2016-21 is set out in the table below along with the current interim strategy allocations.

	Strategic Allocation 31/03/2016 %	Long term Strategy 2016 - 2021 %
Equities	58.5	40.0
Index Linked Assets	14.0	20.0
Other Real Assets	17.5	18.0
Fixed Income Assets	10.0	22.0
Cash	-	-
Total	**100.0**	**100.0**

The investment strategy is now set at the broad asset class level of equities, index-linked assets, other real assets and fixed income assets, the latter two of which had previously been categorised within Alternatives. These broad groupings are the key determinants of investment risk and return. Equities includes listed and unlisted equities; index-linked assets includes index-linked gilts/bonds and gold; other real assets includes property, infrastructure and timber; and fixed income assets includes listed and unlisted debt investments.



Investment performance

The objectives of the Fund are:

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

The Fund has achieved returns in excess of the strategic allocation over the last year and over the longer timeframes shown in the table below. The benchmark return shown in the table is the strategic allocation and comprises equity, index-linked gilt and cash indices as well as an inflation-linked index for Alternatives investments.

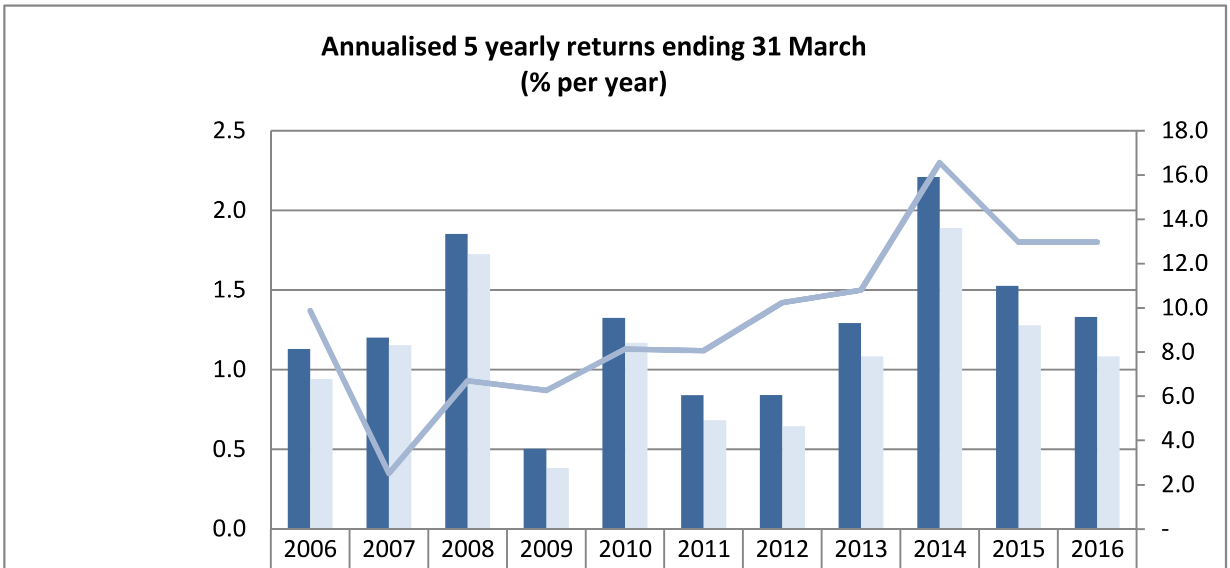
Annualised returns to 31 March 2016 (% per year)	1 year	5 year	10 years
Lothian Buses Pension Fund	3.1	9.6	7.8
Benchmark	1.2	7.8	6.3
Actuarial Valuation Assumptions *	5.0	5.7	5.9
Retail Price Index (RPI)	1.6	2.3	3.0
Consumer Price Index (CPI)	0.5	1.7	2.4
National Average Earnings	1.9	1.6	2.2

*estimate

The strong performance relative to the benchmark over 2015/16 was largely attributable to the global equity portfolios, one internally managed and one externally managed by Baillie Gifford, which together rose in value by 1.4% while the benchmark fell. The Fund's Alternative investments were also a significant contributor, driven primarily by a double digit return from the infrastructure portfolio, which benefited from the purchase of infrastructure assets at attractive valuations.

Returns relative to the benchmark over a one year period need to be placed in the context that there are no ideal benchmarks for many of the assets held in the Fund, especially the Alternatives. The Fund's benchmark for Alternatives is inflation plus 3.5% per annum, which makes sense over the long term as the Fund's liabilities are linked to inflation. However, over shorter periods, there is less information content in the relative returns of the Fund because the development of asset prices is much more volatile than that of UK retail or consumer prices. The Investment Strategy Panel assesses the underlying risks of the portfolios that make up the asset allocation to ensure that these are consistent with the long term objectives of the Fund.

The chart below shows the rolling 5 year performance of the Fund against its strategic benchmark over the last 10 years. The upward sloping line shows that relative returns have been on an improving trend since 2007. It also shows that the Fund has consistently outperformed its benchmark over rolling 5 year periods.



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Fund	8.2	8.7	13.3	3.6	9.6	6.0	6.1	9.3	15.9	11.0	9.6
Benchmark	6.8	8.3	12.4	2.8	8.4	4.9	4.6	7.8	13.6	9.2	7.8
Relative (LHS)	1.4	0.4	0.9	0.9	1.1	1.1	1.4	1.5	2.3	1.8	1.8

Lothian Buses Pension Fund

Fund Account for year ended 31 March 2016

Restated* 2014/15 £000		Note	2015/16 £000
	Income		
7,094	Contributions from employer	**4**	7,538
2,162	Contributions from members		2,129
-	Transfers from other schemes		-
9,256			**9,667**
	Less: expenditure		
7,790	Pension payments including increases		8,087
2,864	Lump sum retirement payments		2,101
262	Lump sum death benefits		530
-	Refunds to members leaving service		2
17	Transfers to other schemes	**5**	129
112	Administrative expenses	**6a**	102
11,045			**10,951**
(1,789)	**Net withdrawls from dealing with members**		**(1,284)**
	Returns on investments		
8,426	Investment income	**7**	8,076
43,422	Change in market value of investments	**9, 15b**	3,532
(1,400)	Investment management expenses	**6b**	(1,677)
50,448	**Net returns on investments**		**9,931**
48,659	**Net increase in the Fund during the year**		**8,647**
337,125	**Net assets of the Fund at 1 April 2015**		385,784
385,784	**Net assets of the Fund at 31 March 2016**		**394,431**

* The results for the year ended 31 March 2015 have been restated to reflect a change in the accounting policy on securities lending revenue and the related management charges. The effect is to increase both investment income and investment management expenses by £80k. There is no change in the net return on investement. See note 2 for details.

Lothian Buses Pension Fund

Net Assets Statement as at 31 March 2016

31 March 2015 £000		Note	31 March 2016 £000
	Investment Assets		
13,209	Fixed interest securities	8	19,661
242,863	Equities	8	236,417
105,943	Pooled investment vehicles	8	121,923
-	Derivatives - forward foreign exchange	10	-
19,174	Cash Deposits		11,811
1,072	Other investment assets		1,291
382,261			**391,103**
	Investment Liabilities		
-	Derivatives - forward foreign exchange	10	(32)
(98)	Other investment assets		(283)
(98)			**(315)**
382,163	**Net investment assets**	**9, 11**	**390,788**
	Current assets		
1,113	The City of Edinburgh Council	22	400
2,026	Cash balances	16, 22	2,867
726	Debtors	19	828
3,865			**4,095**
	Current liabilities		
(244)	Creditors	20	(452)
(244)			**(452)**
3,621	**Net current assets**		**3,643**
385,784	**Net assets of the Fund at 31 March 2016**		**394,431**

JOHN BURNS FCMA CGMA
Chief Finance Officer, Lothian Pension Fund
27 June 2016

Notes to the net asset statement

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

Notes to the Financial Statements

1 Statement of Accounting Policies

The statement of accounting policies for all three Funds' can be found on page 112.

2 Prior year adjustment

During the year, the Fund has changed its accounting policy in respect to securities lending revenue that has required the restatement of 2014/15 results.

Previously securities lending revenue was recognised net of fees, as management charges were deducted from source. The new treatment recognises the gross income from securities lending revenue that impacts both the investment income of the Fund and the investment management expenses.

	2014/15 Restated £000	Adjustment £000
Investment income	8,426	80
Investment management expenses	(1,400)	(80)

3 Events after the Reporting Date

There have been no events since 31 March 2016, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

4 Contributions from employer

By category	2014/15 £000	2015/16 £000
Normal (ongoing contributions)	7,094	7,425
Deficit contribution	-	-
Strain costs and augmentation contribution	-	113
	7,094	7,538

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

From 2015/16 onwards, no deficit funding was required (as stated in the actuarial valuation of 31 March 2014). The employer contribution rate was 21.7% for the period from 1 April 2015 to 31 December 2015 then 22.9% of pensionable pay for service currently being accrued for the remainder of the financial year.

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

Notes to the Financial Statements

5 Transfers out to other pension schemes

	2014/15 £000	2015/16 £000
Group transfers	-	-
Individual transfers	17	129
	17	129

6a Administrative expenses

	2014/15 £000	2015/16 £000
Employee Costs	53	52
The City of Edinburgh Council - other support costs	7	7
System costs	12	13
Actuarial fees	21	13
External audit fees	2	2
Legal fees	-	-
Printing and postage	5	4
Depreciation	4	3
Office costs	5	6
Sundry costs less sundry income	3	2
	112	102

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

6b Investment management expenses

	2014/15 £000	2015/16 £000
External management fees -		
invoiced	539	704
deducted from capital (direct investment)	381	329
deducted from capital (indirect investment)	208	368
Securities lending fees	80	43
Transaction costs	31	59
Employee costs	63	70
Custody fees	36	34
Engagement and voting fees	5	6
Performance measurement fees	17	17
Consultancy fees	-	12
System costs	11	13
Legal fees	8	3
The City of Edinburgh Council - other support costs	12	9
Depreciation	-	1
Office costs	4	5
Sundry costs less sundry income	5	4
	1,400	1,677

6b Investment management expenses (cont)

Any costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales (see note 9 - Reconciliation of movements in investments and derivatives).

It should be noted that Lothian Buses Pension Funds disclosure on investment management fees goes further than CIPFA's LGPS Management Cost revised guidance on cost transparency. Consistent with previous years, the Fund recognises fees deducted from investments not within its direct control (such as fund of fund fees) to give a full picture of its investment management costs. Further details can be found on page 16. This further disclosure highlights an extra £368k in costs (2014/15 £208k)

The external investment management fees above include £0.1m in respect of performance-related fees (2014/15 £0.1m).

6c Total Management expenses

	2014/15 £000	2015/16 £000
Administrative costs	84	80
Investment management expenses*	1,339	1,621
Oversight and governance costs	89	78
	1,512	1,779

* includes £368k (2014/15 £208k) in costs above CIPFA guidance

In accordance with CIPFA, the above analysis looks at the combined administration and investment management expenses in note 6a and b and splits out the costs to include a third heading covering oversight and governance expenditure.

Notes to the Financial Statements

7 Investment income

	2014/15 £000	2015/16 £000
Income from fixed interest securities	84	92
Dividends from equities	6,230	6,025
Income from pooled investment vehicles	1,747	1,751
Interest on cash deposits	50	53
Stock lending and sundries	400	214
	8,511	8,135
Irrecoverable withholding tax	(85)	(59)
	8,426	8,076

8 Analysis of investments

Investment Assets	Region	31 March 2015 £000	31 March 2016 £000
Fixed Interest securities			
Public sector fixed interest securities	Overseas	-	1,122
Public sector index linked gilts quoted	UK	13,209	18,539
		13,209	19,661
Equities			
Quoted	UK	39,225	32,849
Quoted	Overseas	203,638	203,568
		242,863	236,417
Pooled investment vehicles *			
Managed funds - property	UK	34,201	37,492
Managed funds - index linked	UK	28,449	28,326
Managed funds - other bonds	UK	27,380	27,221
Timber funds - unquoted	Overseas	6,341	8,023
Infrastructure - unquoted	UK	2,053	4,424
Infrastructure - unquoted	Overseas	7,519	13,583
Private debt funds - unquoted	UK	-	1,051
Private debt funds - unquoted	Overseas	-	1,803
		105,943	121,923

Notes to the Financial Statements

9 Reconciliation of movement in investments and derivatives

	Market value at 31 March 2015 £000	Purchases at cost & derivative payments £000	Sales & derivative receipts £000	Change in market value £000	Market value at 31 March 2016 £000
Fixed interest	13,209	10,193	(4,284)	543	19,661
Equities	242,863	27,541	(31,081)	(2,906)	236,417
Pooled investment vehicles	105,943	12,172	(1,947)	5,755	121,923
Derivatives - fwd foreign exchange	-	31	(7)	(56)	(32)
	362,015	49,937	(37,319)	3,336	377,969
Other financial assets / (liabilities)					
Cash deposits	19,174			112	11,811
Broker balances	(17)			84	(73)
Dividend due etc	991			-	1,081
	20,148			196	12,819
	382,163			3,532	390,788

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

Any costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

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

10 Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2016

Contract settlement within	Currency bought	Currency sold	Local currency bought 000	Local currency sold 000	Asset value £000	Liability value £000
Up to one month	GBP	EUR	1,055	(1,370)	-	(32)
Open forward currency contracts at 31 March 2016					-	(32)
Net forward currency contracts at 31 March 2016						(32)

Prior year comparative

Open forward currency contracts at 31 March 2015	-	-
Net forward currency contracts at 31 March 2015		-

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

In order to maintain appropriate diversification of investments in the portfolio and take advantage of wider opportunities, the Lothian Buses Pension Fund invests in overseas markets. Forward foreign exchange contracts, were used to the extent to which the Fund is exposed to certain currency movements.

Notes to the Financial Statements

11 Investment managers and mandates

Manager	Mandate	Market value at 31 March 2015 £000	% of total 31 March 2015 %	Market value at 31 March 2016 £000	% of total 31 March 2016 %
Baillie Gifford	Global equities	120,728	31.7	112,761	28.9
In-house	Global high dividend	113,824	29.8	116,638	29.8
In-house	Private equity quoted	4,753	1.2	4,659	1.2
Total global equities		239,305	62.7	234,058	59.9
Baillie Gifford	Index linked gilts	28,449	7.5	28,326	7.2
In-house	Index linked gilts	13,915	3.6	19,771	5.1
Total inflation linked bonds		42,364	11.1	48,097	12.3
Baillie Gifford	Corporate bonds	27,380	7.2	27,221	7.0
In-house	Secured loans quoted	530	0.1	4	0.0
In-house	Secured loans unquoted	-	-	2,855	0.7
Total fixed income assets		27,910	7.3	30,080	7.7
Standard Life	Property	34,201	8.9	37,491	9.6
In-house	Infrastructure unquoted	7,915	2.1	18,007	4.6
In-house	Infrastructure quoted	7,026	1.8	6,660	1.7
In-house	Timber	6,341	1.7	8,022	2.1
In-house	Alternatives Cash	1,657	0.4	515	0.1
Total other real assets		57,140	14.9	70,695	18.1
In-house	Cash	11,986	3.1	7,858	2.0
In-house	Transition	3,458	0.9	-	-
Total cash and sundries		15,444	4.0	7,858	2.0
Net financial assets		382,163	100.0	390,788	100.0

12 Investments representing more than 5% of the net assets of the Fund

	Market value at 31 March 2015 £000	% of net assets 31 March 2015	Market value at 31 March 2016 £000	% of net assets 31 March 2016
Standard Life Property Fund	34,201	8.9	37,491	9.5
Baillie Gifford Index Linked Gilt Fund	28,449	7.4	28,326	7.2
Baillie Gifford Inv Grade Bond Fund	27,380	7.1	27,221	6.9

13 Investments representing more than 5% of any investment class

Fixed interest	Market value at 31 March 2015 £000	% of asset class 31 March 2015	Market value at 31 March 2016 £000	% of asset class 31 March 2016
UK Gov 0.125% Index Linked 22/03/44	1,151	8.7	3,142	16.0
UK Gov 1.25% Index Linked 2055	758	5.7	2,341	11.9
UK Gov 0.125% Index Linked 22/03/68	-	-	1,981	10.1
UK Gov 0.125% Index Linked 22/03/58	-	-	1,847	9.4
UK Gov 2% Index Linked 26/01/35	1,368	10.4	1,360	6.9
UK Gov 0.625% Index Linked 22/03/40	1,215	9.2	1,228	6.2
UK Gov 1.125% Index Linked 22/11/37	1,472	11.1	1,213	6.2
UK Gov 0.25% Index Linked 22/03/52	-	-	1,133	5.8
UK Gov 0.375% Index Linked 22/03/62	866	6.6	919	4.7
UK Gov 0.75% Index Linked 22/11/2047	880	6.7	877	4.5
UK Gov1.25% Index Linked 22/11/2032	1,125	8.5	797	4.1
UK Gov 0.75% Index Linked 22/03/34	1,161	8.8	-	-
UK Gov 4.125% Index Linked 22/07/30	878	6.6	-	-
Pooled funds				
Standard Life Property Fund	34,201	32.3	37,491	30.8
Baillie Gifford Index Linked Gilt Fund	28,449	26.9	28,326	23.2
Baillie Gifford Inv Grade Bond Fund	27,380	25.8	27,221	22.3

14 Securities lending

During the year Lothian Buses Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2016, £10.4m (2015 £10.5m) of securities were released to third parties. Collateral valued at 110.26% (2015 106.1%) of the market value of the securities on loan was held at that date.

15 Financial Instruments

15a Classification of financial instruments

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

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

Notes to the Financial Statements

15a Classification of financial instruments

Financial assets	31 March 2015 Designated as fair value through fund account £000	31 March 2015 Loans and receivables £000	31 March 2015 Financial liabilities at amortised cost £000	31 March 2016 Designated as fair value through fund account £000	31 March 2016 Loans and receivables £000	31 March 2016 Financial liabilities at amortised cost £000
Investment assets						
Fixed interest	13,209	-	-	19,661	-	-
Equities	242,863	-	-	236,417	-	-
Pooled investments	105,943	-	-	121,923	-	-
Cash	-	19,174	-		11,811	-
Other balances	-	1,071	-		1,291	-
	362,015	20,245	-	378,001	13,102	-
Other assets						
City of Edinburgh Council	-	1,113	-	-	400	-
Cash	-	2,027	-	-	2,867	-
Debtors	-	726	-	-	828	-
	-	3,866	-	-	4,095	-
Assets total	362,015	24,111	-	378,001	17,197	-
Financial liabilities						
Investment liabilities						
Derivative contracts	-	-	-	(32)	-	-
Other investment balances	(98)	-	-	(283)	-	-
	(98)	-	-	(315)	-	-
Other liabilities						
Creditors	-	-	(244)	-	-	(452)
Liabilities total	(98)	-	(244)	(315)	-	(452)
Total net assets	361,917	24,111	(244)	377,686	17,197	(452)

	31 March 2015	31 March 2016
Total net financial assets	385,784	394,431

15b Net gains and losses on financial instruments

	2014/15 £000	2015/16 £000
Designated as fair value through fund account	43,538	3,336
Loans and receivables	(116)	196
Financial liabilities at amortised cost	-	-
Total	43,422	3,532

Notes to the Financial Statements

15c Valuation of financial instruments carried at fair value

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

Level 1

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

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

Level 2

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

Level 3

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

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

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

Notes to the Financial Statements

15c Valuation of financial instruments carried at fair value (cont)

	31 March 2016			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
Financial assets				
Designated as fair value through fund account	329,457	19,661	28,883	378,001
Loans and receivables	17,197	-	-	17,197
Total financial assets	346,654	19,661	28,883	395,198
Financial liabilities				
Designated as fair value through fund account	(315)	-	-	(315)
Financial liabilities at amortised cost	(452)	-	-	(452)
Total financial liabilities	(767)	-	-	(767)
Net financial assets	345,887	19,661	28,883	394,431

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

16 Nature and extent of risk arising from financial instruments

Risk and risk management

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

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

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

Notes to the Financial Statements

16 Nature and extent of risk arising from financial instruments (cont)

Types of investment risk

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

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

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

The Fund manages these risks in a number of ways:

- assessing and establishing acceptable levels of market risk when setting overall investment strategy. Importantly, risk is considered relative to the liabilities of the Fund
- diversification of investments in terms of type of asset, investment styles, investment managers, geographical and industry sectors as well as individual securities
- taking stewardship responsibilities seriously and pursuing constructive engagement with the companies in which we invest
- monitoring market risk and market conditions to ensure risk remains within tolerable levels
- using equity futures contracts from time to time to manage market risk. Exchange traded options are not used by the Fund.

Sensitivity analysis

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

Asset type	Potential price movement (+ or -)
Equities - Developed Markets	20.5%
Private Equity	30.0%
Timber and Gold	18.0%
Secured Loans	14.0%
Corporate Bonds	6.0%
Index-Linked Gilts	10.8%
Infrastructure	18.0%
Property	13.0%
Cash	1.1%

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

16 Nature and extent of risk arising from financial instruments (cont)

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

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

	Value at 31 March 2016 £000	% of fund %	Potential Change +/- %	Value on increase £000	Value on decrease £000
Equities - Developed Markets	229,399	58.7	20.5	276,426	182,372
Private Equity	4,659	1.2	30.0	6,057	3,261
Timber and Gold	8,023	2.1	18.0	9,467	6,579
Secured Loan	2,859	0.7	14.0	3,259	2,459
Corporate Bonds	27,221	7.0	6.0	28,854	25,588
Index-Linked Gilts	48,097	12.3	10.8	53,291	42,903
Infrastructure	24,667	6.3	18.0	29,107	20,227
Property	37,491	9.6	13.0	42,365	32,617
Cash and forward foreign exchange	8,372	2.1	1.1	8,464	8,280
Total [1]	390,788	100.0	17.0	457,290	324,286
Total [2]			14.1	446,083	335,493
Total [3]			14.2	446,344	n/a

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

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

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

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

However, because the purpose of a pension scheme is to make payments to scheme beneficiaries, the true risk of a pension scheme is not measured in absolute terms, but relative to its liabilities [3].

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

16 Nature and extent of risk arising from financial instruments (cont)

Credit risk

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

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

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

Cash deposits

At 31 March 2016, cash deposits represented £14.2m, 3.6% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2016	Balances at 31 March 2015 £000	Balances at 31 March 2016 £000
Held for investment purposes			
Northern Trust Global Investment Limited - liquidity funds	Aaa-mf	3,285	2,384
Northern Trust Company - cash deposits	Aa2	3,903	8,509
The City of Edinburgh Council - treasury management	See below	11,986	918
Total investment cash		19,174	11,811
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	2,026	2,867
Total cash		21,200	14,678

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

The Council has in place institutional restrictions on investments and counterparty criteria. These include -

(a) UK Government and other UK local Authorities with no limit, other public bodies up to £20 million per organisation.

(b) Money market funds (MMFs) no more than £30 million or 15% with any one Fund.

(c) Financial Institutions: Banks and Building Societies with multiple criteria based on a range of short and long term credit ratings, as well as any security provided, from maximum of £60 million / 20% of assets under management (AUM) for institutions with the highest criteria to £10 million / 5% of AUM for institutions with the lowest acceptable criteria.

Notes to the Financial Statements

16 Nature and extent of risk arising from financial instruments (cont)

	Moody's Credit Rating at 31 March 2016	Balances at 31 March 2015 £000	Balances at 31 March 2016 £000
Money market funds			
Deutsche Bank AG, London	Aaa-mf	2,057	505
Goldman Sachs	Aaa-mf	2,055	4
Bank call accounts			
Bank of Scotland	A1	1,324	248
Royal Bank of Scotland	A3	186	40
Santander UK	A1	1,285	-
Barclays Bank	A2	1,341	256
Svenska Handelsbanken	Aa2	2,090	261
HSBC Bank	Aa2	2,045	-
Commonwealth Bank of Australia	Aa2	543	-
Floating rate note			
Rabobank	Aa2	362	-
Building society fixed term deposits			
Nationwide Building Society	A1	362	-
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa1	-	1,717
UK Government Treasury Bills	Aa1	362	754
		14,012	3,785

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2016 was 'Aa1').

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

Securities lending

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

Derivatives

The Fund transacts foreign currency derivatives over-the-counter and hence is exposed to credit risk in the event of a counterparty defaulting on the net payment or receipt that remains outstanding. This risk is minimised by the use of counterparties that are recognised financial intermediaries with acceptable credit ratings and by netting agreements. At 31 March 2016, the Fund was owed £32k on over-the-counter foreign currency derivatives.

Refinancing risk

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

Notes to the Financial Statements

16 Nature and extent of risk arising from financial instruments (cont)

Liquidity risk

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

The majority (estimated to be approximately 83%) of the Fund's investments could be converted to cash within three months in a normal trading environment.

17 Actuarial statement

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

18 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £374m (2015 £400m). This figure is used for statutory accounting purposes by Lothian Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end.

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

Financial assumptions	**31 March 2015 % p.a.**	**31 March 2016 % p.a.**
Inflation/pensions increase rate	2.4	2.2
Salary increase rate	4.3	4.2
Discount rate	3.2	3.5

Longevity assumptions

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

	31 March 2015		31 March 2016	
	Males	Females	Males	Females
Current pensioners	20.4 years	22.6 years	20.4 years	22.9 years
Future pensioners (assumed to be currently 45)	23.5 years	25.9 years	23.5 years	25.9 years

Commutation assumption

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

19 Debtors

	2014/15 £000	2015/16 £000
Contributions due - employer	528	576
Contributions due - members	161	158
Sundry debtors	37	94
	726	828

Analysis of debtors

	31 March 2015 £000	31 March 2016 £000
Administering Authority	1	1
Other Scheduled Bodies	689	818
Other entities and individuals	36	9
	726	828

20 Creditors

	31 March 2015 £000	31 March 2016 £000
Benefits payable	73	275
Miscellaneous creditors and accrued expenses	171	177
	244	452

Analysis of creditors

	31 March 2015 £000	31 March 2016 £000
Other entities and individuals	244	452
	244	452

21 Additional Voluntary Contributions

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

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

Notes to the Financial Statements

21 Additional Voluntary Contributions (cont)

Total contributions during year for Lothian Buses Pension fund	2014/15 £000	2015/16 £000
Standard Life	9	6
Prudential	73	61
	82	67

Total value at year end for Lothian Buses Pension Fund	31 March 2015 £000	31 March 2016 £000
Standard Life	167	170
Prudential	251	315
	418	485

22 Related party transactions

The City of Edinburgh Council

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

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

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

	31 March 2015 £000	31 March 2016 £000
Year end balance of holding account	1,113	400
	1,113	400

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2016, the fund had an average investment balance of £9.5m (2015 £6.8m). Interest earned was £12.2k (2015 £31k).

Year end balance on treasury management account	31 March 2015 £000	31 March 2016 £000
Held for investment purposes	11,986	918
Held for other purposes	2,026	2,867
	14,012	3,785

Notes to the Financial Statements

22 Related party transactions (cont)

Office accommodation - 144 Morrison Street, Edinburgh

Investment and Pensions Division of the Council entered into an internal agreement with the Council for the provision of office accommodation at 144 Morrison Street in Edinburgh. The terms of the agreement are equivalent to those that would have been obtained had the accommodation been let on a commercial basis. In the accounts of the Fund the arrangement has been treated as a operational lease. The Investment and Pensions Division is committed to making the following future payments. City of Edinburgh Council sold the property on 31 March 2016, the lease with the new landlord is on the same terms as the internal agreement.

	31 March 2015 £000	31 March 2016 £000
Within one year	-	42
Between one and five years	272	345
After five years	1,379	992
	1,651	1,379

Recognised as an expense during the year	91	92

The above expense has been allocated across the three Funds, Lothian Buses Pension Fund's share is £2.7k.

Governance

As at 31 March 2016, all members of the Pensions Committee, with the exception of Councillor Bill Cook and Richard Lamont, and all members of the Pensions Board, with the exception of Graham Turnbull, were active members of the Lothian Pension Fund or Lothian Buses Pension Fund.

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

During the period from 1 April 2015 to the date of issuing of these accounts, a number of employees of the City of Edinburgh Council and its wholly owned subsidiary, LPFE Limited, held key positions in the financial management of the Lothian Pension Fund. With effect from 1 May 2015, all the employees listed below, with the exception of the Executive Director of Resources, were employed by LPFE Limited. These employees and their financial relationship with the Fund (expressed as cash-equivalent transfer values or CETV) are set out below:

Name	Position held	Accrued CETV as at 31 March 2015 £000	Accrued CETV as at 31 March 2016 £000
Hugh Dunn*	Acting Executive Director of Resources	734	755
Clare Scott	Chief Executive Officer, Lothian Pension Fund	147	175
Bruce Miller	Chief Investment Officer, Lothian Pension Fund	139	185
Struan Fairbairn	Chief Legal & Risk Officer, Lothian Pension Fund	19	30
John Burns	Chief Finance Officer, Lothian Pension Fund	426	474
Esmond Hamilton	Financial Controller	138	161

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

22 Related party transactions (cont)

Governance

There is no need to produce a remuneration report for 2015/16, as the Pension Fund did not directly employ any staff.

Staff are either employed by City of Edinburgh Council or LPFE Limited, and their costs reimbursed by the Pension Fund. The Councillors, who are members of the Pensions Committee are also remunerated by City of Edinburgh Council.

23 Contractual commitments

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

	31 March 2015 £000	31 March 2016 £000
Outstanding investment commitments	5,387	6,722
	5,387	6,722

As disclosed in note 22 on related party transactions the Investment and Pensions Division has a commitment to make future payments equivalent to rent in respect office accommodation at 144 Morrison Street. Details of the future payments are provided in that note.

24 Contingent assets and liabilities

At 31 March 2016 the Fund had entered into negotiations for two infrastructure co-investments in which it is exposed to the potential risk of investment abort costs. Lothian Buses Pension Fund's exposure to this is approximately £15k.

There were no contingent assets at year end.

25 Impairment losses

No impairment losses have been identified during the year.

Lothian Buses Pension Fund

Actuarial Statement for 2015/16

This statement has been prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2014. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

Description of Funding Policy

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

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

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £337 million, were sufficient to meet 117% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2014 valuation was £48 million.

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

The employer contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its Funding Strategy Statement.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the valuation report dated 31 March 2014.

Method

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

Assumptions

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

Lothian Buses Pension Fund

Actuarial Statement for 2015/16

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

Financial assumptions	31 March 2015 % p.a. Nominal	31 March 2015 % p.a. Real
Discount rate	5.0%	2.3%
Pay increases*	5.0%	2.3%
Price inflation/Pension increases	2.7%	-

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

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

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

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

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

Experience over the period since April 2014

Experience has been worse than expected since the last formal valuation (excluding the effect of any membership movements). Real bond yields have fallen dramatically placing a higher value on liabilities. The effect of this has been only partially offset by the effect of strong asset returns. The funding level is therefore likely to have worsened over the period.

Richard Warden FFA
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB

22 April 2016

Scottish Homes Pension Fund

Membership records

Status	Membership at 31/03/2013	Membership at 31/03/2014	Membership at 31/03/2015	Membership at 31/03/2016
Active	-	-	-	-
Deferred	626	595	562	522
Pensioners	978	956	928	922
Dependants	308	298	293	291
Total	**1,912**	**1,849**	**1,783**	**1,735**

Investment strategy

The funding agreement with the Scottish Government and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilties will mature over time. They allow for acceleration in the sale of equities and property and purchase of bonds if the actual funding level improves to the target funding level. The 2014 Actuarial Valuation showed that the actual funding level (88.8%) was below the target funding level (91.5%).

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

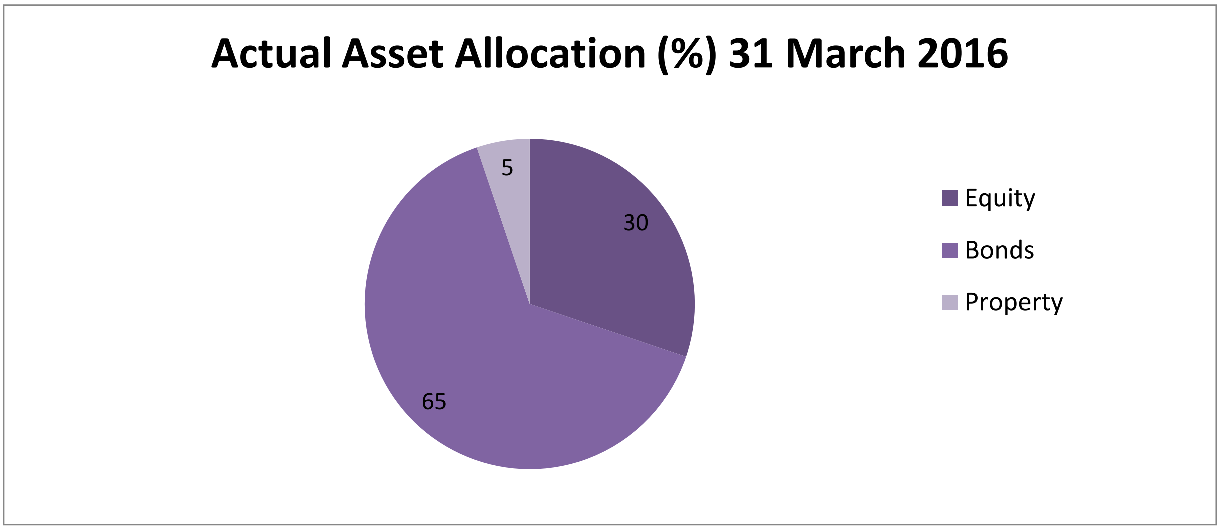
Year [1]	Target Funding Level %	Target Equity Allocation %
2014	91.5	30
2017	93.0	25
2020	94.5	20
2023	95.5	15
2026	96.5	10

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

Over 2015/16, the actual funding level fluctuated above and below the target funding level reflecting movements in market interest rates and fund asset prices. Action was taken to vary the equity allocation between 25% and 30% over the year, consistent with the funding approach. The strategic asset allocation at the end of the 2015 and 2016 financial years are shown below.

	Strategic Allocation 31 March 2015 %	Strategic Allocation 31 March 2016 %
Equities	27.5	30.0
Bonds	67.5	65.0
Property	5.0	5.0
Cash	-	-
Total	**100.0**	**100.0**

The actual asset allocation at 31 March 2016 is shown in the pie chart below.



During 2015/16, there were three changes in strategy: a reduction in equities in April 2015 to 25%, an increase in equities in October 2015 to 27.5% and a further increase in equities to 30% in February 2016. These changes were made to take advantage of movements in financial markets.

Following a review of the investment strategy during 2015/16, proposals have been put forward to the Scottish Government to change and update its funding agreement. The Scottish Government has agreed to consider alternatives to the existing funding approach. The current bond-focused investment strategy provides income yield of less than 2%, and so the Fund is required to sell assets on a regular basis to pay pensions. The review concluded that a less prescriptive investment and funding strategy would allow a higher-yielding investment strategy and a more flexible approach to setting contributions. Further development of an alternative investment strategy will be taken forward in 2016.

Investment performance

The objectives of the Fund are:

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

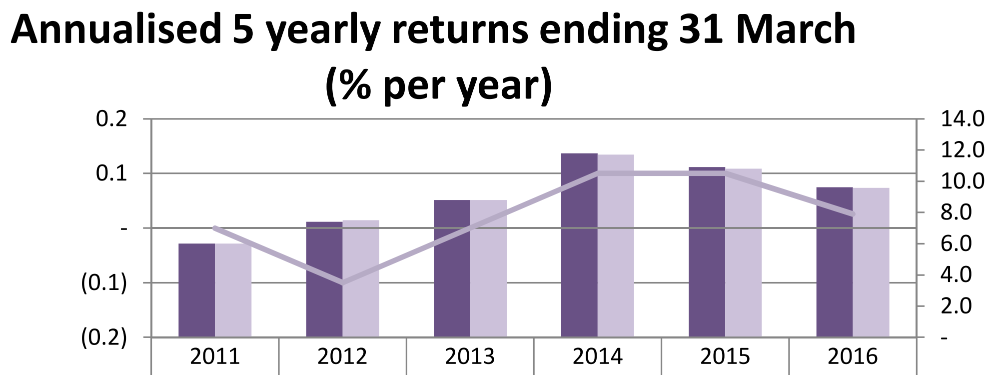
The Fund's annualised performance over the year and longer-term periods is shown in the table below. The Fund has performed broadly in line with its benchmark over all time periods.

Annualised returns to 31 March 2016 (% per year)	1 year	5 years	10 years
Scottish Homes Pension Fund	1.7	9.6	7.8
Benchmark	1.9	9.6	7.8
Actuarial Valuation Assumptions *	1.0	3.6	4.0
Retail Price Index (RPI)	1.6	2.3	3.0
Consumer Price Index (CPI)	0.5	1.7	2.4
National Average Earnings	1.9	1.6	2.2

* estimated

The absolute performance of Scottish Homes Pension Fund over the 12-month period was 1.7% and 5 year performance was 9.6% per annum. The Fund's large holdings of bonds made a small gain of 1.6% over 2015/16 while equities fell 2.1%. Property was the best performing asset class in the Fund over the year returning 11.4%. The Fund's equity and bond assets are currently managed passively, pending the review of strategy. The Fund's risk has been slightly lower than that of the benchmark over the last year and 5 years. Schroder (property portfolio) slightly underperformed its benchmarks over the year while the internally managed gilt portfolio performed in line with its benchmark. Since inception, in July 2005, the Fund has returned +8.5% per annum, well ahead of measures of inflation and of national average earnings.

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



	2011	2012	2013	2014	2015	2016
Fund	6.0	7.4	8.8	11.8	10.9	9.6
Benchmark	6.0	7.5	8.8	11.7	10.8	9.6
Relative (LHS)	-	(0.1)	-	0.1	0.1	0.0

Scottish Homes Pension Fund

Fund Account for year ended 31 March 2016

2014/15 £000		Note	2015/16 £000
	Income		
771	Contributions from employer	*3*	675
-	Transfers from other schemes		-
771			**675**
	Less: expenditure		
7,057	Pension payments including increases		6,890
372	Lump sum retirement payments		472
11	Lump sum death benefits		7
93	Transfers to other schemes	*4*	290
69	Administrative expenses	*5b*	53
7,602			**7,712**
(6,831)	**Net withdrawls from dealing with members**		**(7,037)**
	Returns on investments		
569	Investment income	*6*	799
24,861	Change in market value of investments	*7, 10b*	1,962
(184)	Investment management expenses	*5c*	(169)
25,246	**Net returns on investments**		**2,592**
18,415	**Net increase/(decrease) in the Fund during the year**		**(4,445)**
136,305	**Net assets of the Fund at 1 April 2015**		154,720
154,720	**Net assets of the Fund at 31 March 2016**	*10*	**150,275**

Scottish Homes Pension Fund

Net Assets Statement as at 31 March 2016

31 March 2015 £000		Note	31 March 2016 £000
	Investment Assets		
54,147	Fixed interest securities		59,749
97,503	Pooled investment vehicles		88,661
7,875	*- UK managed fund - Property*		*7,788*
42,611	*- UK managed fund - Equity*		*44,928*
47,017	*- UK managed fund - Gilts*		*35,945*
244	Cash Deposits		11
173	Other investment assets		177
152,067			**148,598**
	Investment Liabilities		
-	Other investment assets		-
-			-
152,067	**Net investment assets**	*8*	**148,598**
	Current assets		
219	The City of Edinburgh Council	*16*	95
2,433	Cash balances	*11, 16*	1,610
27	Debtors	*14*	22
2,679			**1,727**
	Current liabilities		
(26)	Creditors	*15*	(50)
(26)			**(50)**
2,653	**Net current assets**		**1,677**
154,720	**Net assets of the Fund at 31 March 2016**	*10*	**150,275**

JOHN BURNS FCMA CGMA
Chief Finance Officer, Lothian Pension Fund
27 June 2016

Note to the net asset statement

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

Notes to the Financial Statements

1 Statement of Accounting Policies

The statement of accounting policies for all Funds can be found on page 112.

2 Events after the Reporting Date

There have been no events since 31 March 2016, and up to the date when these Financial Statements were authorised, that require any adjustments to these Financial Statements.

3 Contributions from employer

	2014/15 £000	2015/16 £000
Deficit funding	671	575
Administration expenses	100	100
	771	675

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

Following the actuarial valuation at 31 March 2014, deficit funding of £575,000 per year is being paid by the Scottish Government over the period April 2015 to March 2018. In addition, the Scottish Government agreed to pay £100,000 every year towards the cost of ongoing administration.

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

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

4 Transfers out to other pension schemes

	2014/15 £000	2015/16 £000
Group transfers	-	-
Individual transfers	93	290
	93	290

5a Total Management expenses

	2014/15 £000	2015/16 £000
Administrative costs	40	38
Investment management expenses	159	149
Oversight and governance costs	54	35
	253	222

This analysis of costs for the Scottish Homes Pension Fund has been prepared in accordance with CIPFA guidance. The analysis looks at the combined administration and investment management expenses in note 9b and c and splits out the costs to include a third heading covering oversight and governance expenditure.

Notes to the Financial Statements

5b Administrative expenses

	2014/15 £000	2015/16 £000
Employee Costs	25	23
The City of Edinburgh Council - other support costs	3	3
System costs	7	7
Actuarial fees	25	12
External audit fees	1	1
Printing and postage	2	2
Depreciation	2	1
Office costs	2	2
Sundry costs less sundry income	2	2
	69	53

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

5c Investment management expenses

	2014/15 £000	2015/16 £000
External management fees - invoiced	59	52
External management fees - deducted from capital (direct)	60	52
External management fees - deducted from capital (indirect)	-	-
Transaction costs	-	1
Employee costs	25	25
Custody fees	18	17
Engagement and voting fees	2	2
Performance measurement fees	5	5
Consultancy fees	-	2
System costs	4	5
Legal fees	2	-
The City of Edinburgh Council - other support costs	5	3
Office costs	2	2
Sundry costs less sundry income	2	3
	184	169

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

The Fund has not incurred any performance-related investment management fees in 2015/16 or 2014/15.

Notes to the Financial Statements

6 Investment income

	2014/15 £000	2015/16 £000
Income from fixed interest securities	250	512
Income from pooled investments - property	308	277
Interest on cash deposits	11	10
	569	799
Irrecoverable withholding tax	-	-
	569	799

7 Reconciliation of movement in investments

	Market value at 31 March 2015 £000	Purchases at cost £000	Sales & proceeds £000	Change in market value £000	Market value at 31 March 2016 £000
Fixed interest securities	54,147	5,698	-	(96)	59,749
Pooled investment vehicles	97,503	13,987	(24,887)	2,058	88,661
	151,650	19,685	(24,887)	1,962	148,410
Other financial assets / (liabilities)					
Cash deposits	244			-	11
Dividend due etc	173			-	177
	417			-	188
Net financial assets	152,067			1,962	148,598

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

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

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

Notes to the Financial Statements

8 Investment managers and mandates

Manager	Mandate	Market value at 31 March 2015 £000	% of total 31 March 2015 %	Market value at 31 March 2016 £000	% of total 31 March 2016 %
State Street	UK equities	9,199	6.0	10,060	6.8
Total UK equities		9,199	6.0	10,060	6.8
State Street	N American equities	12,575	8.3	13,752	9.3
State Street	European (ex UK) equities	8,580	5.6	8,994	6.1
State Street	Pacific (ex Japan) equities	3,544	2.3	3,617	2.4
State Street	Japanese equities	5,264	3.5	4,834	3.3
State Street	Emerging markets equities	3,449	2.3	3,672	2.5
Total regional overseas equities		33,412	22.0	34,869	23.5
In-house	UK Index linked gilts	54,564	35.9	59,937	40.3
State Street	UK Fixed interest gilts	21,362	14.0	19,777	13.3
State Street	UK Index linked gilts	25,655	16.9	16,167	10.9
Total fixed interest and	**inflation linked bonds**	101,581	66.8	95,881	64.5
Standard Life	Property	7,875	5.2	7,788	5.2
Total property		7,875	5.2	7,788	5.2
Net financial assets		152,067	100.0	148,598	100.0

The Fund's investments with State Street are structured in Unitised Insurance Policies.

9 Investments representing more than 5% of the net assets of the Fund

	Market value at 31 March 2015 £000	% of total 31 March 2015 %	Market value at 31 March 2016 £000	% of total 31 March 2016 %
UK Gov 1.125% Index Linked 22/11/27	26,489	17.4	26,386	17.6
State Street UK Index Linked Gilts Over 15 Years	25,655	16.9	16,167	10.8
State Street UK Conventional Gilts Over 15 Years	21,362	14.0	19,777	13.2
UK Gov 1.25% Index Linked 22/11/32	16,401	10.8	16,380	10.9
State Street MPF North America Equity Index	12,575	8.3	13,752	9.2
UK Gov 1.125% Index Linked 22/11/37	11,257	7.4	11,321	7.5
State Street MPF UK Equity Index	9,199	6.0	10,060	6.7
State Street MPF Europe ex-UK Equity Index	8,580	5.6	8,994	6.0
Schroders UK Real Estate Income Units	7,874	5.2	7,788	5.2

Notes to the Financial Statements

10 Financial Instruments

10a Classification of financial instruments

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

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

	31 March 2015			31 March 2016		
Financial assets	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000
Investment assets						
Fixed interest	54,147	-	-	59,749	-	-
Pooled investments	97,503	-	-	88,661	-	-
Cash	-	244	-	-	11	-
Other balances	-	173	-	-	177	-
	151,650	417	-	148,410	188	-
Other assets						
City of Edinburgh Council	-	219	-	-	95	-
Cash	-	2,433	-	-	1,610	-
Debtors	-	27	-	-	22	-
	-	2,679	-	-	1,727	-
Assets total	151,650	3,096	-	148,410	1,915	-
Financial liabilities						
Other liabilities						
Creditors	-	-	(26)	-	-	(50)
Liabilities total	-	-	(26)	-	-	(50)
Total net assets	151,650	3,096	(26)	148,410	1,915	(50)

Total net financial instruments	154,720	150,275

10b Net gains and losses on financial instruments

	2014/15 £000	2015/16 £000
Designated as fair value through fund account	24,681	1,962
Loans and receivables	-	-
Financial liabilities at amortised cost	-	-
Total	24,681	1,962

Notes to the Financial Statements

10c Valuation of financial instruments carried at fair value

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

Level 1

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

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

Level 2

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

Level 3

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

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

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

	31 March 2016			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
Financial assets				
Designated as fair value through fund account	88,661	59,749	-	148,410
Loans and receivables	1,915	-	-	1,915
Total financial assets	90,576	59,749	-	150,325
Financial liabilities				
Designated as fair value through fund account	-	-	-	-
Financial liabilities at amortised cost	(50)	-	-	(50)
Total financial liabilities	(50)	-	-	(50)
Net financial assets	90,526	59,749	-	150,275

10c Valuation of financial instruments carried at fair value (cont)

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

11 Nature and extent of risk arising from financial instruments

Risk and risk management

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

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

Types of investment risk

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

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

The Fund manages these risks in a number of ways:

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

Notes to the Financial Statements

11 Nature and extent of risk arising from financial instruments (cont)

Sensitivity analysis

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

Asset type	Potential price movement (+ or -)
Equities - Developed Markets	20.5%
Equities - Emerging Markets	30.0%
Fixed Interest Gilts	6.7%
Index-Linked Gilts	10.8%
Property	13.0%

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

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

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

	Value at 31 March 2016 £000	% of fund %	Potential Change +/- %	Value on increase £000	Value on decrease £000
Equities - Developed Markets	41,256	27.8	20.5	49,713	32,799
Equities - Emerging Markets	3,672	2.5	30.0	4,774	2,570
Fixed Interest Gilts	19,777	13.3	6.7	21,102	18,452
Index-Linked Gilts	76,105	51.2	10.8	84,324	67,886
Property	7,788	5.2	13.0	8,800	6,776
Total [1]	148,598	100.0	13.5	168,714	128,482
Total [2]			9.4	162,566	134,630
Total [3]			8.3	160,932	n/a

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

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

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

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

11 Nature and extent of risk arising from financial instruments (cont)

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

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

Credit risk

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

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

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

Cash deposits

At 31 March 2016, cash deposits represented £1.6m, 1% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2016	Balances at 31 March 2015 £000	Balances at 31 March 2016 £000
Held for investment purposes			
Northern Trust Company - cash deposits	Aaa-mf	244	11
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	2,433	1,610
Total cash		2,677	1,621

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

The Council has in place institutional restrictions on investments and counterparty criteria. These include -

(a) UK Government and other UK local Authorities with no limit, other public bodies up to £20 million per organisation.

(b) Money market funds (MMFs) no more than £30 million or 15% with any one Fund.

(c) Financial Institutions: Banks and Building Societies with multiple criteria based on a range of short and long term credit ratings, as well as any security provided, from maximum of £60 million / 20% of assets under management (AUM) for institutions with the highest criteria to £10 million / 5% of AUM for institutions with the lowest acceptable criteria.

Notes to the Financial Statements

11 Nature and extent of risk arising from financial instruments (cont)

	Moody's Credit Rating at 31 March 2016	Balances at 31 March 2015 £000	Balances at 31 March 2016 £000
Money market funds			
Deutsche Bank AG, London	Aaa-mf	357	215
Goldman Sachs	Aaa-mf	357	2
Bank call accounts			
Bank of Scotland	A1	230	105
Royal Bank of Scotland	A3	32	17
Santander UK	A1	223	-
Barclays Bank	A2	233	109
Svenska Handelsbanken	Aa2	363	111
HSBC Bank	Aa2	355	-
Commonwealth Bank of Australia	Aa2	94	-
Floating rate note			
Rabobank	Aa2	63	-
Building society fixed term deposits			
Nationwide Building Society	A1	63	-
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa1	-	730
UK Government Treasury Bills	Aa1	63	321
		2,433	1,610

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2016 was 'Aa1').

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

Refinancing risk

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

Liquidity risk

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

All of the Fund’s investments could be converted to cash within three months in a normal trading environment.

12 Actuarial statement

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

Notes to the Financial Statements

13 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £130m (2015 £141m). This figure is used for statutory accounting purposes by Scottish Homes Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end.

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

	31 March 2015 % p.a.	31 March 2016 % p.a.
Inflation/pensions increase rate	2.1%	2.2%
Discount rate	3.1%	3.5%

Longevity assumptions

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

	31 March 2015		31 March 2016	
	Males	Females	Males	Females
Current pensioners	24.5 years	25.4 years	24.5 years	25.4 years
Future pensioners (assumed to be currently 45)	26.8 years	28.6 years	26.8 years	28.6 years

Commutation assumption

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

14 Debtors

	31 March 2015 £000	31 March 2016 £000
Sundry debtors	27	22
	27	22

Analysis of debtors

	31 March 2015 £000	31 March 2016 £000
Administering Authority	1	1
Other entities and individuals	26	21
	27	22

15 Creditors

	31 March 2015 £000	31 March 2016 £000
Benefits payable	5	8
Miscellaneous creditors and accrued expenses	21	42
	26	50

Analysis of creditors	31 March 2015 £000	31 March 2016 £000
Other entities and individuals	26	50
	26	50

16 Related party transactions

The City of Edinburgh Council

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

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

Transactions between the Council and the Fund are managed via a holding account. Each month the Fund pays a cash sum to the Council leaving a working balance in the account.

	31 March 2015 £000	31 March 2016 £000
Year end balance of holding account	219	95
	219	95

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2016, the fund had an average investment balance of £2.2m (2015 £2.5m). Interest earned was £10.5k (2015 £11.5k).

Year end balance on treasury management account	31 March 2015 £000	31 March 2016 £000
Held for investment purposes	-	-
Held for other purposes	2,433	1,610
	2,433	1,610

Notes to the Financial Statements

16 Related party transactions (cont)

Office accommodation - 144 Morrison Street, Edinburgh

Investment and Pensions Division of the Council entered into an internal agreement with the Council for the provision of office accommodation at 144 Morrison Street in Edinburgh. The terms of the agreement are equivalent to those that would have been obtained had the accommodation been let on a commercial basis. In the accounts of the Fund the arrangement has been treated as a operational lease. The Investment and Pensions Division is committed to making the following future payments. City of Edinburgh Council sold the property on 31 March 2016, the lease with the new landlord is on the same terms as the internal agreement.

	31 March 2015 £000	31 March 2016 £000
Within one year	-	42
Between one and five years	272	345
After five years	1,379	992
	1,651	1,379

Recognised as an expense during the year	91	92

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

Governance

As at 31 March 2016, all members of the Pensions Committee, with the exception of Councillor Bill Cook and Richard Lamont, and all members of the Pensions Board, with the exception of Graham Turnbull, were active members of the Lothian Pension Fund or Lothian Buses Pension Fund.

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

During the period from 1 April 2015 to the date of issuing of these Financial Statements, a number of employees of the City of Edinburgh Council and its wholly owned subsidiary, LPFE Limited, held key positions in the financial management of the Lothian Pension Fund. With effect from 1 May 2015, all the employees listed below, with the exception of the Executive DIrector of Resources, were employed by LPFE Limited. These employees and their financial relationship with the Fund (expressed as cash-equivalent transfer values or CETV) are set out below:

Name	Position held	Accrued CETV as at 31 March 2015 £000	Accrued CETV as at 31 March 2016 £000
Hugh Dunn*	Acting Executive Director of Resources	734	755
Clare Scott	Chief Executive, Lothian Pension Fund	147	175
Bruce Miller	Chief Investment Officer, Lothian Pension Fund	139	185
Struan Fairbairn	Chief Legal & Risk Officer, Lothian Pension Fund	19	30
John Burns	Chief Finance Officer, Lothian Pension Fund	426	474
Esmond Hamilton	Financial Controller	138	161

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

16 Related party transactions (cont)

There is no need to produce a remuneration report for 2015/16, as the Pension Fund did not directly employ any staff.

Staff are either employed by City of Edinburgh Council or LPFE Ltd, and their costs reimbursed by the Pension Fund. The Councillors, who are members of the Pensions Committee are also remunerated by City of Edinburgh Council.

17 Contingent assets/liabilities and contractual commitments

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

18 Impairment losses

No impairment losses have been identified during the year.

Actuarial Statement for 2015/16

This statement has been prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2014. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

Description of Funding Policy

The administering authority's Funding Strategy Statement, dated November 2015, states that a bespoke funding strategy has been adopted for the Fund.

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

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

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £136 million, were sufficient to meet 89% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £17 million.

The Guarantor's contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its Financial Strategy Statement.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the valuation report dated 4 December 2014.

Method

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

Assumptions

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

Scottish Homes Pension Fund

Actuarial Statement for 2015/16

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

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

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

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

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

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

Experience over the period since April 2014

The administering authority monitors the funding position on a regular basis as part of its risk management programme. The funding level at 31 March 2016 is estimated to be 92%, an increase of 3% since the formal funding valuation at 31 March 2014.

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

Richard Warden FFA
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB

21 April 2016

Statement of Accounting Policies and General Notes

1 Basis of preparation

The Financial Statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The Financial Statements summarise the transactions of the Funds for the year ended 31 March 2016 and report on the net assets available to pay pension benefits as at 31 March 2016. The Financial Statements do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present values of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, are disclosed in the Notes to the Financial Statements.

2 Summary of significant accounting policies

General

a) Basis of consolidation

Commencing with the year ended 31 March 2016, Consolidated Financial Statements have been prepared for Lothian Pension Fund. The Financial Statements of Lothian Buses Pension Fund and Scottish Homes Pension Fund continue to be prepared on a single entity basis.

The Consolidated Financial Statements for Lothian Pension Fund are prepared by combining the Financial Statements of the Fund (the parent entity) and its controlled entity (LPFE Limited) as defined in accounting standard IAS27 - Consolidated and Separate Financial Statements. Consistent accounting policies are employed in the preparation and presentation of the Consolidated Financial Statements. All inter-entity balances and transactions between entities, including any unrealised profits or losses, have been eliminated on consolidation.

As LPFE Limited commenced trading on 1 May 2015, the prior year comparative figures consist only of the results of Lothian Pension Fund. Further details of the consolidation are provide in the Notes to the Financial Statements of Lothian Pension Fund.

LPFE Limited is wholly owned by the City of Edinburgh Council. As the purpose of the Company is to provide staff services in respect of investment and general management of the Pension Funds, it is considered appropriate to consolidate the Company's Financial Statements with those of Lothian Pension Fund.

Fund account - revenue recognition

b) Contribution income

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

Similarly, employer deficit funding contributions are accounted for on the due date on which they are payable as certified by the scheme actuary.

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

c) Transfers to and from other schemes

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

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

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

d) Investment income

i) Interest income

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

ii) Dividend income

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

iii) Distributions from pooled funds

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

iv) Income from unquoted private equity and infrastructure investments

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

v) Property related income

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

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

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

vi) Movement in the net market value of investments

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

Fund account - expense items

e) Benefits payable

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

f) Taxation

i) Pension Funds

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

ii) Controlled entity - LPFE Limited

The Company is a mutual trader and is therefore not liable to corporation tax on any surpluses generated from services provided in respect of the Pension Funds. The tax charge for the period is based on any profit for the period from non-mutual trade, adjusted for any non-assessable or disallowed items. It is calculated using tax rates that have been enacted or are substantively enacted by the period end date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Financial Statements. No deferred tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is credited in the income statement except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred tax assets are recognised to the extent that it is probable that future profits will be available against which deductible temporary differences can be utilised.

The amount of benefit brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the economic entity will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

g) Administrative expenses

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

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

h) Investment management expenses

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

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

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, the decision to recognise investment management costs that are deducted from the value of an investment and recognised this as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments.

h) Investment management expenses (cont)

In March 2016, CIPFA revised and updated its guidance "Accounting for Local Government Pension Scheme Management Costs". Whilst the underlying principle of transparency of investment costs remains unchanged, there has been a degree of relaxation to full cost disclosure. Specifically, for complex "Fund of Funds" structures, the new guidance states that "Investment costs incurred by a separate legal entity, or in respect of investment decisions over which the pension fund has no control, should not be included in the (Pension) Fund Account......If pension funds wish to provide information about the total cost of Fund of Fund investments, this should be included as part of the Investments section in the Annual Report". The impact of this is that investment management costs deducted from any underlying fund in a "Fund of Funds" investment would not be included in the costs disclosed in the Fund Account. As this would significantly under-report investment management costs the decision has been made not to adopt this element of the CIPFA guidance. However, this type of cost is separately identified as "external management fees - deducted from capital (indirect)" in the notes on investment management expenses.

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

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

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

During the year, the policy on accounting for securities lending revenue has been revised. Previously, this revenue was stated net of the agent's management fee. The new policy is to report the revenue gross and include the fee in investment management expenses. The results for 2014/15 have been restated but there is no change in the net return on investments for the year.

i) Operating lease

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

Net assets statement

j) Financial assets

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

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

i) Market quoted investments

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

ii) Fixed interest securities

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

iii) Unquoted investments

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

- valuations of delisted securities are based on the last sale price prior to delisting, or where subject to liquidation, the amount the council expects to receive on wind-up, less estimated realisation costs.
- securities subject to takeover offer – the value of the consideration offered under the offer, less estimated realisation costs.
- directly held investments include investments in limited partnerships, shares in unlisted companies, trusts and bonds. Other unquoted securities typically include pooled investments in property, infrastructure, debt securities and private equity. The valuation of these pools or directly held securities is undertaken by the investment manager or responsible entity and advised as a unit or security price. The valuation standards followed in these valuations adhere to industry guidelines or to standards set by the constituent documents of the pool or the management agreement.
- investments in unquoted property and infrastructure pooled funds are valued at the net asset value or a single price advised by the fund manager.
- the values of the direct investments in unquoted private equity, infrastructure, timber and real estate are based on valuations provided by the general partners to the funds in which the Fund has invested. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines, which follow the valuation principles of IFRS. The valuations are usually undertaken at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

iv) Pooled investment vehicles

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

v) Freehold and leasehold properties

The properties were valued at fair value at 31 March 2016 by John Symes-Thompson FRICS and Genine Terry MRICS of independent external valuers CB Richard Ellis Ltd. The valuations have been prepared in accordance with the RICS Valuation – Professional Standards global – January 2014 and the RICS Valuation Professional Standards UK January 2014 (revised April 2015), (“the Red Book”). The valuer’s opinion of fair value was primarily derived using comparable recent market transactions on arm’s-length terms.

k) Foreign currency transactions and balances

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

l) Derivatives

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

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

Statement of Accounting Policies and General Notes

l) Derivatives (cont)

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

m) Cash and cash equivalents

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

n) Financial liabilities

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

o) Actuarial present value of promised retirement benefits

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

As permitted under IAS26, the Funds have opted to disclose the actuarial present value of promised retirement benefits by way of a note to the net assets statements.

p) Additional voluntary contributions

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

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

q) Employee benefits

i) Pension Funds

Staff working on the administration of the Pension Funds that are employed by the City of Edinburgh Council are eligible to join the Lothian Pension. As these people are employees of the Council, it's the Council that accounts for the benefits of the defined benefits scheme under IAS19. The Council recharges employment costs to the Pension Funds, including employer contributions to the Lothian Pension Fund.

ii) Controlled entity - LPFE Limited

The employees of LPFE Limited are eligible to participate in the Lothian Pension Fund and the Company contributes to the defined benefits scheme on behalf of its employees.

In the Consolidated Financial Statements the current service cost for the period is charged to the Fund Account. The assets of Lothian Pension Fund are held separately from those of the Company. The Company has fully adopted the accounting principles as required by IAS19 – Employee Benefits.

ii) Controlled entity - LPFE Limited (cont)

The liability recognised in the Net Asset Statement in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognised past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in a currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligations.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the Net Asset Statement in the period in which they arise.

Past-service costs are recognised immediately in the Net Asset Statement, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

3 Accounting Standards that have been issued but not yet adopted

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This applies to the adoption of the following new or amended standards within the 2016/17 Code:

- Annual Improvements to IFRSs 2010 – 2012 Cycle
- Annual Improvements to IFRSs 2012 – 2014 Cycle
- The changes to the format of the Pension Fund Account and the Net Assets Statement.

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

4 Critical judgements in applying accounting policies
Unquoted private equity and infrastructure investments

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

For the Lothian Pension Fund, the value of unquoted private equity, infrastructure and timber investments at 31 March 2016 was £716.2m (2015 £564.2m).

For the Lothian Buses Pension Fund, the value of unquoted private equity, infrastructure and timber investments at 31 March 2016 was £26.0m (2015 £14.3m).

Actuarial present value of promised retirement benefits

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

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

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

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

The items in the net assets statement at 31 March 2016 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

a) Actuarial present value of promised retirement benefits
Uncertainties

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

Effect if actual results differ from assumptions - Lothian Pension Fund

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

Change in assumptions - year ended 31 March 2016	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in discount rate	11	669
1 year increase in member life expectancy	3	188
0.5% increase in salary increase rate	4	241
0.5% increase in pensions increase rate	7	414

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

Change in assumptions - year ended 31 March 2016	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in discount rate	11	40
1 year increase in member life expectancy	3	11
0.5% increase in salary increase rate	4	14
0.5% increase in pensions increase rate	7	25

Statement of Accounting Policies and General Notes

a) Actuarial present value of promised retirement benefits (cont)

Uncertainties

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

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

Change in assumptions - year ended 31 March 2016	Approx % increase in liabilities	Approx monetary amount
	%	£m
0.5% decrease in discount rate	6	7
1 year increase in member life expectancy	3	4
0.5% increase in pensions increase rate	6	7

b) Valuation of unquoted private equity and infrastructure investments

Uncertainties

These investments are not publicly listed and therefore there is a degree of estimation involved in their valuation.

Effect if actual results differ from assumptions

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

c) Quantifying the cost of investment fees deducted from capital

Uncertainties

Section 2 h) describes the accounting policy for investment management expenses in relation to expenses deducted from the capital value of investments. Quantification of these costs involves asking the relevant managers for information and only some of this information can be independently verified. In cases where the charges relate to an investment as a whole, an estimate needs to be made of the costs applicable to the holding owned by the relevant Fund.

Effect if actual results differ from assumptions

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

Statement of responsibilities for the Statement of Accounts

The responsibilities of the Administering Authority

The Administering Authority's responsibilities require it to:

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

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

- Ensure the Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014), and so far as is compatible with that legislation, in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003).

- Approve the Annual Accounts for signature.

The Statement of Accounts presents a true and fair view of the financial position of the Pension Funds as at 31 March 2016, and their income and expenditure for the year ended 31 March 2016.

COUNCILLOR ALASDAIR RANKIN
Pensions Committee Convener
27 June 2016

Statement of responsibilities for the Statement of Accounts

The responsibilities of the Chief Finance Officer, Lothian Pension Fund

The Chief Finance Officer, Lothian Pension Fund, is responsible for the preparation of the Pension Funds' statement of accounts which, in terms of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 (the Code of Practice), is required to present a true and fair view of the financial position of the Pension Funds at the accounting date and their income and expenditure for the year (ended 31 March 2016).

In preparing this statement of accounts, the Chief Finance Officer, Lothian Pension Fund, has:

- selected suitable accounting policies and then applied them consistently
- made judgements and estimates that were reasonable and prudent
- complied with the Code of Practice.

The Chief Finance Officer, Lothian Pension Fund, has also:

- kept proper accounting records which were up to date
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

The Statement of Accounts presents a true and fair view of the financial position of the Pension Funds as at 31 March 2016, and their income and expenditure for the year ended 31 March 2016.

JOHN BURNS, FCMA CGMA
Chief Finance Officer, Lothian Pension Fund
27 June 2016

Annual Governance Statement

Roles and responsibilities

The City of Edinburgh Council (the "Council") has statutory responsibility for the administration of the Local Government Pension Scheme (LGPS) in the Lothian area of Scotland. This responsibility is for three separate Funds: Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund (the "Pension Funds").

The main functions of the Administering Authority are administration of scheme benefits and the investment of the assets of the Funds. These functions are conducted in accordance with the Local Government Pension Scheme (Scotland) Regulations which are statutory instruments made under the Superannuation Act 1972.

The role of Administering Authority is carried out via:

- The Pensions Committee and the Pensions Audit Sub-Committee.
- The Pension Board
- The Investment and Pensions Division of the Resources Directorate of the Council
- The Investment Strategy Panel
- LPFE Limited and LPFI Limited (not yet trading at 31/3/16), wholly owned subsidiaries of the Council

Further details on the above arrangements can be found in the Governance section of the Management Commentary towards the front of this document.

Scope of Responsibility

As the Administering Authority of the Funds, the City of Edinburgh Council is responsible for ensuring that its business, including that of the Funds, is conducted in accordance with the law and appropriate standards, and that public money is safeguarded, properly accounted for, and used economically, efficiently and effectively. The Council also has a statutory duty under the Local Government in Scotland Act 2003, to make arrangements to secure best value, which is defined as continuous improvement in the way its functions are carried out.

In discharging these overall responsibilities, elected members and senior officers are responsible for implementing effective arrangements for governing the Council's affairs, and facilitating the effective exercise of its functions, including arrangements for the management of risk. The Pensions Committee has delegated responsibility from Council for additional arrangements specific to the Pension Funds.

To this end, the Council has adopted a Local Code of Corporate Governance that is consistent with the principles of the Chartered Institute of Public Finance and Accountancy (CIPFA) and Society of Local Authority Chief Executives (SOLACE) framework 'Delivering Good Governance in Local Government'. This statement explains how the City of Edinburgh Council delivers good governance and reviews the effectiveness of those arrangements.

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

Annual Governance Statement

The Governance Framework

The Pension Funds operate within the wider governance framework of the Council to which is added arrangements specific to the Pension Funds themselves. The governance framework comprises the systems, processes, cultures and values by which the Pension Funds are directed and controlled. It also describes the way the Pension Funds engage with and account to stakeholders. It enables the Pension Funds to monitor the achievement of their objectives and consider whether those objectives have led to the delivery of appropriate, cost-effective services. The framework also applies to any subsidiary companies including LPFE Limited and LPFI Limited which are members of the Council's Group.

The Council's Local Code of Corporate Governance is supported by evidence of compliance which is regularly reviewed and considered by the Governance, Risk & Best Value Committee. The rest of the Group observes the principles of the code.

The Council has a self assessment assurance process to support the Annual Governance Statement given by the Council each year in their Audited Annual Accounts. As part of this process, each Council Company is required to self assess the controls framework within their Company. The Chief Executive Officer of the Pension Funds reviewed the underlying controls framework and confirmed that no significant control problems or other matters existed that should prevent the signing of the Council's Annual Governance Statement.

The Council's Governance and Democratic Services manager reviewed the Evidence of Assurance provided by the Pension Funds and was satisfied with the effectiveness of the controls described. The annual assurance questionnaire process provides the Council's Chief Executive with a level of assurance on the adequacy of the governance arrangements in place within each of the Arms Length Companies for which the Council is the majority shareholder. The Council's Corporate Governance Framework meets the principles of effective governance.

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

Elements of the governance framework specific to the Pension Funds include:

- Identifying the objectives of the Funds in the Funding Strategy Statement, Statement of Investment Principles and Service Plan.
- With effect from April 2015 the Pensions Regulator is responsible for setting standards of governance and administration for Local Government and other Public Sector pension schemes. The Pension Funds have taken steps to fully integrate compliance with these standards within the overall governance framework operated by the Funds.
- A systematic approach to monitoring service performance by the Pensions Committee, Pensions Audit Sub-Committee, senior officers and stakeholders, including the Pension Board and Independent Professional Observer.
- A structured programme to ensure that Pensions Committee members have the required standard of knowledge and understanding of Local Government Pension Scheme matters.
- Operating within clearly established investment guidelines defined by the Local Government Pension Scheme Investment Regulations and the Funds' Statement of Investment Principles;
- Compliance with the CIPFA Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme.

Annual Governance Statement

- With the exception of managed funds, unlisted investments and property, all investments are held under custody by a global custodian. The Funds benefit from the custodian's extensive internal control framework.

- Benchmarking of services in terms of standards and cost against other pension funds.

Elements of the governance framework of the Council that are relevant to the Pension Funds include:

- The Council's key corporate vision and priorities are set out and published in the City of Edinburgh Council Business Plan 2016-2020.

- A performance management framework, incorporating internal and public performance reporting, which focuses on continuous improvement of our services, applying reliable improvement methods to ensure that services are consistently well designed based on the best evidence and are delivered on a right first time basis.

- The Council is embedding a culture of commercial excellence to ensure that our services always deliver Best Value. Focused work is underway to further improve standards in buying practices and processes across the Council

- The submission of reports, findings and recommendations from Audit Scotland, the external auditor, other inspectorates and internal audit, to the Corporate Leadership Team, Governance, Risk and Best Value Committee and Council, and to the Pensions Committee and Pensions Audit Sub-Committee for all matters affecting the Funds, where appropriate, supports effective scrutiny and service improvement activities.

- The roles and responsibilities of Elected Members and Officers are defined in Procedural Standing Orders, Committee Terms of Reference and Delegated Functions, Contract Standing Orders, Scheme of Delegation to Officers, the Member/officer protocol and Financial Regulations. These are subject to annual review.

- The Chief Executive has overall responsibility to Council, as head of paid service, for all aspects of operational management and overall responsibility for ensuring the continued development and improvement of systems and processes concerned with ensuring appropriate direction, accountability and control.

- The Acting Executive Director of Resources, as Section 95 Officer, has overall responsibility for ensuring appropriate advice is given to the Council and Group on all financial matters, keeping proper financial records of accounts and maintaining an effective system of internal financial control. For the Funds, the Section 95 officer responsibility has sub-delegated to the Chief Finance Officer, Lothian Pension Fund.

- The Chief Internal Auditor has overall responsibility to review, appraise and report to management and the Governance, Risk and Best Value Committee, and for Pension Fund matters to the Pensions Committee and Pensions Audit Sub-Committee, on the adequacy of the Council's internal control and corporate governance arrangements and on risks relating to approved policies, programmes and projects.

- The Council's Governance and Democratic Services Manager, reporting to the Head of Strategy and Insight, has responsibility for advising the Council on corporate governance arrangements.

- The Governance, Risk and Best Value Committee, and for Pension Fund matters, the Pensions Committee and Pensions Audit Sub-Committee, provides the Council with independent assurance of the adequacy of the governance and risk management frameworks and internal control environment. Also providing independent scrutiny of financial and non-financial performance, approving and monitoring the progress of the Internal Audit risk based plan, and monitoring performance of the internal audit service.

- The risk management policy and framework set out the responsibilities of elected members, Governance, Risk and Best Value Committee, and for Pension Fund matters, the Pensions Committee and Pensions Audit Sub-Committee, management and staff for the identification and management of risks to corporate and service related priorities.
- The Community Risk Register, Council Risk Register and Service area risk registers identify risks and proposed treatment or actions. These registers are regularly reviewed, updated and reported to the Corporate Leadership Group, which reviews Council-wide risk and reports to the Governance, Risk and Best Value Committee for scrutiny and challenge. For Pension Fund matters the Pensions Committee and Pensions Audit Sub-Committee are responsible for scrutiny and challenge.
- Resilience and business continuity plans are in place for all essential Council services. These set out arrangements for continuing to deliver essential services in the event of an emergency or other disruption.
- Senior management and Heads of Service have formal objectives, with performance reviewed by the appropriate chief officer. Officers have personal work objectives, and receive feedback on their performance through the Council-wide performance review and development process.
- An Elected Members remuneration and expenses scheme is in place and is consistent with the Scottish Government's 'Councillors Remuneration: allowances and expenses – Guidance'. Information on the amounts and composition of elected members salaries, allowances and expenses is published on the Council's website.
- The Council's Governance and Democratic Services Manager ensures that induction training on roles and responsibilities, and ongoing development opportunities, are provided for Elected Members. For the Pension Funds, a policy on Committee and Board member training has been adopted.
- Codes of Conduct that set out the standards of behaviour expected from Elected Members and officers are in place.
- The Employee Code of Conduct, Anti Bribery Policy and Policy on Fraud Prevention set out the responsibilities of officers and Elected Members in relation to fraud and corruption, and are reinforced by the Councillors' Code of Conduct, the Code of Ethical Standards and the Financial Regulations. An annual refresher exercise is undertaken for officers to confirm that they have read and understood the relevant policies.
- The Whistleblowing policy provides a process for disclosure in the public interest about the Council and its activities by officers, Elected Members and others.
- A Register of Members' Interests and Registers of Officers' interests are maintained and available for public inspection.

A significant element of the governance framework is the system of internal controls, which is based on an ongoing process to indentify and prioritise risks to the achievement of the Council's objectives, including those relevant to the Pension Funds. Following the establishment of the wholly-owned subsidiary companies, LPFE Limited and LPFI Limited, the Council continues to have appropriate assurance processes and procedures in relation to the responsible officers involved in the administration of the Pension Funds.

Review of Effectiveness

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

Annual Governance Statement

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

The Chief Internal Auditor has also provided an assurance statement to the Pensions Committee and Pensions Audit Sub-Committee on the effectiveness of the system of internal control. The opinion in the assurance statement states:

"Whilst Internal Audit have not identified any fundamental weaknesses in the framework of governance, risk management and control at the Fund, based on our work performed in the year (set out below), the management recommendations that remain outstanding at the date of this report, and the work performed during the year over governance, risk management and controls at the City of Edinburgh Council, Internal Audit considers that there are some weaknesses in the framework of governance, risk management and controls which could potentially put the achievement of organisational objectives at risk if not addressed and there are instances of non-compliance with controls that, if not addressed, may put the achievement of organisational objectives at risk. We consider that addressing the matters identified will further enhance the adequacy and effectiveness of governance, risk management and control."

During the year the Internal Audit Section conducted three specific reviews of the internal controls operating within the Pension Funds. The first, review looked at systems for making one-off payments to members (including retirement lump sumps, death benefits and transfer payments). Two medium risk and three low risk findings were reported. At the date of preparation of this Statement all of these findings have been addressed with the exception of one of low risk. This relates to the level of checking of retirement quotations not being as rigorous as the checking applied to actual benefit payments. Procedures are being reviewed to address this risk.

The second review looked at the compliance of the Pension Funds with the LGPS Regulations. Two medium risk and two low risk findings were reported. At the date of preparation of this Statement all of these findings have been addressed with the exception of one of medium risk. This relates to the value of Scottish Homes Pension Fund investments held as a single insurance policy exceeding the threshold in the Regulations of 25%. This matter is currently being resolved with the external investment manager, so that the holdings are within the threshold. The third review considered the controls applied to externally managed investments. No risks were identified as a result of this review.

The assurance statement also refers to one finding from 2014/15, this relates to the performance of monthly contribution reconciliations and was originally due to be completed by 31 March 2015. Implementation has proved more difficult than was anticipated with some employer organisations and the completion date for this has been reset to 30 April 2016 with the agreement of the Pensions Committee. Under the revised Pension Administration Strategy, a fine will be levied on any employer failing to submit monthly contribution returns. Any such charge will be effective for the year 2016/17. The Chief Finance Officer of Lothian Pension Fund has assessed progress at 30 April 2016 and is happy that significant improvement has been achieved.

In compliance with standard accounting practice, the Acting Executive Director of Resources has provided the Chief Executive with a statement of the effectiveness of the Group's internal financial control system for the year ended 31st March 2016. It is the Acting Executive Director of Resources' opinion that "The system of control can provide reasonable, but not absolute, assurance that material control weaknesses or irregularities do not exist, and that there is no unacceptable risk of material error, loss, fraud or breach of legislation."

Annual Governance Statement

The Chief Finance Officer of Lothian Pension Fund has provided a statement of the effectiveness of the internal financial control system for the year ended 31st March 2016 for the Pension Funds. It is the Chief Finance Officer's opinion "that reasonable assurance can be placed upon the adequacy and effectiveness of the system of internal control for the Lothian Pension Find, Lothian Buses Pension Fund and Scottish Homes Pension Fund."

Certification

It is our opinion, in light of the foregoing, that reasonable assurance can be placed upon the adequacy and effectiveness of the systems of governance that operate within the Group in its administration of the Funds. We consider the governance and internal control environment operating during the financial year from 1 April 2015 to 31 March 2016 to provide reasonable and objective assurance that any significant risks impacting on the Group and its ability to achieve its objectives in properly administering the Funds have and will continue to be identified and actions have and will be taken to avoid or mitigate the impact of any such risks.

Where areas for improvement have been identified and action plans agreed, we will ensure that they are treated as priority and progress towards implementation is reviewed through the governance structures and processes established for the Group and summarised herein. We will continue to review and enhance, as necessary, our governance arrangements.

COUNCILLOR ALASDAIR RANKIN
Pensions Committee Convener
27 June 2016

ANDREW KERR
Chief Executive of the City of Edinburgh Council
27 June 2016

HUGH DUNN
Acting Executive Director of Resources of the City of Edinburgh Council
27 June 2016

CLARE SCOTT
Chief Executive Officer of the Lothian Pension Fund
27 June 2016

Governance Compliance Statement

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

The statement below discusses arrangements at 31 March 2016, prior to the introduction of new governance arrangements on 1 April 2016. Please also see the How the Fund works section for an overview of the changes implemented.

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

Governance Compliance Statement

Principle		Full Compliance	Comments
Structure (cont'd)		Yes	The Investment Strategy Panel consists of the Executive Director of Resources, Chief Executive of the Lothian Pension Fund, Chief Finance Officer, Chief Investment Officer and three experienced external industry advisers.
Representation	That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include employing authorities (including non-scheme employers, e.g. admitted bodies) and scheme members (including deferred and pensioner scheme members).	Yes	The Pension Board consists of a mix of representatives: - Five employer representatives from non-administering authority employers; - Five member representatives appointed by the Trade Unions in accordance with the approach required under Scottish statute.
	Where appropriate, independent professional observers, and expert advisors (on an ad-hoc basis).	Yes	An Independent Professional Observer was appointed in March 2013 to help Committee scrutinise advice. Three external investment advisers sit on the Investment Strategy Panel. A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the pension funds.
	That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Yes	The Pension Board attends the Pensions Committee meetings to help ensure that the operation of the pension funds is in accordance with the applicable law and regulation. The Pension Board takes part in all Committee training events. The Pensions Committee takes account of the views of the Pension Board when making decisions.

Governance Compliance Statement

Principle		Full Compliance	Comments
Selection and Role of Lay Members	That committee or board members are made fully aware of the status, role and function that they are required to perform on either a main or secondary committee.	Yes	A comprehensive training programme including induction is in place. Members of the Pensions Committee and Pension Board are expected to attend no less than three days of training (21 hours) per year. The non-elected members confirm that they have read, signed and will abide by a Code of Conduct (specifically tailored for the Committee and Board) prior to their appointment to the Pensions Committee and Pension Board. The elected members are required to read, sign and abide by the Councillors' Code of Conduct.
	That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes	The declaration of members' interests is a standard item on the agenda for meetings of the Pensions Committee, Pensions Audit Sub-Committee and Pension Board. A Code of Conduct also applies to all members of the Pensions Committee and the Pension Board.
Voting	The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes	Five of the seven places of the Pensions Committee are held by elected members of the City of Edinburgh Council, which is required to retain a 2/3 majority in line with the Local Government (Scotland) Act 1973. The Nomination and Appointments Policy of the Lothian Pension Fund, available on the Fund's website, clearly documents how employer and member representatives will be elected to the Pensions Committee and Pension Board.
Training / Facility Time / Expenses	a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision making process.	Yes	A Training and Attendance Policy is in place covering training requirements and reimbursement of expenses. The policy is available on the Fund's website www.lpf.org.uk
	b) That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	Yes	The Training and Attendance Policy applies to both the Pensions Committee and the Pension Board. Advisers have their own professional development obligations.

Governance Compliance Statement

Principle		Full Compliance	Comments
Training / Facility Time / Expenses (cont)	c) That the administering authority considers the adoption of annual training plans for committee and board members and maintains a log of all such training.	Yes	Each Pensions Committee and Pension Board member is expected to attend no less than three days training per year (21 hours) per year. Attendance at meetings and training is monitored and reported.
Meetings frequency	a) That an administering authority's main committee or committees meet at least quarterly.	Yes	The Pensions Committee meets at least four times a year.
	b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committees sits.	Yes	The Pension Board attends all the Pensions Committee meetings and separately meets in advance of each such meetings. Further meetings are held if necessary. The Pensions Audit Sub-Committee is held before the Pensions Committee at least three times a year with further meetings held if necessary. The Investment Strategy Panel meets quarterly or more frequently as required.
	c) That an administering authority who does not include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Not applicable	
Access	That subject to any rules in the council's constitution, all members of main and secondary committees or boards have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	Committee papers and minutes are publicly available on the Council's website and all Committee and Pension Board members have equal access, receiving electronic copies and/or paper copies suitable to their own circumstances.

Governance Compliance Statement

Principle		Full Compliance	Comments
Scope	That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The Pensions Committee deals with all matters relating to both the administration and investment of the Funds. A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the pension funds. The Convener of the Pensions Committee is also a member of the National Scheme Advisory Board which considers matters on a national level.
Publicity	That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes	Pensions Committee The City of Edinburgh Council is responsible for the appointment of non elected members to the Pensions Committee. Where required to fill a vacancy, employer bodies that participate in the funds are invited to nominate a suitable representative to be considered for the Pensions Committee. Where required to fill a vacancy, the members of the funds will be invited to nominate themselves to be considered for selection for the Pensions Committee. Pension Board Where required to fill a vacancy or vacancies, employer bodies are invited to nominate suitable representative(s). Similarly trade union representatives are asked to invite nominations, elect and put forward suitable individuals for appointment as Employee Member(s) to the Pension Board. Governance documents, policies and details of Pension Board membership are on the Fund's website. The Fund also communicates regularly with employers and scheme members.

Additional information

Key documents online

You can find further information on what we do and how we do it, on our website at www.lpf.org.uk/policy

- Actuarial Valuation reports
- Pension Board constitution
- Annual Report and Accounts
- Statement of Investment Principles
- Pension Administration Strategy
- Communications strategy
- Funding Strategy Statement
- Service Plan
- Training and attendance policy

Fund advisers

Actuaries:	Hymans Robertson LLP
Auditor:	David McConnell, Assistant Director of Audit, Audit Scotland
Bankers:	Royal Bank of Scotland
Investment consultancy:	KPMG LLP, Gordon Bagot and Scott Jamieson
Investment custodians:	The Northern Trust Company
Investment managers:	Details can be found in the notes to the accounts.
Additional Voluntary Contributions (AVC) managers:	Standard Life and Prudential
Property valuations:	CB Richard Ellis Ltd
Solicitors:	Dedicated in-house resource

Comments and suggestions

We appreciate your comments and suggestions on this report. Please let us know which sections you found useful and if you have any suggestions for items to be included in the future. Please email your comments to pensions@lpf.org.uk

Accessibility

You can get this document on tape, in Braille, large print and various computer formats if you ask us. Please contact the Interpretation and Translation Service (ITS) on 0131 242 8181 and quote reference number 00819. The ITS can also give information on community language translations.

Contact details

If you would like further information about Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Home Pension Fund, please contact us.

Email: pensions@lpf.org.uk
Telephone: 0131 529 4638
Web: www.lpf.org.uk
Fax: 0131 529 6229

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

LOTHIAN PENSION FUND

Pensions Committee

Appendix 2

2.00 p.m., Monday, 27 June 2016

Internal Audit Annual Report and Opinion for the Year Ended 31 March 2016

Item number	
Report number	
Executive/routine	
Wards	

Executive summary

This report provides the Internal Audit Annual Report and Opinion based on Internal Audit activity undertaken for the financial year ended 31 March 2016.

This report details the scope of internal audit, the opinion for the year ended 31 March 2016 and a note on the role and limitations of internal audit. This report is prepared per the requirement set out in the Public Sector Internal Audit Standards (PSIAS).

Links

Coalition pledges	P30
Council outcomes	CO25
Single Outcome Agreement	All

EDINBURGH
THE CITY OF EDINBURGH COUNCIL

Report

Internal Audit Annual Report for the Year Ended 31 March 2016

Recommendations

1.1 It is recommended that the Committee note the internal audit opinion for the year ended 31 March 2016.

Background

2.1 The Public Sector Internal Audit Standards (PSIAS) requires that the Chief Internal Auditor delivers an annual opinion to the Pensions Committee that can be used to inform the organisation's Annual Governance Statement. The purpose of this report is to present Internal Audit's opinion on the overall adequacy and effectiveness of the Lothian Pension Fund's framework of governance, risk management and controls, as relevant to our internal audit work performed for the financial year 1 April 2015 to 31 March 2016.

2.2 Whilst this report is a key element of the framework designed to inform the Annual Governance Statement, there are also a number of other important sources to which the Pension Committee should look to gain assurance. This report does not supplant the Pensions Committee's responsibility for forming their own view on governance, risk management and control.

Main report

Opinion

3.1 Whilst Internal Audit have not identified any fundamental weaknesses in the framework of governance, risk management and control at the Fund, based on our work performed in the year (set out below), the management recommendations that remain outstanding at the date of this report, and the work performed during the year over governance, risk management and controls at the City of Edinburgh Council, Internal Audit considers that there are some weaknesses in the framework of governance, risk management and controls which could potentially put the achievement of organisational objectives at risk if not addressed and there are instances of non-compliance with controls that, if not addressed, may put the achievement of organisational objectives at risk. We consider that addressing the matters identified will further enhance the adequacy and effectiveness of governance, risk management and control.

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

Basis of opinion

3.3 Our opinion is based solely on our assessment of whether the governance, risk management and controls in place support the achievement of the Fund's objectives.

3.4 We have conducted three specific Pension Fund Reviews during the year;

	Findings		
Review	High	Medium	Low
Immediate Payments	-	2	3
Pension Compliance	-	2	2
Externally managed investments	-	-	-
Total 15/16	**-**	**4**	**5**
Total 14/15 (2 reports)	*-*	*3*	*-*

For all completed internal audit reviews, finalised action plans have been agreed with management for the recommendations made. Completion of these recommendations will assist with improvement to the Fund's governance, risk management and internal control framework.

3.7 The total number of Internal Audit recommendations that remain unresolved is set out below:

	Findings		
Review	High	Medium	Low
Immediate Payments	-	-	1*
Pension Compliance	-	1**	-
Pensions Administration (2014/15 audit)		1***	-
Total	**-**	**2**	**1**
Total 14/15	*-*	*1*	*1*

* This finding has not yet reached its agreed implementation date and is not overdue.

** This finding relates to the Scottish Homes Fund, which at the time of audit held 59% of the total fund value in a single insurance contract with State Street. This is a breach of the Local Government Pension Scheme investment limits. A revised legal agreement, restructuring the investment to ensure compliance has been received from State Street. This is now being reviewed by the Chief Legal and Risk Officer prior to signature. This action was originally due for completion by 31 March 2016.

*** This finding relates to the performance of monthly contribution reconciliations and was originally due to be completed by 31 March 2015.

Implementation has proved more difficult than was anticipated with some employer organisations and the completion date for this has been reset to 30 April 2016 with the agreement of the Pensions Committee. Under the revised Pension Administration Strategy, a fine will be levied on any employer failing to submit monthly contribution returns. Any such charge will be effective for the year 2016/17, the first payment (and monthly contribution return) for April 2016 being due by 19 May 2016.

3.8 We have considered the effect of any changes in the Fund's systems & objectives as well as the level of resources available to Internal Audit. Given the Fund's dependence on the City of Edinburgh Council for a number of support services, we have also considered the results of the work that we performed on the governance, risk management and internal control framework in place at the City of Edinburgh Council. Our opinion and findings are set out in the report to the City of Edinburgh Council , Governance, Risk & Best Value Committee on 23 June 2016, entitled *'Internal Audit Annual Report and Opinion for the Year Ended 31 March 2016'.*

Conformance with Public Sector Internal Audit Standards

3.8 The Public Sector Internal Audit Standards (PSIAS) require us to report annually on conformance. Adoption of the PSIAS is mandatory for UK public sector organisations and they provide a coherent and consistent internal audit framework for the whole of the public sector.

3.9 The Chartered Institute of Public Finance & Accountancy (CIPFA) has prepared a Local Government Application Note and a Checklist for Assessing Conformance with the PSIAS in order to allow internal audit teams to evaluate the effectiveness of Internal Audit's performance. The Checklist, which contains 334 best practice questions, was completed in Q4 2015 as part of the Internal Audit team's quality programme.

3.10 The review identified one substantive areas of non-compliance with the PSIAS that is relevant to Internal Audit's activities in connection with the Fund.

Area of Non-compliance	*Explanation*
The Internal Audit team had not evaluated the Risk function and Risk Management processes within the Council.	The structure that the Council traditionally delivered Risk & Internal Audit Services resulted in the Internal Audit function not being sufficiently independent to evaluate the Risk function. During 2015/16, the Internal Audit function has moved towards greater autonomy as part of the transformation process and we now consider that we have reached a position where we are sufficiently independent to conduct a review of the Risk function.

	As a result our internal audit plan for 2016/17 includes for the first time, a review of the activities & operation of the Risk function and the outcome of this will be reported to the Governance, Risk and Best Value Committee in the normal manner.

Quality Assurance and Improvement Programme

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

3.12 Internal Assessments must include ongoing monitoring of the performance of the internal audit activity and periodic self-assessments. Ongoing monitoring is an integral part of the day-to-day supervision, review and measurement of the internal audit activity, and is incorporated in the routine policies and practices used to manage the internal audit activity. All work is reviewed by qualified staff prior to being issued to ensure it is of sufficient quality and complies with the methodology set out in the Internal Audit Manual.

3.13 The requirement for the periodic self-assessment is met by;

- An annual self review of compliance with the PSIAS via reviewing our conformance with the CIPFA Local Government Application Note and Checklist;
- Analysis of Internal Audit KPI trends;
- Analysis of feedback received from clients on completed reviews to identify any trends emerging; and
- The completion of quality review checklists on a sample of reviews to ensure that they comply with the Audit Manual. These reviews will be undertaken by a team member independent of the reviews.

3.14 External assessments must be performed every 5 years with the current long-stop date being 31 March 2018. It is currently envisaged that we will take part in the External Quality Assessment (EQA) process of peer reviews that has being facilitated by the Scottish Local Authorities Chief Internal Auditors Group.

3.15 Our initial external assessment under this process is provisionally timetabled for the final quarter of 2016/17. The scope of this assessment will be agreed with the Convenor of the Governance, Risk & Best Value Committee and the external assessor prior to work commencing.

3.16 For detailed analysis of Internal Audit's KPI trends and the results of the internal quality reviews, please refer to our report to the City of Edinburgh Council Governance, Risk & Best Value Committee on 23 June 2016, entitled *'Internal Audit Annual Report and Opinion for the Year Ended 31 March 2016'.*

Measures of success

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

Financial impact

5.1 No direct financial impact.

Risk, policy, compliance and governance impact

6.1 No direct impact.

Equalities impact

7.1 No direct impact.

Sustainability impact

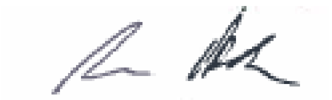
8.1 No direct impact.

Consultation and engagement

9.1 None.

Background reading/external references

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



Magnus Aitken
Chief Internal Auditor

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Links

Coalition pledges	P30
Council outcomes	CO25
Single Outcome Agreement	All

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

Limitations and responsibilities of internal audit

The opinion is based solely on the internal audit work performed for the financial year 1 April 2015 to 31 March 2016. The work addressed the Terms of Reference agreed for each individual internal audit assignment as set out in the individual assignment reports. However, where other matters have come to the attention of Internal Audit which is considered relevant, they have been taken into account when forming the opinion.

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

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

Future periods

The assessment of controls relating to the Fund is for the year ended 31 March 2016. Historic evaluation of effectiveness may not be relevant to future periods due to the risk that:

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

Responsibilities of Management and Internal Audit

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

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

The City of Edinburgh Council

Statement on the system of internal financial control

1. This statement is given in respect of the internal financial controls operated by The City of Edinburgh Council. As the Council's designated section 95 officer as defined under the provisions of the Local Government (Scotland) Act 1973, I acknowledge my responsibility for ensuring that an effective system of internal financial control is put in place and its effectiveness regularly reviewed.

2. The system of control can provide reasonable, but not absolute, assurance that material control weaknesses or irregularities do not exist, and that there is no unacceptable risk of material error, loss, fraud or breach of legislation. Consequently, the Council continually seeks to improve the effectiveness of its systems of internal control so that irregularities are either prevented or detected within an acceptable period of time. Tracking of agreed audit actions forms a standing item on the Resources Senior Management Team agenda, with progress also regularly reported to the Governance, Risk and Best Value Committee. The effectiveness of the Council's internal financial control framework as a whole is subject to annual review by Audit Scotland, with the principal findings of the most recent annual assessment reported to the Governance, Risk and Best Value Committee in August 2015.

3. The system of internal financial control is based on a framework of regular management information, financial rules and regulations, administrative procedures (including segregation of duties), management supervision and a scheme of delegation and accountability. The system is maintained and developed by Council management and includes:

   - comprehensive budgeting systems;
   - preparation and regular review of periodic reports that measure actual financial performance against forecasts. For 2015/16, the effectiveness and regularity of this review was enhanced through more systematic monitoring and scrutiny of the delivery of approved savings and management of risks and budget pressures by the Corporate Leadership Team (CLT) and elected members. This rigour has again been applied to 2016/17's savings, both prior to and following Council approval, highlighting a need for mitigating actions in some areas;
   - agreement of targets against which financial and operational performance can be assessed;
   - clearly-defined capital expenditure guidelines communicated to services and set out in the Finance Rules. These Rules, alongside the Financial Regulations, were fully updated during the year;
   - an approved long-term financial strategy and plan, updates in respect of which are regularly discussed at the CLT and reported to the Finance and Resources Committee;
   - formal project management disciplines as supported and promoted by the Corporate Programmes Office (and now the wider Transformation Programme), including senior Finance representation on all major project boards and assurance review panels; and
   - formal governance arrangements operated within both subsidiary and associated companies.

4. The Internal Audit section operates in accordance with the Chartered Institute of Public Finance and Accountancy's United Kingdom Public Sector Internal Audit Standards. The Section undertakes an annual programme based on an agreed audit strategy. The plan is based on formal assessments of risk and audit needs which are reviewed regularly to reflect evolving risks and changes within the Council. During 2015/16, the section reported to the Head of Legal, Risk and Compliance until January 2016 and thereafter to the Acting Head of Legal and Risk. However, it also has free access to the Chief Executive, Executive Directors, Heads of Service (including the Head of Finance) and elected members of the Council when required. The Chief Risk Officer has provided an assurance statement that includes his opinion on the adequacy and effectiveness of the system of internal financial control.

5. My review of the effectiveness of the internal financial control system is informed by:

   - assurance certificates on internal control received from all Executive Directors of Council service areas;
   - governance arrangements in place for subsidiary and associated companies and an ongoing assessment of the effectiveness of these arrangements;
   - the work of managers within the Council;
   - the work of internal audit; and
   - external audit reports, in particular the independent annual report on the Council's financial statements and internal control framework.

6. The Council's financial management arrangements conform with the governance requirements of the CIPFA Statement on the Role of the Chief Financial Officer (2010) as set out in the Application Note to Delivering Good Governance in Local Government Framework, an opinion confirmed by Audit Scotland as part of the 2014/15 financial statements audit. Having reviewed the framework, it is therefore my opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Group's systems of internal control.

7. I have overseen the improvements put in place in response to recommendations made by internal and external audit work during the year. This said, the extent of change underpinning the Council's Transformation Programme reinforces the importance of robust, documented and well-understood procedures and a key priority in 2016/17 will be to ensure that required financial savings are not achieved to the detriment of the internal control framework. I have therefore already worked closely, for example, with internal audit in developing improved financial reporting procedures, including greater transparency of the delivery of savings and management of risks and pressures. In the case of Health and Social Care, appropriate due diligence arrangements have also been put in place with regard to the Council's financial offer to the Integrated Joint Board.

8. I have furthermore overseen work consolidating the Council's long-term financial planning arrangements, recognising the need to keep these matters under regular review. While a balanced overall position against the Council's budget was again delivered in 2015/16, significant pressures were nonetheless apparent, particularly in Health and Social Care. These pressures were addressed through identification of corresponding savings across other service and corporate areas. Formal incorporation within the budget framework of additional investment in both Health and Social Care and Corporate Property gives the potential for these to be addressed on a sustainable basis. Crucial to this sustainability, however, is the delivery of an unprecedented level of savings in 2016/17 and these will be subject to on-going monthly monitoring and discussion at CLT and regular scrutiny by elected members, particularly via the planned series of Budget Challenge meetings.

Hugh Dunn

Hugh Dunn
Acting Executive Director of Resources
23 May 2016

Annual Report 2016
of
Lothian Pension Fund,
Lothian Buses Pension Fund
and
Scottish Homes Pension Fund

"Statement on the system of internal financial control

for the year ended 31 March 2016"

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

In compliance with standard accounting practice, the Chief Finance Officer, Lothian Pension Fund, is required to provide the Chief Executive with a statement of the effectiveness of the internal financial control system of the Funds for the year ended 31 March 2016.

The Funds place reliance upon the internal financial controls within the City of Edinburgh Council's financial systems and the monitoring in place to ensure the effectiveness of these controls. Accordingly, the "Statement on the system of internal financial control" by Hugh Dunn, Acting Executive Director of Resources, City of Edinburgh Council, dated 23 May 2016, refers.

Within this overall control framework, specific arrangements for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund are detailed in the Annual Governance Statement. These include:

- identifying the objectives of the Funds in Funding Strategy Statement, Statement of Investment Principles and Service Plan;
- monitoring of the achievement of objectives by the Pensions Committee, Pensions Audit Sub-Committee and senior officers;
- the Chief Legal and Risk Officer, Lothian Pension Fund, reports on any non-compliance with laws and regulations, with a detailed compliance framework covering key activities;
- a risk management policy, including a regularly reviewed risk register, serves to manage risk to the Funds appropriately;
- codes of conduct for elected members, members of the Pensions Board and officers;
- a structured programme to ensure that both Committee and Pension Board members have the required standard of knowledge and understanding of Local Government Pension Scheme matters;
- operating within clearly established investment guidelines defined by the Local Government Pension Scheme Investment Regulations and the Funds' Statements of Investment Principles;
- compliance with the CIPFA Principles for Investment Decision Making in the Local Government Pension Scheme;

- with the exception of managed funds, unlisted investments and property, all investments are held under custody by a global custodian. The Funds benefit from the custodian's extensive internal control framework;
- benchmarking of services in terms of quality and cost against other Local Government Pension Scheme funds.

The Chief Internal Auditor has provided an "Internal Audit Annual Report and Opinion for the year ended 31 March 2016", in accordance with the requirement set out in the Public Sector Internal Audit Standards.

In light of the above, it is my opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the system of internal financial control for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

JM Burns

John Burns, FCMA, CGMA
Chief Finance Officer,
Lothian Pension Fund

26 May 2016

Pensions Committee

2.00 p.m., Monday, 27 June 2016

Statement of Investment Principles

Item number	5.6
Report number	
Executive/routine	
Wards	All

Executive summary

This report introduces the revised Statement of Investment Principles (SIP) for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund (the Funds). It replaces the SIP agreed by Committee in June 2015.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

EDINBVRGH
THE CITY OF EDINBURGH COUNCIL

Report

Statement of Investment Principles

Recommendations

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

1.2 That the Committee adopts the revised Statement of Investment Principles.

Background

2.1 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 require administering authorities to prepare, maintain and publish a written Statement of Investment Principles.

Main report

3.1 The Statement of Investment Principles is formally reviewed annually whether there are policy changes or not. It has been reviewed by officers and the Investment Strategy Panel. The strategic allocations and investment management structures of the three Funds have been updated to reflect the strategy reviews which were completed over the last year.

3.2 One material issue described below is a change to the limit permitted in 'partnership' investments.

Investment Strategy Updates

3.3 Lothian Pension Fund manages two investment strategies, which provide employers with access to a level of risk appropriate to their individual circumstances. The Statement of Investment Principles has been updated to reflect the two investment strategies that are currently available (see Appendix A). The Fund is exploring the feasibility of introducing further strategy options.

3.4 Most employer liabilities of Lothian Pension Fund are funded by Investment Strategy 2012-17 (Strategy 1). The strategy is diversified across a range of assets, but the majority of investments are in growth assets, including equities. Employer liabilities accounting for less than 1% of the Fund are funded by a gilts-only strategy (Strategy 2), which invests entirely in UK index linked gilts in order to reduce risk for these employers.

3.5 The Lothian Buses Investment Strategy approved by Pensions Committee in March 2016 is shown in Appendix A. The Executive Director of Resources has historically implemented strategy within the constraints of permitted ranges of asset allocation. Proposed ranges for asset allocation, which were not defined in the strategy review, are now shown in Appendix A for Committee approval.

Investments in Partnerships

3.6 One material change to the draft Statement of Investment Principles stems from the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Amendment Regulations 2016, which came into force on 1 April 2016. These regulations permit an increase in the proportion of funds that local authority pension funds can invest in partnerships from a maximum of 15% to a maximum of 30%.

3.7 The background to the change were the concerns expressed in some quarters that funds lacked sufficient flexibility to access suitable investment opportunities. The Local Government and Regeneration Committee of the Scottish Parliament noted that local authority pension funds may not be in a position to diversify their investments into vehicles established to take advantage of potential returns from investment in infrastructure. In particular, it was suggested that difficulties were caused by the 15% limit set by the Investment Regulations on investment in partnerships.

3.8 The regulations refer to the proportion “invested” in “partnerships”, which leaves room for interpretation. The term “invested” can be interpreted as the latest market value of the investment or, alternatively (and more commonly used by Funds), as the amount paid into Limited Partnerships less the amount received back as distributions. The interpretation affects the calculation of the proportion invested.

3.9 The ‘partnership’ investments of Lothian Pension Fund and Lothian Buses Pension Fund at 31 March 2016 are shown in the tables below, which demonstrate the importance of the method of calculation.

Lothian Pension Fund	*** Amount Invested £m**	**% of Total Fund**	**Market value at 31 March 2016 £m**	**% of Total Fund**
Private Debt	37	0.7%	38	0.7%
Infrastructure	307	5.7%	384	7.1%
Private Equity	24	0.4%	169	3.1%
Real Estate	12	0.2%	50	0.9%
Timberland	64	1.2%	125	2.3%
TOTAL	444	8.2%	766	14.1%

Lothian Buses Pension Fund	***Amount Invested £m**	**% of Total Fund**	**Market value at 31 March 2016 £m**	**% of Total Fund**
Private Debt	3	0.7%	3	0.7%
Infrastructure	13	3.4%	18	4.6%
Timberland	4	0.9%	8	2.1%
TOTAL	20	5.0%	29	7.4%

***** ‘Amount invested’ is the amount paid into limited partnerships less the amount paid back in distributions.

3.10 In addition to Limited Partnership structures, Lothian Pension Fund has 0.5% invested in other unlisted legal structures at 31 March 2016. Lothian Buses Pension Fund has no other unlisted structures.

3.11 The Fund views the impact of unlisted investment structures on the liquidity of Fund investments as a more important issue than the definitions of “invested” and “partnerships”. Certain asset types and certain investment structures are illiquid. Whether that is an important issue will depend on the Fund’s requirement for cash to pay pension payments. The Fund monitors cashflow requirements and the liquidity of investments as a whole.

3.12 Committee is asked to approve the proposal to increase the Lothian Pension Fund and Lothian Buses Pension Fund maximum permissible proportion of funds invested in partnerships from 15% to 20% on the advice of the Investment Strategy Panel and the officers of the Fund. This increase will allow the implementation of the investment strategy (including further infrastructure and private debt investment) to proceed using the most appropriate legal structures without the concern that the Funds will breach the limit, particularly if interpreted using the current market value. The draft Statement of Investment Principles has incorporated this increase. The appropriateness of the limit will be kept under review.

Fiduciary Duty

3.13 The Statement of Investment Principles Responsible Investment section refers to fiduciary duty. The Fund believes that Environmental, Social and Governance factors should be considered in investment making decisions as they may have a material financial impact. However investments will not be excluded solely on ethical grounds.

3.14 Investments will be made in order to obtain the best returns for the Funds while acting prudently. Investments will be made with the intention of achieving the best financial position for the fund whilst balancing risk and return considerations.

3.15 These principles are based on the current interpretation of fiduciary duty. Committee will recall that a legal opinion has been sought by the Scottish LGPS Scheme Advisory Board and it is anticipated that this will be available to funds in due course. The Statement of Investment Principles will be reviewed when the opinion is released to Funds.

Measures of success

4.1 Success of the investment strategies will, among other things, be measured by the achievement of the investment and funding objectives of the Funds.

Financial impact

5.1 One potential financial implication of increasing the proportion of investments in partnerships is a reduced ability to liquidate assets quickly. However the Fund monitors cashflow requirements and the liquidity of investments as a whole and the Investment Strategy Panel takes this into consideration when advising on investment strategy limits for each Fund. It is entirely appropriate for long term investors, such as Lothian Pension Fund and Lothian Buses Pension Fund, to invest 20% of assets in partnerships.

Risk, policy, compliance and governance impact

6.1 The Statement of Investment Principles details how the risks, compliance and governance aspects of the Funds are managed. Such a statement is required under the Local Government Pension Scheme Regulations. Appendix C of the Statement illustrates compliance with the CIPFA principles.

Equalities impact

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

Sustainability impact

8.1 The Statement sets out the Funds' approach to responsible ownership and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with the Statement is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

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

Background reading/external references

None

Hugh Dunn

Acting Executive Director of Resources

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Links

The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010

http://www.lgpsregs.org/timelineregs/scot/maninvst/SSI20100233/20100233.htm

LGPS Regulations and Guidance, including The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Amendment Regulations 2016

http://www.lgpsregs.org/index.php/scotland/sppa-circulars

The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Amendment Regulations 2016 – SPPA Policy Note

http://www.legislation.gov.uk/ssi/2016/74/pdfs/ssipn_20160074_en.pdf

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 – Statement of Investment Principles including: Appendix A – Investment Strategy Appendix B – Statement of Compliance with UK Stewardship Code Appendix C – Lothian Pension Fund's Compliance with the CIPFA Principles for Investment Decision Making in the Local Governance Pension Scheme

Appendix 1

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

STATEMENT OF INVESTMENT PRINCIPLES (June 2016)

1. Introduction

1.1 This Statement of Investment Principles was agreed by the Pensions Committee of the City of Edinburgh Council on 27 June 2016.

1.2 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 require administering authorities to prepare, maintain and publish a written Statement of Investment Principles (SIP). The SIP must be reviewed from time to time and revised within six months of any material changes in the Policy. In preparing this statement, the Committee has taken professional advice from the Investment Strategy Panel, which includes external advisers.

2. Governance

2.1 The City of Edinburgh Council (CEC) is the administering authority for the Lothian Pension Fund, the Lothian Buses Pension Fund and Scottish Homes Pension Fund.

2.2 The Pensions Committee ("the Committee") of the City of Edinburgh Council has delegated responsibility for the supervision of the Funds.

2.3 This SIP sets out the principles governing decisions about the investments of the Funds. The Committee recognises the importance of environmental, social and corporate governance (ESG) issues in ensuring the long term financial performance of the companies in which they invest.

2.4 The SIP forms part of a framework that includes

- The Statutory Regulations
- The Pensions Committee
- The Pension Board
- The Investment Strategy Panel
- The Funds' Advisors
- The Funds' Funding Strategy Statement.

3. Investment Objectives & Benchmarks

3.1 The primary aim of the Funds is to ensure that all members and their dependants receive their benefits when they become payable.

3.2 The funding objectives for each Fund are documented in the Committee's Funding Strategy Statement.

3.3 The Pensions Committee sets the investment strategies for each Fund, taking into account the funding status and liabilities. The strategies are subject to regular review. Details of each Fund's strategic asset allocations are provided in Appendix A.

3.4 In order to provide suitable investment strategies for differing requirements of employers, Lothian Pension Fund currently operates two investment strategies. Most employer liabilities are funded in Strategy 1, which invests in a diversified portfolio of assets. Employers (with the exception of Transferee Admitted Bodies) that that are close to leaving the Fund are funded in Strategy 2, which invests in a portfolio of UK index linked gilts to reduce investment risk for these employers. These employers account for less than 1% of the Fund's liabilities.

3.5 In addition, it is recognised that there may also be demand from individual employers for other investment strategies for their section of the Fund. The Fund will consider such requests subject to practical implementation of such strategies and if appropriate, a review of employer contribution rates. It is not practical for the Fund to offer individual employers full flexibility on asset allocation.

3.6 The Lothian Pension Fund **Strategy 1** 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.

3.7 The Lothian Pension Fund **Strategy 2** adopts a lower risk approach for some employers (typically those which have a short expected duration in the Fund) and invests in index-linked government bonds to reduce the degree of short-term change in funding level and employer contribution rates.

3.8 The investments in Lothian Pension Fund Strategy 1, Lothian Buses Pension Fund and Scottish Homes Pension Funds are assessed relative to a benchmark, but success is also measured in terms of the level and growth of income and the volatility of absolute performance. The investment objectives of the Lothian Pension Fund Strategy 1, Lothian Buses Pension Fund and Scottish Homes Pension Funds are to achieve the same return as the strategic allocation over the long term economic cycle (typically five years or more). Over shorter periods, the Funds should perform better than the strategic allocation if markets fall significantly. The investment objective of Lothian Pension Fund Strategy 2 is to invest in low risk assets that minimise funding level risk.

4. Investment Management Structure

4.1 The Funds employ a combination of managers and mandates with the aim of delivering, in aggregate, the objectives of each Fund. Each Fund employs different types of managers and mandates depending on the requirements of the Fund.

4.2 To reduce the risk that a Fund does not deliver its objective, performance and risk targets and controls are set for each manager relative to its benchmark. For external managers, the details are included in formal Investment Management Agreements; similarly, internal mandates have formal objectives and constraints. Both external and internal managers' risk and return are measured by an independent performance measurement specialist. Performance and mandate implementation is monitored by the Investment Strategy Panel on a regular basis.

4.3 The investment managers are responsible for the selection of individual holdings within each type of investment category within the parameters set out in their agreement.

4.4 The selection of external investment managers complies fully with European Union directives on competitive tendering.

4.5 The internal investment team manage transitions and specialist transition managers can be employed to manage more complex changes in investment strategy and/or manager(s) if required.

4.6 Details of the Funds' investment managers are provided in Appendix A.

5. Underlying Investments

Types of Investment

5.1 The Committee has approved the use of the following different types of investment and income generating mechanisms to achieve their overall investment objectives:

- Listed and Unlisted Equities (including Managed Funds, Unit Trusts, Investment Trusts, Open Ended Investment Companies and Exchange Traded Funds);
- Bonds (including Index-Linked and Fixed Interest Bonds, issued by both government and corporations);
- Alternative investments (including Infrastructure, Property, Timber, Agriculture, Currency and other asset classes as agreed by the Investment Strategy Panel);
- Cash (including Treasury Bills, Money Market Funds and Secured Investments);
- Derivatives;
- Stock lending;
- Commission recapture;
- Underwriting.

The Balance between Different Types of Investments & Risks

5.2 The Pensions Committee sets investment strategy for each Fund, taking into account the funding status and liabilities. The strategies are subject to regular review. The Executive Director of Resources, with advice from the Investment Strategy Panel, implements the investment strategy, including mandate design and investment manager appointments.

5.3 Asset liability modelling techniques, which measure the risk of the Fund relative to the liabilities, are used to assist in the strategy reviews, as appropriate.

5.4 With the exception of Strategy 2, the Funds seek to control risk by investing in a diverse range of investments both domestically and globally. All investments are assessed consistently and include consideration of environmental, social and governance issues which affect financial risk and returns.

5.5 The risk of the Funds performing differently to their benchmarks is monitored using an independent performance and risk specialist. The internal investment team and the Investment Strategy Panel monitor risks on a quarterly basis.

Expected return on investments

5.6 Each Fund expects its investments to produce a return over the long term above that of the investment return assumed in the actuarial valuation.

Realisation of investments

5.7 The majority of each Fund's investments are quoted on major stock markets and may be realised relatively quickly if required. A proportion of each Fund's investments (such as property, private equity and infrastructure) would take longer to be realised. The overall liquidity of each Fund's assets is considered in the light of potential demands for cash.

Stock Lending

5.8 Lothian Pension Fund and Lothian Buses Pension Fund lend a proportion of their investments in order to maximise additional income. Stock lending is conducted within the parameters prescribed in the regulations. Stock lending does not prevent any investments from being sold. Safeguards are in place to reduce the risk of financial loss in the event of default. These safeguards include receiving liquid collateral in excess of the value of the loan, indemnity agreement with the lending agent and regular reviews of credit-worthiness of potential borrowers.

Responsible Investment

5.9 The Pensions Committee believes that investing responsibly can affect the financial performance of companies. It has a responsibility to take environmental, social and governance issues seriously and where appropriate, to act upon them in a manner which is consistent with the paramount fiduciary duty to provide the highest standards of stewardship on behalf of the members, employers and tax-payers.

5.10 The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting.

5.11 As long term investors, the Funds recognise the importance of promoting responsible stewardship and long term decision making. The Funds seek to adhere to the FRC'S UK Stewardship Code, and encourage our appointed asset managers to do so too. Details of adherence to the Code are provided in Appendix B. The Funds' voting and engagement policies promote good governance and stewardship of companies.

Safekeeping of Assets

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

Performance measurement

5.13 An independent provider is employed to calculate performance for the Funds. Each quarter, the Investment Strategy Panel considers the performance of the combined assets and each manager's portfolio against their respective benchmarks. The Pensions Committee reviews performance on an annual basis.

6. Compliance

Regulations and Investment Limits

6.1 The Funds are compliant with the statutory restrictions set out in the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 and the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Amendment Regulations 2016.

The Regulations contain limits on the percentage of a pension fund that may be invested in certain asset types and provide for the limits to be raised, subject to certain requirements being met. The Committee have agreed the limits applicable to the Funds' investments in partnerships be raised in order to accommodate the allocation to unlisted investments, including infrastructure, timber, property, equity and debt. The limits agreed by Committee are:

- All contributions to any single partnership 5% (which compares with the statutory maximum of 5%)

- Contributions to all partnerships be raised from 15% to 20% (which compares with the statutory maximum of 30%)

The Committee took proper advice in respect of these limits from the Investment Strategy Panel and from officers. The limits will apply for the period during which the Funds' strategic allocations include investments in partnerships, unless investment considerations require an earlier review. This decision is compliant with the Regulations.

CIPFA Principles for Investment Decision Making in the Local Government Pension Scheme

6.2 Regulations require administering authorities to publish the extent to which they comply with guidance issued by the Scottish Ministers, which in turn refer to guidance issued by Chartered Institute of Public Finance and Accountancy. The Funds' compliance with the guidance is provided in Appendix C.

7. Review

7.1 The Pensions Committee will review this statement annually or more frequently if appropriate. The Committee will consult with such persons as it considers appropriate and take proper advice when revising the statement.

Lothian Pension Fund

Investment Strategy 1

	Interim Strategy 01/04/16 (%)	Long Term Strategy 2012-2017 (%)	Permitted Range (%)
Total Equities	**67**	**65**	**50 – 75**
Index-Linked Assets	**7**	**7**	**0 – 20**
Alternatives	**25**	**28**	**20 – 35**
Cash	**1**	**0**	**0 – 10**
TOTAL	**100**	**100**	

Long Term Strategy, initially agreed by Committee in October 2012 and reaffirmed in December 2015, is being implemented gradually, subject to financial market developments.

Investment Management Structure at 31 May 2016

- 5 Global Equity Mandates (external: Nordea, Harris; internal: Global Low Volatility, Global Value, Global High Dividend Yield)
- 4 Regional Equity Mandates (internal: UK All Cap, UK Mid Cap, US and Europe ex-UK)
- 1 Private Equity Mandate (invests in a range of direct funds, fund-of-funds and listed vehicles)
- 1 Index-Linked Asset Mandate (internal: UK Index-Linked Gilts)
- 1 Property Mandate (external: Standard Life)
- 1 Real Assets Mandate (internal: invests in a range of direct funds, fund-of-funds and listed vehicles invested in infrastructure and timber)
- 1 Other Bonds Mandate (internal: invests in a range of direct debt funds and listed sovereign and corporate bonds)
- 1 Currency Mandate (internal: hedges currency exposure of overseas equities to reduce volatility of returns)
- 1 Cash Mandate (managed alongside City of Edinburgh Council cash)

Investment Strategy 2

A lower-risk, gilts-only strategy with a 100% allocation to UK index linked gilts (internally managed). This is primarily to reduce the degree of short-term change in funding level and employer contribution rates in the period prior to an employer leaving the Fund.

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

Lothian Buses Pension Fund

Investment Strategy

Asset Category	Interim Strategy Allocation 01 April 2016 %	Long Term Strategy Allocation 2016-21 %	Permitted Ranges %
Equities	58.5	40	±10% interim strategy
Index-Linked Assets	14.0	20	±10% interim strategy
Other Real Assets	27.5	18	±10% interim strategy
Fixed Income Assets		22	±10% interim strategy
Cash	0.0	0	0%-15%
TOTAL	**100**	**100**	

Long Term Strategy agreed by Committee in March 2016 will be implemented gradually, subject to financial market developments.

Investment Management Structure at 31 May 2016

- 2 Global Equity Mandates (internal: Global High Dividend Yield; external: Baillie Gifford Global Alpha)
- 1 Listed Private Equity Mandate (internal: listed funds)
- 1 Index Linked Gilts Mandate (internal: UK Index-Linked Gilts)
- 1 Property Mandate (external: Standard Life pooled fund)
- 1 Real Assets Mandate (internal: invests in a range of direct funds, fund-of-funds and listed vehicles invested in infrastructure and timber)
- 2 Fixed Income Assets Mandates (external: Baillie Gifford corporate bond pooled fund; and internal: invests in a range of direct debt funds and listed sovereign and corporate bonds)
- 1 Cash Mandate (managed alongside City of Edinburgh cash)

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

Scottish Homes Pension Fund

Investment Strategy

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

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

[1] Target Funding Level as per the Guarantee

The strategy at 30 April 2016 is shown in the table below.

	Strategy at 30/04/2016 %
Equities	**30.0**
Bonds	
UK Fixed Interest Gilts	*13.1*
UK Index Linked Gilts	*51.9*
Subtotal	**65.0**
Property	**5.0**
Cash	**0.0**
TOTAL	**100.0**

Investment Manager Arrangements at 31 May 2016

- 1 Equity Mandate (external: State Street Global Advisers Global Equities)
- 2 Bond Mandates (external: State Street Global Advisers Gilts; and internal: Index-Linked Gilts)
- 1 Property Mandate (external: Schroders pooled fund)

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

Statement of Compliance with UK Stewardship Code	
Principle 1 Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.	We acknowledge our role as an asset owner under the Stewardship Code and therefore seek to hold to account our fund managers and service providers in respect of their commitments to the Code. In practice our policy is to apply the Code through a) The appointment of Hermes Equity Ownership Services (EOS) to assist in fulfilling our fiduciary responsibilities as long term shareholders. We believe that the monitoring of shareholdings by Hermes EOS enables us to provide the highest standards of stewardship on behalf of the beneficiaries of the pension funds. Hermes EOS has the expertise in corporate engagement to carry forward this work on an international basis. Their aim is to bring about positive long-term change at companies through a focussed and value-oriented approach. Engagements undertaken by Hermes EOS on our behalf are guided by the Hermes Responsible Ownership Principles http://www.hermes.co.uk/Portals/8/The_Hermes_Ownership_Principles_UK.pdf Besides engagement on an individual company level, through Hermes EOS, we also work to establish effective regulatory regimes in the various markets in which we invest to encourage governance structures that facilitate accountability of companies to their owners, give companies the certainty they need to plan for the future and to level the playing field to ensure companies are not disadvantaged for prioritising long-term profitability. b) As well as Hermes EOS, two of our Fund Managers, Baillie Gifford and State Street, take direct responsibility for stewardship issues, voting and engagement, in the funds which they manage on our behalf. These managers publish Statements of Compliance with the Stewardship code. Details are available at:- https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code/UK-Stewardship-Code-statements.aspx c) Through our membership of the Local Authority Pension Fund Forum (LAPFF), we keep informed of potential issues of concern at both individual companies and across the market as a whole, which leads to collaborative engagement.

Statement of Compliance with UK Stewardship Code	
Principle 2 Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.	Our relationship with Hermes EOS enables us effectively to manage conflicts of interest in relation to our stewardship work. Hermes EOS conflicts of interest policy, which explains how it manages conflicts on our behalf, can be found at http://hermes.yellowtailcms.co.uk/Portals/8/Conflicts_of_interest_policy.pdf. We also encourage the asset managers employed by the Funds to have effective policies addressing potential conflicts of interest. In respect of conflicts of interest within the Funds, Pensions Committee members are required to make declarations of interest prior to Committee meetings. Our policy of constructive engagement with companies is consistent with the Funds' fiduciary responsibilities.
Principle 3 Institutional investors should monitor their investee companies.	Day-to-day responsibility for monitoring our equity holdings is delegated to Hermes EOS, Baillie Gifford and State Street. We expect them to monitor companies, intervene where necessary, and report back regularly on activity. Details are provided quarterly on the Funds' website. This includes both the total number of company meetings where the Funds have voted and details of individual companies where we have voted against company management. LAPFF also monitors and engages with companies and provides an 'Alerts' service which highlights concerns over corporate governance issues. The internal investment management team adhere to the Funds' compliance policy on insider information. In order to foster a positive working relationship with an individual company and to build trust, Hermes EOS may be willing to become an insider. In such circumstances, the relevant information will not be passed to the internal team until after it is no longer inside information.

<table>
<tr><th colspan="2">Statement of Compliance with UK Stewardship Code</th></tr>
<tr><td>Principle 4
Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.</td><td>As highlighted above, responsibility for day-to-day interaction with companies is delegated, including the escalation of engagement when necessary.
We expect the approach to engagement on our behalf to be value orientated and focussed on long term sustainable profitability. We expect Hermes EOS, Baillie Gifford and State Street to disclose their guidelines for such activities in their own statements of adherence to the Code.
We may also propose escalation of activity through the Local Authority Pension Fund Forum.
Consistent with our fiduciary duty to beneficiaries and in order to encourage improved conduct in future, we consider participating in shareholder litigation where it appears likely that the Fund will recover losses (net of costs) sustained because of inappropriate actions by company directors.</td></tr>
<tr><td>Principle 5
Institutional investors should be willing to act collectively with other investors where appropriate</td><td>We seek to work collaboratively with other institutional shareholders in order to maximise the influence that we can have on individual companies. We do this through:

- membership of the Local Authority Pension Fund Forum, which engages with companies over environmental, social and governance issues on behalf of its members.
- the appointment of Hermes EOS also signals our commitment to the benefits of collective shareholder engagement. Hermes EOS pools together investors' resources to create an engagement service which aims to protect and enhance shareholder value. Hermes EOS represents us at many national, regional and global organisations through which we seek to enhance our effectiveness by working collaboratively with other institutions. Among these are: the Principles for Responsible Investment (PRI) and its Clearinghouse for engagements (as well as a number of more localised PRI initiatives); the International Corporate Governance Network; the Asian Corporate Governance Association; the Canadian Coalition for Good Governance, Eumedion and the Pensions and Lifetime Savings Association (PLSA). Hermes EOS seeks to work with these organisations and also alongside other individual investors to effect change most efficiently.
- being a signatory of the PRI in our own right.
- being a signatory since 2009 to the Carbon Disclosure Project (CDP) Information Request. The information gathered by CDP forms the largest database of corporate climate change information in the world.</td></tr>
</table>

Statement of Compliance with UK Stewardship Code	
Principle 6 Institutional investors should have a clear policy on voting and disclosure of voting activity.	The emphasis of our voting policy is to promote best practice. We seek to vote on all shares held. The Funds have an active stock lending programme but consider recalling stock from a loan where it appears that this would be an appropriate way to safeguard the Funds' financial interests. Our preference is for managers to vote on the Funds' behalf and for responsible stewardship to be integral to the investment decision making process. We are comfortable with delegation of voting to Baillie Gifford for the funds they manage. State Street vote on our behalf because the investment is in a pooled fund. The managers' voting policies can be found at the websites mentioned above. For the remaining funds, Hermes EOS votes consistently, across the portfolios it covers, and makes voting decisions based on a thorough analysis of publicly available information and always take account of a company's individual circumstances. Hermes EOS informs companies where it has concerns and seeks a resolution prior to taking the decision to vote against management. In this way, it uses our votes as a lever for positive change at companies. Underpinning voting decisions are Hermes EOS Regional Corporate Governance policies which can be found at the "How we invest" section of our website. We disclose our historic voting information on our website. This includes the total number of companies where the Funds voted and details of individual companies where we have voted against company management. We disclose in arrears so that we are transparent and accountable but dialogue with companies in our portfolios is not compromised.
Principle 7 Institutional investors should report periodically on their stewardship and voting activities.	We report annually on stewardship activity through a specific section in the Funds' annual report and accounts and on our website. We also report annually on stewardship issues to the Pensions Committee. We have reviewed this Statement in June 2016. We will review the Statement annually.
	For further information please contact Marlyn.McConaghie @edinburgh.gov.uk

Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund (the Funds), Compliance with the CIPFA Principles for Investment Decision Making in the Local Government Pension Scheme.

The Funds comply with the six CIPFA Principles. Details of the principles and the Funds' compliance are described below.

Principle 1 – Effective decision making
Administering authorities should ensure that decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and monitor their implementation; and
Those persons or organisations should have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

- The Funds' Trustee Training Policy (comprising a compulsory training seminar for all new trustees and ongoing training of at least three days per year for all members of the Pensions Committee and Pension Board) provides the knowledge to enable them to evaluate and challenge the advice they receive. Standards relating to the administration of the Committee's business are strictly up-held.

- The Fund has appointed an Independent Professional Observer to strengthen governance. The role of the Observer is to provide the Committee with an impartial, additional source of experience and technical knowledge.

- The Pensions Committee focuses on setting the strategy for the Funds and monitoring performance. The Pension Board also attends Committee meetings and is responsible for assisting the Committee in securing compliance with relevant regulations and other legislation.

- The Committee delegates the day-to-day running of the Funds to the Executive Director of Resources. The Executive Director of Resources is responsible for the provision of the training plan for Committee to help them to make effective decisions to ensure that they are fully aware of their statutory and fiduciary responsibilities, and to regularly remind them of their stewardship role.

- The Investment Strategy Panel advises the Executive Director of Resources on the implementation of the agreed strategies, reviewing structure, funding monitoring, performance and risk and asset allocation. The Investment Strategy Panel meets quarterly and is made up of experienced investment professionals, including independent advisers.

- The in-house team undertakes day-to-day monitoring of the Funds. The team includes personnel with suitable professional qualifications and experience to provide the necessary skills, knowledge, advice and resources to support the Investment Strategy Panel and the Pensions Committee.

- Conflicts of interest are managed actively. At each Committee meeting, elected members (acting as 'trustees' of the Funds) are asked to highlight conflicts of interest. A Code of Conduct applies to members of the Committee and the Pension Board. The Funds have a Compliance Policy which ensures conflicts of interest are highlighted and managed appropriately.

Principle 2 – Clear Objectives
Overall investment objectives should be set out for the fund that take account of the scheme's liabilities, the potential impact on local council tax payers, the strength of the covenant of the participating employers, and the attitude to risk of both the administering authority and the scheme employers, and these should be clearly communicated to advisers and investment managers.

- The Statement of Investment Principles and the Funding Strategy Statement define the Funds' primary funding objectives.

- Asset-liability modelling is undertaken with the help of external advisers to aid the setting of investment strategy in order to understand risks. Each Fund has a scheme-specific investment strategy.

- The attitude to risk of employers is specifically taken into account in the setting of strategy.

- Reviews of investment strategy focus on the split between broad asset classes (equities, bonds and alternative investments).

- Investment Management Agreements set clear benchmarks and risk parameters to achieve and include the requirement to comply with the Funds' Statement of Investment Principles.

- Appointments of advisers are reviewed regularly. Investment and actuarial advisers are appointed under separate contract. Procurement of advisers is conducted within European Union procurement regulations.

- The setting of the Funding Strategy included specific consideration of the need to maintain stability in employer contribution rates.

Principle 3 – Risk and liabilities
In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.
These include the implications for council tax payers; the strength of the covenant of participating authorities; the risk of their default, and longevity risk.

- The Funds take advice from the scheme's actuary regarding the nature of its liabilities. Asset-liability modelling is undertaken periodically to aid the setting of investment strategy, and these exercises specifically take account of covenant strength and longevity risk.

- It is recognised that within Lothian Pension Fund, employers' circumstances vary and a lower-risk investment strategy for their section(s) of the Fund may be deemed suitable. The Fund will also consider such requests subject to practical implementation of such strategies and if appropriate, a review of employer contribution rates. It is not practical for the Fund to offer individual employers full flexibility on asset allocation.

- The Funding objectives for the Funds are expressed in relation to the solvency and employer contribution rates. The Funds regularly assess the covenants of participating employers.

- The Executive Director of Resources is responsible for ensuring appropriate controls of the Funds. Controls are subject to internal audit and results of audits are submitted to the Pensions Audit Sub Committee and/or the Pensions Committee.

- The Funds maintain a risk register, which is reviewed on a quarterly basis.

Principle 4 – Performance assessment
Arrangements should be in place for the formal measurement of the performance of the investments, investment managers and advisers. Administering authorities should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members.

- The Funds' performance and risk analysis is produced by an independent external provider.

- The internal investment team assesses the external investment managers' performance and risk on a regular basis. The Investment Strategy Panel assesses the performance and risk of the internal and external investment managers on a regular basis.

- The Funds' contracts with its advisers are regularly market tested.

- The Investment Strategy Panel assesses its own performance on a regular basis and reports to Committee on its activities, typically annually.

- Training and attendance of members of the Pensions Committee and the Pensions Board are monitored and reported on a regular basis. The composition of the Committee and Pension Board is reviewed on a regular basis.

Principle 5 – Responsible ownership
Administering authorities should adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.
A statement of the authority's policy on responsible ownership should be included in the Statement of Investment Principles.
Administering authorities should report periodically to members on the discharge of such responsibilities.

- The Funds' policy on responsible ownership is included in the statement on the FRC's Stewardship Code (see Appendix B of the Statement of Investment Principles).
- Details of the Funds' voting and engagements are available on the Funds' website. The Funds' annual report and accounts includes a summary of the Funds' approach to responsible investment. A summary of the report and accounts is sent to members. The full report is available on the website and is sent to members on request.

Principle 6 – Transparency and reporting
Administering authorities should act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives; and Provide regular communication to members in the form they consider most appropriate.

- Meetings of the Pensions Committee are open to the public. Members of the public are allowed to provide deputations at Committee meetings. Committee papers are available on the City of Edinburgh Council's website. The Pension Board joins the Committee at all meetings.
- The Committee's remit covers wider pension scheme issues, other than the management and investment of funds.
- The Funds' policy statements, including the Communications Strategy, Statement of Investment Principles and Funding Strategy Statement are maintained regularly. Stakeholders are consulted on changes. Documents are available on the Funds' website.
- The Funds produce an Annual Report & Accounts. The full report is available on the website, and is sent to members on request.
- The Funds also produce regular newsletters for members as well as an annual benefit statement. Regular briefings are also provided to employers. The Funds' website is updated regularly.

Pensions Committee

2.00 p.m., Monday, 27 June 2016

Investment Strategy Panel Activity

Item number	5.7
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to provide an update on the activity of the Investment Strategy Panel ("the Panel") for the year to 31 March 2016.

The focus of the Panel has been on the implementation of the investment strategies of the three pension funds. Panel and the internal team have focused on restructuring and reducing the equity exposure, increasing the allocation to alternative investments, researching available bond-related investments, and making changes to Scottish Homes Pension Fund according to its funding approach. The Panel also continues to oversee the performance, asset allocation and risk of the investments.

The Terms of Reference for the Panel were agreed by the Pensions Committee in June 2013. A small amendment has been made reflecting the decision by Committee in December 2015 that the Panel should scrutinise the audit of foreign exchange transactions in future. The updated Terms of Reference are included as an appendix to this paper.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

EDINBVRGH
THE CITY OF EDINBURGH COUNCIL

Report

Investment Strategy Panel Activity

Recommendations

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

1.2 That Committee notes the activities of the Investment Strategy Panel during the financial year 2015/16.

Background

2.1 The purpose of this report is to provide an update on the activity of the Investment Strategy Panel for the year to 31 March 2016.

2.2 The Investment Strategy Panel ("the Panel") currently comprises four officers:

- the Executive Director of Resources of the City of Edinburgh Council;
- the Chief Executive of Lothian Pension Fund;
- Chief Investment Officer of Lothian Pension Fund; and
- Chief Financial Officer of Lothian Pension Fund.

2.3 Three investment consultants are also members of the Investment Strategy Panel (KPMG, represented by David O'Hara, and two independent advisors, Gordon Bagot and Scott Jamieson).

2.4 The Terms of Reference for the Panel were agreed by the Pensions Committee in June 2013. A small amendment has been made reflecting the decision by Committee in December 2015 that the Panel should scrutinise the audit of foreign exchange transactions in future. The updated Terms of Reference are included as Appendix A to this paper.

Main report

3.1 The Panel meets quarterly and considers all aspects of the Fund's investments. Regular activities include reporting to and making recommendations about investment strategy to the Committee, directing and monitoring strategy implementation and risk and advising the Executive Director of Resources on investment structure and managers.

3.2 The Panel considers the appropriate investment management structure required to implement the Fund's investment strategy and on the process for the appointment and monitoring of external investment managers. In addition, it is responsible for setting objectives and restrictions for internally managed portfolios. It monitors the risk and performance of all portfolios. Panel and the internal investment team monitor all managers on a regular basis using a traffic light system to ensure that scrutiny of portfolios is robust. Performance, continuity of investment process, philosophy, people and ownership, are considered in the monitoring process. Where there are concerns over a manager, more regular and in-depth monitoring is undertaken.

3.3 The primary focus for the Panel during 2015/16 has been implementation of the investment strategies previously agreed by Committee. In addition reviews of the investment strategies for the three Funds were undertaken following the conclusion of the 2014 actuarial valuations to ensure that they remain appropriate.

3.4 Other special items have included:

- Analysis of new strategies and mandates and the impact of their inclusion on the overall funds. This year this has included the Lothian Pension Fund's emerging markets exposure and the impact of extending the internal global mandates to include emerging markets;
- Analysis and oversight of the transitions of assets;
- In-depth review of internal mandates which are subject to periodic scrutiny to assess whether they have achieved their objectives and to ensure the premise of the mandate remains sound. Panel has considered potential changes to the internal European equity portfolio, reviewed the existing US equity mandate and considered proposals from the new internal bond manager for the internal index-linked gilts;
- Cash flow projections for unlisted assets including private equity, infrastructure and timber;
- Review of members AVC investments with Standard Life and Prudential;
- Draft Statement of Investment Principles.

3.5 Panel's reviews and decisions have resulted in:

- Progress of the implementation of the pension funds' investment strategies, as detailed elsewhere on the agenda;
- Reduced number of equity mandates for Lothian Pension Fund, including higher allocation to global mandates and more assets being managed internally;
- Updated mandates for each of the investment portfolios, including objectives and controls;
- Indicative timescales for further implementation of the investment strategies.

3.6 Each year, the Panel undertakes a self-assessment to review its effectiveness. The self-assessment in June 2016 will result in some minor changes to its regular quarterly meetings to make them more efficient. A new agenda planning document has been developed – see Appendix B.

3.7 Over 2016/17, the Investment Strategy Panel will focus on:

- implementation of the strategy for the three Funds, including changes to the actual allocations at the asset class level and potential changes to the structure within asset classes;
- the potential to merge Lothian Buses Pension Fund into Lothian Pension Fund;
- scenario analysis to ensure the best possible preparedness for potentially changing investment market environments;
- continuing to scrutinise the management of the individual portfolios;
- reviewing currency hedging policy;
- continuing to explore other suitable alternative investment opportunities;
- finalising alternative funding approaches for the Scottish Homes Pension Fund.

3.8 Importantly, the focus of the Panel is the long term superior asset returns of the Funds rather than the short term vacillations of the investment markets by deploying each Fund's long term capital at an appropriate level of risk.

Measures of success

4.1 The investment performance of the pension funds is crucial to the achievement of the required investment return which impacts on the funding level and employers' contributions. The objectives for the investments are:

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

Financial impact

5.1 This report details the investment activities of the Investment Strategy Panel. The investment performance of the three Funds has a significant impact on the funding levels and potentially on the contributions required from employers.

Risk, policy, compliance and governance impact

6.1 Investment strategy is a key determinant of funding level, risk and volatility of employer contribution rates. The Funds' investment strategies are aimed at reducing the risk without sacrificing returns.

6.2 There is no governance impact as a result of this report. Committee delegates the implementation of investment strategy to the 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. In addition, active engagement with the companies in which the Fund invests should reduce risk Fund and enhance the sustainability of investment performance.

Equalities impact

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

Sustainability impact

8.1 The Statement of Investment Principles (covered elsewhere on the agenda) sets out the Funds' approach as responsible asset owners, and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with it is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

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

Background reading/external references

None

Hugh Dunn

Acting Executive Director of Resources

Contact: Bruce Miller, Chief Investment Officer

E-mail: bruce.miller@edinburgh.gov.uk | Tel: 0131 469 3866

Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed
Single Outcome Agreement	
Appendices	Appendix 1 – Updated Terms of Reference for the Investment Strategy Panel Appendix 2 – Agenda Planning for Investment Strategy Panel

Appendix 1

Investment Strategy Panel – Terms of Reference

1. Establishment

The Executive Director of Resources has established the Investment Strategy Panel ("the Panel") to advise the Pensions Committee ("Committee") of the City of Edinburgh Council ("Council") in the exercise of investment functions in relation to the pension funds administered by the Council.

2. Membership

Membership of the Panel will comprise:

- The Executive Director of Resources, who will chair the Panel. In his absence, he will appoint an alternative chair;
- The Chief Executive Officer, the Chief Investment Officer and the Chief Financial Officer of Lothian Pension Fund;
- A minimum of 2 external investment professionals.

3. Meetings

Frequency: The Panel will meet at least four times each year, normally to coincide with monitoring the pension funds over calendar quarters.

Attendees: The Panel may invite any persons to attend all or part of any meeting but such invited persons shall not have a right to vote on any matter before the Panel. By prior agreement with the Executive Director of Resources, the Convener of the Committee can attend any meeting of the Panel, although it is anticipated that attendance by the Convener will be on an infrequent basis.

Quorum: A minimum of three members is required to be present including one external investment professional.

Decisions: The Panel reaches decisions by majority vote. In the event of equal votes the Chair shall have a casting vote.

Papers: Papers are distributed to members at least one week in advance of any meeting (unless a shorter period is agreed by the Chair).

Minutes: Draft minutes are forwarded to members for agreement within ten working days and thereafter circulated to the Convener of the Pensions Committee.

4. Responsibilities

The Panel is responsible for ensuring that the pension funds are properly and effectively managed and for advising Committee on all matters relating to the investments of the pension funds.

It is responsible for:

Statement of Investment Principles

- Reviewing, and monitoring compliance with, the Statement of Investment Principles and recommending amendments to Committee.

Investment Strategy

- Recommending to the Committee the funds' investment strategies and objectives;
- Monitoring the appropriateness of the strategies on an ongoing basis;
- Identifying possible new asset classes within Alternative investments and agreeing their appropriateness for the funds;
- Determining that the level of investment-related risk taken by the funds is consistent with the investment strategy;
- Determining the appropriate timing of any changes to the investment strategies, within the parameters set by Committee;
- Monitoring adherence to the investment strategies and asset allocation ranges;
- Monitoring the performance of the funds;
- Monitoring cashflow and agreeing the approach to the allocation of cash;
- In the event of extreme investment market fluctuations, the Executive Director of Resources with the advice of the Panel may undertake investment activity outside the agreed investment strategies and asset allocation ranges subject to consultation with the Convener of the Committee and reporting of such activity to the next meeting of the Committee.
- Reviewing the audit of foreign exchange transaction costs.

Investment Structure & Managers

- Advising the Executive Director of Resources on the appropriate investment management structure required to implement the funds' investment strategies;
- Advising the Executive Director of Resources on the process for the appointment and monitoring of external investment managers;
- Setting objectives and restrictions for internally managed portfolios and monitor appropriateness;
- Monitoring the risk and performance of the funds and each portfolio and ensuring action is taken to address performance issues.

Reporting

The Panel will review its effectiveness annually.

The Director will provide a report summarising the Panel's work and the outcome of its assessment of its effectiveness annually to Committee, or more frequently as required by Committee.

5. Requirements from External Investment Professionals appointed to the Investment Strategy Panel

Provide challenge and direction to the Executive Director of Resources and the internal investment team, including:

- Providing input to the advice to the Pensions Committee on investment strategy;
- Advising the Executive Director of Resources and the internal investment team on the implementation of investment strategy;
- Scrutinising the investments of the pension funds, in particular those managed internally;
- Suggesting new investment opportunities which may be suitable for the pension funds;
- Attending meetings of the Investment Strategy Panel, usually quarterly;
- Other ad-hoc advice and services, such as training.

Investment Strategy Panel – Agenda Planning

Appendix 2

Frequency			Month
Annually	**Fund Strategy Focus**		
	Lothian Pension Fund		March
	Lothian Buses Pension Fund		September
	Scottish Homes Pension Fund		December
	Asset Class Focus – Annual Reviews		
	Index-Linked (gilts & gold)		March
	Equities (listed & unlisted)		June
	Real Assets (property, infra & timber)		September
	Currency Exposures/Hedging		September
	Fixed Income		December
	Statement of Investment Principles		June
	Investment Strategy Panel – Terms of Reference		June
	Investment Strategy Panel – Effectiveness		June
	Investment Mandates – Annual Update		June
	Audit of Foreign Exchange Transaction Costs		September
	Stewardship	Committee Report	December
	Investment Cost Benchmarking	Committee Report	December
	Investment Controls & Compliance (inc. custodian)	Committee Report	December
	AVC Monitoring		December

Frequency				Month
Quarterly	Investment Portfolio Monitoring (traffic lights) Asset/Liability Context – Investment Markets (inc Adviser Ideas/Recommendations) Investment Strategy Implementation/Funding Updates			March, June, September and December
3 Times per year	Review of Governance of Internal Portfolios by ISP member			June, Sept, Dec
Every 3 Years (minimum)	Investment Strategy Reviews			
	Actuarial Valuation (LPF/LPBF/SHPF)	Committee Report		Typically December or March
	Funding Strategy Statement	Committee Report		
	Internal Mandate Reviews	**Most recent review:**	**Review due:**	
	UK All Cap	June 2015	June 2018	March, June, September and December
	UK Mid Cap	June 2015	June 2018	
	Europe ex-UK	June 2016	June 2019	
	US	March 2016	March 2019	
	GLOVE	June 2015	June 2018	
	GHDY	March 2015	March 2018	
	GLOVAL	September 2014	September 2017	
	Index-linked Gilts	December 2015	December 2018	
	Fixed Income Assets	N/A	September 2016	
As required	Development Work Transitions			

Pensions Committee

2.00 p.m., Monday, 27 June 2016

Annual Investment Update – Lothian Pension Fund

Item number	5.8
Report number	
Executive/routine	
Wards	All

Executive summary

This report provides an update on the investments and funding position of the Lothian Pension Fund to 31 March 2016.

Following completion of the 2014 Actuarial Valuation, the Fund's Investment Strategy was reviewed. The Pensions Committee agreed in December 2015 that the Investment Strategy 2012-17 remained appropriate.

Over the twelve months to 31 March 2016, investment market returns were generally low - global equities fell modestly, index-linked gilts rose modestly but property rose over 10%. The strategy of lowering risk was rewarded over 2015/16 as the Fund produced a return of +6.5%; the benchmark return was +0.2%. Over five years, the Fund returned 9.1% per annum, ahead of benchmark by 1.9% per annum.

The Fund's actuary completed the triennial valuation during 2014 and reported that Lothian Pension Fund's funding level (the ratio of assets to liabilities) was 91.3% at 31 March 2014. Despite good growth in the Fund's investments since then, liability values have grown faster as yields have fallen. Hence, the overall funding level is expected to be lower.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Report

Annual Investment Update – Lothian Pension Fund

Recommendations

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

1.2 That the Committee notes the performance, funding update and asset allocation of the Lothian Pension Fund.

Background

2.1 The purpose of the report is to provide an update on the investments and funding position of the Lothian Pension Fund to 31 March 2016.

2.2 The investment performance of the Fund has a significant impact on the funding level and potentially on the contributions required by employers.

Main report

Market Background to 31 March 2016

3.1 UK economic growth moderated somewhat in 2015, slowing from 2.9% in 2014 to 2.4% in 2015. The recovery in the labour market continued with unemployment falling to a 10 year low of 5%. Despite this, wage growth has remained subdued, with average earnings staying around 2%. The big surprise of 2015 was inflation falling below zero as oil and other commodity prices continued their slump. Other global economies showed quite diverse growth rates. Growth in developed economies has broadly returned to levels prior to the 2007/08 global financial crisis, around 2%. Growth in emerging markets on the other hand, has reduced significantly over recent years. Brazil and Russia are in recession and growth in China has slowed markedly.

3.2 Asset markets gave relatively lacklustre but volatile returns during 2015/16. Equity market returns were mainly negative, with only the US giving a positive return to UK investors, of 5%. The UK, Eurozone and Japan all gave returns of between -2 and -10% to a UK investor. The worst performing equity markets were those of the emerging markets, with Brazil and China returning -9% and -20% respectively in Sterling terms. The UK index-linked government bond market produced a modest positive return of 2%. Property returns were strongly positive, giving a return of +11%.

3.3 A positive outlook for asset markets relies on developed markets continuing to grow and for emerging markets to recover. In the US, the Federal Reserve has felt confident enough in the growth outlook to raise interest rates by 0.25%, the first monetary tightening in 9 years. Only a very slow and gradual further increase in interest rates is expected, due to low US inflation and the weakness of the global economy. Both the European Central Bank and the Bank of Japan have continued to ease monetary policy in the face of domestic economic weakness and falling inflation. Further easing in both areas is expected in 2016. Growth expectations in the UK lie between those in the US and the Eurozone. Brexit fears have weighed on the currency and investment intentions. UK monetary policy has been unchanged for over 7 years.

3.4 The outcome of the Brexit referendum, the speed of interest rate rises in the US and the performance of emerging economies will have a major impact on global assets. Longer term, asset returns are likely to remain low as global growth, inflation and interest rates all remain subdued.

Investment Strategy and Objectives

3.5 In order to provide suitable investment strategies for the differing requirements of employers, the Fund currently operates two investment strategies.

3.6 Most employer liabilities are funded under Strategy 1, which 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.

3.7 A small number of employers are funded in Strategy 2, which invests in a portfolio of UK index-linked gilts to reduce funding level and contribution rate risk to a level appropriate to their circumstances. The liabilities funded by Strategy 2 represent less than 1% of total liabilities.

3.8 Following completion of the 2014 Actuarial Valuation, the Investment Strategy Panel reviewed the Fund's investment strategy in light of developments in pension fund membership, expected cash flow, funding level, investment risk and return and employer covenant. The Pensions Committee agreed in December 2015 that the Investment Strategy 2012-17 (previously agreed in October 2012) remained appropriate for Strategy 1. It includes Equities and Alternatives on the assumption that these assets will deliver better performance than Index-Linked Gilts in the long-term.

Investment Strategy 2012-17 (Strategy 1)

	Long term Strategy Allocation %	Permitted Range %
Equities	65	50 – 75
Index-Linked Assets	7	0 – 20
Alternatives	28	20 - 35
Cash	0	0 - 10
TOTAL	**100**	

3.9 Strategy 1 makes a small reduction in the allocation to Equities (including private equity), a reduction in risk within Equities and a small increase in the allocation to Index-Linked Gilts and Alternatives. It recognises a gradually changing risk profile for the Fund, but retains significant exposure to real investments, such as Index-Linked Gilts and Equities, which have a history of protecting or enhancing purchasing power, after the effects of inflation have been taken into account.

3.10 The Fund's investment objectives are:

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

Asset Allocation and Strategy Implementation

3.11 As described above, Strategy 2 invests in a portfolio of index-linked gilts, which has been in place notionally since 1 April 2015. A new portfolio of these gilts was created during 2015/16.

3.12 The remainder of this section of the report focuses on implementation of the Investment Strategy 2012-17 (Strategy 1). It is proceeding at a measured pace as investment opportunities become available and as research on opportunities is completed. This is reflected in the interim strategy allocation shown in the table below.

Investment Strategy 2012-17 (Strategy 1)

Asset Category	Manager	Actual Allocation 31 March 2015 %	Actual Allocation 31 March 2016 %	Interim Strategy Allocation 31 March 2015 %	Interim Strategy Allocation 31 March 2016 %
EQUITIES					
UK All Cap	Internal	2.0	2.0	2.0	2.0
UK Mid Cap	Internal	2.0	2.0	1.8	1.8
Europe (ex UK)	Internal	2.0	2.0	2.1	2.1
US	Internal	2.3	2.2	2.1	2.1
Emerging Markets	Mondrian	2.1	0.0	2.3	0.0
Emerging Markets	UBS	2.4	0.0	2.3	0.0
Global High Dividend Yield	Internal	13.3	14.2	14.3	14.3
Global Low Volatility	Internal	17.5	18.0	17.5	17.5
Global Value	Internal	6.6	15.4	6.5	15.0
Global	Cantillon	5.2	0.0	5.0	0.0
Global	Nordea	4.0	4.1	3.7	3.7
Global	Harris	4.0	3.5	3.5	3.5
Private Equity	Various	4.8	4.2	5.0	5.0
Currency Hedge	Internal	0.6	-0.2	0.0	0.0
Transition Account	Internal	0.3	0.4	0.0	0.0
Subtotal		**69.1**	**67.8**	**68.0**	**67.0**
INDEX-LINKED ASSETS					
Index-linked gilts/gold	Internal	6.1	7.0	7.0	7.0
Subtotal		**6.1**	**7.0**	**7.0**	**7.0**
ALTERNATIVES					
Property	Various	8.4	8.8	10.0	10.0
Other Real Assets [1]	Various	7.6	10.1	8.0	9.0
Other Bonds [2]	Various	2.9	3.5	6.0	6.0
Alternatives Cash	Internal	2.1	1.6	0.0	0.0
Subtotal		**21.0**	**24.0**	**24.0**	**25.0**
CASH	Internal	3.8	1.0	1.0	1.0
TOTAL FUND		**100**	**100**	**100**	**100**

The table includes small rounding effects
[1] Includes infrastructure and timber; [2] includes sovereign bonds, corporate debt and private debt.

3.13 At 31 March 2016, the Fund had a small overweight position in equities and a small underweight position in Alternatives as a result of the Other Bonds weighting, compared to the interim strategy at 31 March 2016. The table below shows the changes in actual allocation over the financial year 2015/16 and the current interim strategy allocation at end of March 2016.

Equities

3.14 A key objective of the Fund's investment strategy is to reduce risk, including risk within the equity pool of assets, and involves a shift from a regional to a global manager structure. Further steps were taken during 2015/16 in this direction with the termination of the Fund's two emerging market mandates managed by Mondrian and UBS. The decision to terminate was strategic and unrelated to the underlying performance of the portfolios. The portfolios were transitioned into the internally managed Global Value equity portfolio, which is unconstrained and is able to own the shares of emerging market companies if their characteristics meet the mandate criteria.

3.15 One other significant change was made to the equity pool of assets, also in early 2016. A key personnel change at one of the external global equity managers, Cantillon, prompted a review and the decision to terminate the mandate. Cantillon had added value over its benchmark since inception. This portfolio was also transitioned to the internally managed Global Value equity portfolio.

3.16 The activity described above follows the actions taken in recent years to fund internally managed global equity strategies to reduce investment risk. The latest evolution of the structure of the equity portfolio has lowered overall risk slightly. The resultant equity pool of assets is expected to perform relatively well when equity markets are weak and produce good positive absolute returns in rising equity markets.

a. None of the Fund’s equity portfolios are constrained by market capitalisation indices, or the tracking error measurement of risk, which is regarded as a suboptimal approach to portfolio construction. Instead the focus is capital preservation and the sustainability of income generation. The Fund’s independent performance measurer, Portfolio Evaluation, estimates that the Fund’s equity risk is now approximately 94% of the risk of the equity benchmark. This compares with 98% as at 31 March 2012.
b. The transitions described above have increased the equity assets managed by the internal team. Almost 90% of the Fund’s listed equities are managed internally with the majority of these in low cost, low turnover strategies, which are expected to enhance the Fund’s risk-adjusted returns over the long term.
c. The Fund also hedges exposures to the currencies of overseas listed equities with the explicit aim of reducing volatility rather than making a return. The Fund therefore maintains exposure to currencies that are expected to reduce volatility, such as the US Dollar and Japanese Yen which tend to fall as equities rise, and hedges exposure to currencies that are expected to increase volatility, such as the Australian Dollar which tend to rise as equities rise. The hedge achieved its objective of reducing volatility over 2015/16, but it detracted modestly from Fund return (-0.2%). The Fund did not hedge most currencies, which was very beneficial to the Fund as its largest equity related currency exposures appreciated against sterling – the US Dollar by 3%, the Euro by 9% and the Japanese Yen by 10%.
d. Given the desire to reduce risk, the decision was made in 2012 not to make further private equity investments as they tend to be more volatile investments involving greater leverage. Rather than sell the private equity holdings, it was decided to allow the allocation to reduce gradually over time as the funds matured and returned capital. The proportion invested has reduced from 4.8% to 4.2% over the year.

Index-Linked Assets

3.17 The Fund's strategy entails a small increase in index-linked assets (gilts, bonds and gold), which provides diversification, some insurance against an unexpected rise in inflation and a return broadly in line with the Fund's liabilities. The prospective long term real return is, however, very low. Over 2015/16, the allocation to index-linked gilts increased to 7.0% from 5.9% largely due to new purchases. The Fund also hired an experienced bond portfolio manager to run a new active mandate, which was reviewed and approved by Investment Strategy Panel and implemented during the year.

Alternative Investments

3.18 The Fund's strategy is to increase the actual allocation to alternative investments, which includes assets such as property, infrastructure, bond-like assets and timber, to provide greater diversification and attractive returns. Many of these investments are unlisted and increasing exposure is dependent on finding attractive opportunities. The Fund's actual allocation increased from 21% to 24% as a result of investments being made in infrastructure, timber and bond-like assets as well as the relative strength of these investments compared with equities and index-linked gilts.

- The Fund's longstanding commitment to infrastructure investing bore further fruit over 2015/16 as a strong pipeline of opportunities allowed the Fund to make a number of investments and commitments with a focus on secondary fund interests, selective primary fund commitments and co-investments alongside the Fund's existing manager/fund relationships. The investment value of the Fund's infrastructure assets increased from 6% to 8% despite strong distributions of £38million from several successful investments.
- The allocation to commercial property rose modestly over the year due to relative strength in the asset class.
- The other sub-category in Other Real Assets is timber. 2015/16 brought further opportunities to make small additions to the portfolio through secondary fund investments. The allocation rose modestly to 2.3%.
- In the Other Bond category, the actual allocation remains well below the interim strategy allocation of 6%. A considerable amount of research effort has been expended on identifying attractive investments. It remains the case, however, that opportunities to achieve the target return of 3.5% in excess of inflation without the use of leverage are few and far between. However, during the year, a further commitment was made to a private debt fund, which invests in corporate loans and promises such a return with acceptable risk. Further investments are being appraised. The backdrop of unusually low interest rates and narrow corporate credit spreads means that the pace of investment is likely to be slow unless there is a dislocation in market prices. Meantime, the Fund continues to search for investments providing diversification and secure returns.

3.19 The Fund makes commitments to unlisted investment and the timing of these can be uncertain as it depends on the manager being able to purchase assets. Details of outstanding commitments as at 31 March 2016 were as follows:

	Unfunded Commitments in Local Currency			**TOTAL**
	US$ m	**Euros m**	**£ m**	**£ m**
Private Equity	60	10	1	51
Infrastructure	14	48	23	72
Real Estate	-	2	-	1
Private Debt	-	-	10	10
Total	**75**	**60**	**34**	**133**

3.20 Implementation of the investment strategy is delegated to the Executive Director of Resources taking advice from the Investment Strategy Panel and the officers of the Fund. The Director reviews and considers the wide range of implementation options available in the market. Over recent years, the expansion of the internal team has enhanced the Fund's intellectual capital, improved the cost structure of the Fund and lead to the development and implementation of innovative and low cost investment strategies to meet the significant funding challenges faced by the pension funds. The Director will continue to focus on the best ways of achieving the required net investment returns.

Investment Performance to 31 March 2016

3.21 The Fund's performance over the last year and over the longer term timeframes is shown in the table below:

% per annum	**1 Year**	**5 Years**	**10 Years**
Lothian Pension Fund	+6.5%	+9.1%	+6.9%
Benchmark	+0.2%	+7.1%	+5.1%
Relative	***+6.2%***	***+1.9%***	***+1.8%***

3.22 The Fund's return (+6.5%) over the year was substantially ahead of the benchmark return (+0.2%) despite significant restructuring activity affecting the equity pool of assets and the index-linked gilt portfolio. The returns from the underlying asset class benchmarks over 1 and 5 years are as follows:

% per annum	**1 Year**		**5 Years**	
	Fund	Benchmark	Fund	Benchmark
Equities	+4.9%	-1.9%	+8.6%	+7.1%
Index-linked gilts	+2.8%	+2.4%	+9.3%	+10.4%
Alternatives	+10.5%	+5.1%	+9.2%	+5.9%

3.23 The direction of the Fund's performance when markets are increasing and decreasing is one way of measuring the volatility. It has been a relatively short time since the lower volatility objective and strategy was put in place and markets volatility has been relatively benign. Nevertheless, performance over the last 3 years does indicate that the Fund is delivering lower volatility. Fund performance over the last 3 years was:

- better than the strategic allocation when markets fell (12 out of 36 months) with average performance of 0.67% better than the strategic benchmark and;
- marginally better than the strategic allocation when markets were rising (24 out of 36 months) with average performance 0.05% better than the strategic benchmark.

3.24 The structure of the equity pool of assets and the currency hedge were helpful in achieving this outcome of lower volatility. The Fund hedges exposure to overseas equities where hedging is expected to reduce Fund risk and does not hedge exposure where hedging is expected to magnify Fund risk. Over 2015/16, the impact of currency hedging on overseas equities exposure was in line with the strategy – although it generated a small negative return (0.2%), it succeeded in reducing Fund risk (volatility), which is its primary purpose. The negative return occurred because the Fund had two small hedges and sterling was notably weak over the year against most currencies.

3.25 Over 2015/16, asset allocation differences with the benchmark had a minor impact, detracting 0.2% from relative returns. The only significant effect came from the underweight in Alternatives – the underweight reflected the pace of building the portfolio of private market assets up to the strategy weight. The return of the Alternatives RPI-related benchmark was 5.1%, which was better than the 2.4% return of the Index-Linked Asset benchmark and the 1.8% decline in the Equity benchmark.

3.26 The asset allocation effect was overwhelmed by the very positive stock selection effect, which added 6.4% to relative performance. Notable performance within each asset class was as follows:

- The Fund's Equity investments, managed by the internal team and several external managers, combined to produce an exceptional return of 5.8% over the year, 7.7% ahead of the benchmark led by the global lower volatility portfolios and the internal UK Mid Cap. Private equity returned 19.4% over the year as existing holdings returned capital typically in excess of previously estimated valuations.
- The Fund's Index-Linked investments delivered a return of 2.7% over the year as real yields on index-linked gilts changed little over the 12 month period while the Fund's small gold holding rose 7% in sterling terms by virtue of being priced in US dollars.
- The Fund's Alternative investment performance was 10.5% over the year. Within Alternatives, both the unlisted infrastructure portfolio and the property portfolio returned double digit growth of 20% and 10% respectively. In contrast, bond-related assets returned only 2.7% from conventional sovereign bonds and private debt investments.

3.27 The benchmark shown in the table above comprises equity, index-linked gilt and cash indices as well as an inflation-linked index for the Alternatives allocation. The strong relative returns over one year reflect much better returns for equities than the market capitalisation weighted benchmark and much better returns for Alternatives than the inflation-linked index.

3.28 Returns relative to the benchmark over a one year period need to be placed in the context that there are no ideal benchmarks for many of the assets held in the Fund, especially the Alternatives. The true value and returns on the unlisted investments in the Alternatives portfolio will not be known until assets are realised, perhaps not for several years. Investments are made in Alternative asset classes due to the attractive expected long-term returns and the diversification they provide. Committee should expect returns to deviate meaningfully from the benchmark over shorter time periods. The Investment Strategy Panel assesses the underlying risks of the portfolios that make up the asset allocation to ensure that these are consistent with the long term objectives of the Fund.

Scrutiny & Transparency of Investments

3.29 Details of the Lothian Pension Fund's investments are reported regularly, both in Committee reports and in the Report & Accounts, both of which are publicly available. The Fund is also subject to regular Freedom of Information requests to which it responds promptly. A complete list of holdings is also made available on the Fund's website.

Funding Level Update and 2017 Actuarial Valuation

3.30 The funding level is the ratio of the pension scheme's assets to liabilities. At the last actuarial valuation at end March 2014, the funding level was 91.3%. The key financial assumptions included in the actuarial valuation were:

- the return which will be generated by the assets i.e. the rate used to discount the liabilities. This was 3.5% on the gilts basis and 5.0% p.a. on the ongoing basis and;
- the rate at which pension liabilities increase, the Consumer Price Index (assumed to be 2.7%p.a., the market's expectation for Retail Price Index less 0.8%).

3.31 The table below compares these assumptions with the actual experience of the Fund in the two years since the actuarial valuation.

	2014/15 %	**2015/16 %**	**Two years 2014-2016 % p.a.**	**Assumed % p.a.**
Pension Increase[1]	+1.2	-0.1	+0.7	+2.7
Investment Return – Strategy 1	+15.1	+6.5	+10.8	+5.0
Investment Return – Strategy 2	+15.1	+2.4	+8.8	+3.5

[1] CPI applied to pensions in April 2015 and 2016

3.32 Inflation has been lower than expected and investment returns for both strategies have been in excess of that assumed. These would be expected to increase the funding level.

3.33 The following table shows the current market-based assumptions at 20 May 2016 (as if the Actuary was undertaking a valuation now) and compares them with the market-based assumptions at the 2014 actuarial valuation.

	31 March 2014 %	**Current [1] %**	**Change %**
Pension Increase	2.7	2.3	-0.4
Investment Return – Strategy 1	5.0	3.7	-1.3
Investment Return – Strategy 2	3.5	2.2	-1.3

[1] As at 20 May 2016

3.34 The net discount rate used to value the liabilities has fallen by 0.9% (i.e. 1.3% - 0.4%) since 31 March 2014. This is expected to have increased the value of the liabilities by approximately 15-18%.

3.35 In summary, despite good growth in the Fund's investments since March 2014, liability values have grown faster as yields have fallen. Hence, the overall funding level is expected to be lower.

3.36 A preparatory meeting has been held with the Actuary ahead of the 2017 actuarial valuation. Committee will recall the Contribution Stability Mechanism put in place for large, financially secure employers ahead of the 2014 actuarial valuation. The Mechanism set unchanged contribution rates for 2015-2018 for these employers and provided an indication of rates for 2018-2021 limiting the annual increases and decreases. For most employers, this was an increase of 0.5% per annum from April 2018 onwards. Before the end of 2016, work will be undertaken with the Actuary to review the sustainability of the Contribution Stability Mechanism and other key assumptions for the 2017 actuarial valuation. A report on the review will be provided to the Pensions Committee.

Conclusion

3.37 Implementation of Investment Strategy 1 has progressed steadily over the last twelve months. Three external equity portfolios were transitioned to an internal global equity portfolio targeting improved risk-adjusted returns; exposure to index-linked gilts was increased and a new active mandate reviewed and approved; the allocation to the other bonds portfolio was increased through a private debt commitment; and a strong pipeline of real asset opportunities in both infrastructure and timber were converted into investments. Strategy 2 is invested in a portfolio of index-linked gilts to minimise funding risk.

3.38 The absolute performance of Lothian Pension Fund over the twelve month period was 6.5%. Five year performance is 9.1% per annum. Over ten years, the Fund returned 6.9% per annum.

3.39 The context for the one year mid-single digit return for the Fund was a period of generally weak investment markets with the Fund’s largest asset class, equities falling. The Fund’s equity investments provided protection in falling markets and Alternative investments provided strong performance over the year.

3.40 At the 2014 triennial actuarial valuation, the funding level at 31 March 2014 was 91.3%. Despite good growth in the Fund’s investments since March 2014, liability values have grown faster as yields have fallen. Hence, the overall funding level is expected to be lower.

3.41 The Investment Strategy Panel and internal team continue to focus on implementation of the two investment strategies with a focus on increasing the allocation to alternative investments in Strategy 1 where possible and on researching and funding complementary strategies.

Measures of success

4.1 The investment performance of the Lothian Pension Fund is crucial to the achievement of the required investment return which impacts on the funding level and employers’ contributions. The objectives for the investments are:

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

Financial impact

5.1 The report details the investment performance of the Lothian Pension Fund. The investment performance has a significant impact on the funding levels and potentially on the contributions required from employers.

Risk, policy, compliance and governance impact

6.1 Investment strategy is a key determinant of funding level, risk and volatility of employer contribution rates. The Funds' investment strategies are aimed at reducing the risk without sacrificing returns.

6.2 There is no governance impact as a result of this report. Committee delegates the implementation of investment strategy to the 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. In addition, active engagement with the companies in which the Fund invests should reduce risk and enhance the sustainability of investment performance.

Equalities impact

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

Sustainability impact

8.1 The Statement of Investment Principles (covered elsewhere on the agenda) sets out the Funds' approach as responsible asset owners, and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with it is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

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

Background reading/external references

None

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Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed
Single Outcome Agreement	
Appendices	

Pensions Committee

2.00 p.m., Monday, 27 June 2016

Annual Investment Update – Lothian Buses Pension Fund

Item number	5.9
Report number	
Executive/routine	
Wards	All

Executive summary

This report provides an update on the investments and funding position of the Lothian Buses Pension Fund to 31 March 2016.

As planned, the Fund's equity allocation was reduced over the year and allocations to index-linked, other real and fixed income allocations increased.

Over the twelve months to 31 March 2016, investment market returns were generally low – global equities fell modestly, index-linked gilts rose modestly and property rose over 10%. The Fund produced a return of 3.1% over the year, ahead of the benchmark return of 1.2%. Over five years, the Fund returned 9.6% per annum, ahead of benchmark by 1.8% per annum.

Despite good growth in the Fund's investments since March 2014 (the most recent actuarial valuation), liability values have grown faster as yields have fallen. Hence, the overall funding level is expected to have fallen.

The Fund's Investment Strategy was reviewed over the year and in March 2016 the Pensions Committee agreed a revised Investment Strategy for 2016-21 reflecting the increasing maturity of the scheme, which is closed to new members.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

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Report

Annual Investment Update – Lothian Buses Pension Fund

Recommendations

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

1.2 That the Committee notes the performance, funding update and asset allocation of the Lothian Buses Pension Fund.

Background

2.1 The purpose of the report is to provide an update on the investments and funding position of the Lothian Buses Pension Fund to 31 March 2016.

2.2 The investment performance of the Fund has a significant impact on the funding level and potentially on the contributions required by the employer, Lothian Buses plc.

Main report

Investment Strategy Implementation

3.1 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 2012-17 was agreed by Committee in October 2012.

3.2 The Fund's investment objectives are:

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

3.3 The implementation of the strategy progressed over the financial year 2015/16 as investment opportunities became available and as research on opportunities was completed. Progress involved the interim strategy allocation and the actual asset allocation changing gradually over time.

3.4 The changes to the interim strategy allocations and actual allocations over the financial year 2015/16 are shown in the table below.

Asset Category	Manager	Actual Allocation 31 March 2015 %	Actual Allocation 31 March 2016 %	Interim Strategy Allocation 31 March 2015 %	Interim Strategy Allocation 31 March 2016 %
EQUITIES					
Global High Dividend Yield	Internal	30	30		
Global Alpha	Baillie Gifford	32	29		
Private Equity	Internal	1	1		
Subtotal		**63**	**60**	**60.5**	**58.5**
INDEX-LINKED ASSETS					
Index-Linked Bonds	Baillie Gifford	7	7		
Index-Linked Gilts	Internal	4	5		
Subtotal		**11**	**12**	**12.0**	**14.0**
ALTERNATIVES					
Property	Standard Life	9	10		
Infrastructure, Timber	Internal	6	9		
Other Bonds [1]	Various	7	8		
Subtotal		**22**	**26**	**27.5**	**27.5**
CASH	Internal	**4**	**2**	**0**	**0**
TOTAL		**100**	**100**	**100**	**118**

[1] Includes corporate bonds and loans

3.5 The Investment Strategy Panel reviews asset allocation and the progress to the long term investment strategy on a quarterly basis and the internal team reviews it weekly.

3.6 At 31 March 2016, the Fund has an overweight position in equities, other real assets and cash compared to the interim strategy allocation. The Fund has an underweight position in index-linked and fixed income assets.

3.7 The main changes made over 2015/16 are described below:

- As part of the move to reduce equity exposure towards the interim strategy allocation, £7.7m was withdrawn from Baillie Gifford's equity portfolio.
- Dividend income has also been withdrawn regularly from the internally managed global equity portfolio to further aid the targeted reduction in equities.
- The allocation to index-linked gilts was increased slightly, but the pace of investment has been gradual due to the high valuations/ reflected in low real yields available in the market.
- The Fund's longstanding commitment to infrastructure investing bore further fruit over 2015/16 as a strong pipeline of opportunities allowed the Fund to make a number of investments and commitments with a focus on secondary fund interests, selective primary fund commitments and co-investments alongside the Fund's existing manager/fund relationships. The investment value of the Fund's 'Other Real assets' assets increased from 15% to 18%, a combination of new commitments and valuation uplifts offset by strong distributions from some successful investments. Several UK, European and US infrastructure investments and two global

timber investments were made amounting to £10.2m, and distributions from existing investments were £1.9m, meaning that net investment was £8.3m.

3.8 The Fund makes commitments to unlisted investments and the timing of these is uncertain as they depend on the manager being able to purchase assets. Details of outstanding commitments as at 31 March 2016 were as follows:

	Unfunded Commitments in Local Currency			**TOTAL**
	US$ m	**Euros m**	**£ m**	**£ m**
Infrastructure	-	2.7	1.7	3.9
Private Debt	-	-	0.7	0.7
Total	**-**	**2.7**	**2.5**	**4.6**

Investment Strategy Review

3.9 Following completion of the 2014 Actuarial Valuation, an in-depth review of Lothian Buses Pension Fund's investment strategy was undertaken by the Investment Strategy Panel supported by asset liability modelling from the Fund's investment adviser over 2015/16.

3.10 The review highlighted the potential impact of future funding level volatility on the company's balance sheet and contributions. In recognition of this and the increasing maturity of the scheme, Lothian Buses agreed to continue paying deficit contributions (if required) after the last active member has left the Fund. With this clarity, the Fund is able to adopt a long-term investment approach.

3.11 The Pensions Committee approved in March 2016 a revised Investment Strategy 2016-21, which is shown in the table below, together with the Fund's previous strategy:

<table>
<tr><th>Asset Class</th><th>PREVIOUS Long Term Strategy Allocation 2012-17</th><th>REVISED Long Term Strategy Allocation 2016-21</th></tr>
<tr><td>Equities [1]</td><td>55%</td><td>40%</td></tr>
<tr><td>Index-Linked Assets [2]</td><td>15%</td><td>20%</td></tr>
<tr><td>Other Real Assets [3]</td><td rowspan="2">30%</td><td>18%</td></tr>
<tr><td>Fixed Income Assets [4]</td><td>22%</td></tr>
<tr><td>Cash</td><td>0%</td><td>0%</td></tr>
<tr><td>TOTAL</td><td>100%</td><td>100%</td></tr>
</table>

[1] Includes listed & unlisted equities

[2] Includes index-linked gilts & gold

[3] Includes property, infrastructure & timber

[4] Includes corporate bonds and loans

3.12 The revised strategy reduces the long term allocation to equities (including private equity) from 55% to 40% by the end of 2021 and increases the allocation to index-linked gilts from 15% to 20% within the same timeframe.

3.13 It recognises a gradually changing risk profile for the Fund, but retains significant exposure to real investments, such as index-linked gilts and equities, which have a history of protecting or enhancing purchasing power, after the effects of inflation have been taken into account.

3.14 The Investment Strategy Panel will be reviewing the implementation of the strategy, together with a review of the potential to merge the Lothian Buses Pension Fund into Lothian Pension Fund over the summer of 2016. Updates will be provided to Committee in due course.

Investment Performance to 31 March 2016

3.15 The Fund has achieved returns in excess of the strategic allocation over the last year and over the longer term timeframes shown in the table.

% per annum	**1 Year**	**5 Years**	**10 Years**
Lothian Buses Pension Fund	+3.1	+9.6	+7.8
Benchmark	+1.2	+7.8	+6.3
Relative	***+1.9***	***+1.8***	***+1.5***

3.16 The Fund's return (+3.1%) over the year was ahead of the benchmark return (+1.2%). The five year return was 9.6% per annum and the 10 year return was 7.8% per annum.

3.17 The Fund's equity investments delivered marginally positive returns (+1.4%) against the backdrop of a falling benchmark (-1.2%) over the year. All three equity portfolios contributed positively: the internally managed Global High Yield Equity portfolio rose 2.9%; Baillie Gifford's Global Alpha portfolio was flat (but better than benchmark) and the much smaller Private Equity portfolio rose 1.6%.

3.18 The Fund's Index Linked assets gained 1.9% over the year, lagging their benchmark return of 2.1%. Following the recruitment of an experienced bond manager, a new active mandate was approved and implemented during the year. After the end of the financial year, the Baillie Gifford index-linked gilt fund was sold due to ongoing performance concerns and the proceeds were reinvested in the new internal mandate.

3.19 The Fund's Alternative assets gained 8.1% over the year, which compares with the inflation-linked benchmark return of 5.1%. Within Alternatives, returns were positive for infrastructure (+18.4%) and timber investments (+6.9%) - the double digit gain from the infrastructure portfolio was by far the largest contributor to the excess return. Property investments produced a return of almost 10% while investment grade bonds generated a disappointing zero return.

3.20 The benchmark shown in the table above comprises equity, index-linked gilt and cash indices as well as an inflation-linked index for the alternatives allocation. Returns relative to the benchmark over a one year period need to be placed in the context that there are no ideal benchmarks for many of the assets held in the Fund, especially the Alternatives. The strong relative returns over one year reflect much better returns for equities than the market capitalisation weighted benchmark and much better returns for Alternatives than the inflation-linked index. Committee should expect returns to deviate meaningfully from the benchmark over shorter time periods. The Investment Strategy Panel assesses the underlying risks of the portfolios that make up the asset allocation to ensure that these are consistent with the long term objectives of the Fund.

Funding Level

3.21 The funding level is the ratio of the pension scheme's assets to liabilities. At the last actuarial valuation at end March 2014, the funding level was 116.7% on an ongoing basis and 88.2% on a more prudent gilts basis.

3.22 The key financial assumptions included in the actuarial valuation were:

- the return which will be generated by the assets i.e. the rate used to discount the liabilities (assumed to be 5.0% p.a., based on 1.5% in excess of the return available on government bonds) and;
- the rate at which pension liabilities increase, the Consumer Price Index (assumed to be 2.7%p.a., the market's expectation for Retail Price Index less 0.8%).

3.23 The table below compares these assumptions with the actual experience of the Fund in the two years since the actuarial valuation.

	2014/15 %	**2015/16 %**	**Two years 2014-2016 %p.a.**	**Assumed %p.a.**
Pension Increase[1]	+1.2	-0.1	+0.7	+2.7
Fund Return	+16.5	+3.1	+9.8	+3.5 or +5.0

[1] CPI applied to pensions in April 2015 and 2016

3.24 Inflation has been lower than expected and investment return has been in excess of that assumed. These would be expected to increase the funding level.

3.25 The following table shows the current market-based assumptions at 20 May 2016 (as if the Actuary was undertaking a valuation now) and compares them with the market-based assumptions at the 2014 actuarial valuation.

	31 March 2014 %	Current [1] %	Change
Pension Increase	2.7	2.3	-0.4
Investment Return – Ongoing basis	5.0	3.7	-1.3
Investment Return – Gilts basis	3.5	2.2	-1.3

[1] As at 20 May 2016

3.26 The net discount rate used to value the liabilities has fallen by 0.9% (i.e. 1.3% - 0.4%) since 31 March 2014. This is expected to have increased the value of the liabilities by at least 10%.

3.27 In summary, despite good growth in the Fund's investments since March 2014, liability values have grown faster as yields have fallen. Hence, the overall funding level is expected to be lower.

Conclusion

3.28 Implementation of the Investment Strategy 2012-17 progressed over the year with a decrease in the actual allocation to equities and cash and an increase in the actual allocation to index-linked gilts and alternatives.

3.29 A revised investment strategy has been agreed for the period 2016-21 recognising the increasing maturity of the Fund, which demands a lower risk investment approach over time. Implementation will be planned over the summer together with a review of the option to merge Lothian Buses Pension Fund into Lothian Pension Fund.

3.30 The absolute performance of Lothian Buses Pension Fund over the twelve month period was +3.1%. Five year performance was +9.6% per annum. Over ten years, the Fund returned +7.8% per annum.

3.31 Despite good performance of the Fund's assets since the 2014 actuarial valuation, the reduction in gilt yields has increased the value of liabilities, leading to a reduction in the funding level.

Measures of success

4.1 The investment performance of the fund is crucial to the achievement of the required investment return which impacts on the funding level and employer contributions. The objectives for the investment are:

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

Financial impact

5.1 This report details the investment performance of the Lothian Buses Pension Fund. The investment performance has a significant impact on the funding levels and potentially on the contributions required from the employer, Lothian Buses plc.

Risk, policy, compliance and governance impact

6.1 Investment Strategy is the main determinant of funding level and volatility of employer contribution rates. The Investment Strategy is aimed at reducing the risk without sacrificing returns. There is no governance impact as a result of this report. Committee delegates the implementation of investment strategy to the Acting 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

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

Sustainability impact

8.1 The Statement of Investment Principles (covered elsewhere on the agenda) sets out the Funds' approach as responsible asset owners, and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with it is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund. The Pension Board includes a union representative from Lothian Buses.

9.2 Regular meetings are held with Lothian Buses plc to update them on the Fund and to consult on strategic issues.

Background reading/external references

None

Hugh Dunn

Acting Executive Director of Resources

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Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed
Single Outcome Agreement	
Appendices	None

Pensions Committee

2.00 p.m., Monday, 27 June 2016

Annual Investment Update – Scottish Homes Pension Fund

Item number	5.10
Report number	
Executive/routine	
Wards	All

Executive summary

Over the twelve months to 31 March 2016, the Scottish Homes Pension Fund produced a return of 1.7%. The Fund's estimated funding level (the ratio of assets to liabilities) has increased to 92.3% at 31 March 2016 from 88.8% at the last formal valuation date of 31 March 2014.

Changes to the Fund's asset allocation based on funding level progress were agreed by the Pensions Committee in December 2014. During 2015/16, there were a number of changes to asset allocation reflecting the evolution in the funding level. The equity strategic allocation was increased over the year from 27.5% to 30%.

In March 2016, the results of an investment strategy review were reported to Committee. Committee approved the recommendation that the Executive Director of Resources conclude an updated funding agreement with Scottish Government, in consultation with the Actuary, Investment Strategy Panel and Convener of the Pensions Committee. Further engagement with the Scottish Government is ongoing and progress will be reported to Pensions Committee in due course.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Report

Annual Investment Update – Scottish Homes Pension Fund

Recommendations

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

1.2 That the Committee notes the performance, funding update and asset allocation of the Scottish Homes Pension Fund.

Background

2.1 The City of Edinburgh Council took over the administration of the deferred and pensioner liabilities of Scottish Homes in July 2005. An agreement between the Scottish Government and the City of Edinburgh Council ('the Guarantee') was put in place in June 2005. The Scottish Government acts as the 'Guarantor' for the Fund liabilities.

2.2 The Guarantee and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over the time.

2.3 The investment strategy is set at the broad asset class level of equities, bonds and property, which are the key determinants of investment risk and return. The strategy changes the allocation to equities, bonds and property dependent on the development of the actuary's estimate of the funding level.

2.4 The Target Funding Level (TFL), as set out in the Guarantee, was 91.5% at 31 March 2014, the date of the last formal actuarial valuation. The actual funding level was below target at this date. Therefore Scottish Government will pay a contribution of £675,000 p.a. from April 2015 to March 2018.

2.5 The results of the review of the Scottish Homes Pension Fund investment strategy were reported to Committee in March 2016. Committee approved the recommendation that the Executive Director of Resources concludes an updated funding agreement with Scottish Government, in consultation with the Actuary, Investment Strategy Panel and Convener of the Pensions Committee. Discussions regarding potential changes to the funding agreement have been held with the Scottish Government reviewing options to change the funding approach, including an option where contributions would be determined by fund cash flows rather than funding level. Work is currently ongoing and progress will be reported to Pensions Committee in due course.

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

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

[1] TFL: Target Funding Level

2.7 The purpose of the report is to provide an update on the investment and funding position of the Scottish Homes Pension Fund to 31 March 2016.

2.8 The investment performance of the Fund has a significant impact on the funding level and potentially on the contributions required from the Scottish Government.

Main report

Investment Performance to 31 March 2016

3.1 The Fund's investment objectives agreed in December 2013 are:

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

3.2 The Fund's annualised performance over the year and longer-term periods is shown in the table below. The Fund has performed broadly in line with its benchmark over all time periods. The slight negative over the last year reflects a small overweight position in equities, which produced a negative return. The Fund's equity and bond assets are currently managed passively.

% per annum	1 Year	5 Years	10 Years
Scottish Homes Pension Fund	+1.7	+9.6	+8.6
Benchmark	+1.9	+9.6	+8.4
Relative	-0.2	0.0	0.2

3.3 Over one and five year periods, broad indices of global equities returned -1% and +8% per annum; UK fixed income gilts +3% and +7% per annum; UK index-linked gilts +1% and +7% per annum; and UK property +12% and +10% per annum.

Funding Level and Investment Strategy

3.4 The funding level is monitored regularly by the internal team using an on-line system provided by the Fund's actuary. The progression of the estimated funding level since 31 March 2014 is shown below.

Source: Hymans Robertson

3.5 The funding level at 31 March 2016 was estimated to be 92.3%, very similar to the estimate of 92.8% at 31 March 2015. The last point on the graph above is the estimate at 13 May 2016, which is 92.7%.

3.6 The actuary's estimate of the funding level affects the asset allocation of the Fund. As a result of changes to interest rates and asset prices affecting the funding level over the year to 31 March 2016, the strategic equity allocation was first decreased from 27.5% to 25% and then increased in two stages from 25% to 30%. The bond allocation adjusted in the opposite direction when these changes were made. The changes in investment strategy over 2015/16 are summarised in the table below:

	Scottish Homes Pension Fund Evolution of Strategy 2015/16			
Asset Class	**Strategy Allocation 31 March 2015 %**	**Strategy Allocation 30 April 2015 %**	**Strategy Allocation 14 Oct 2015 %**	**Strategy Allocation 15 Feb 2016 %**
Equities	27.5	25	27.5	30
Bonds	67.5	70	67.5	65
Property	5	5	5	5
TOTAL	**100**	**100**	**100**	**100**

3.7 Over the year, assets are withdrawn from the investment manager(s) to pay pensions. The amount withdrawn over 2015/16 was £6.2m.

3.8 The Fund's actual allocation to each manager and asset class at 31 March 2016 is shown in the table below, together with the strategic allocation at 31 March 2016.

Asset Class	Manager	Actual Allocation 31 March 2016 %	Strategy Allocation 31 March 2016 %
Equities			
UK	State Street	6.8	6.8
US	State Street	9.2	9.1
Europe Ex-UK	State Street	6.0	6.0
Asia Pacific	State Street	2.4	2.4
Japan	State Street	3.3	3.3
Emerging Markets	State Street	2.5	2.4
Subtotal		**30.2**	**30.0**
Bonds			
Index-linked gilts	In-house	40.3	41.0
Index-linked gilts	State Street	10.9	10.9
Fixed income gilts	State Street	13.3	13.1
Subtotal		**64.5**	**65.0**
Property			
Property	Schroders	5.3	5.0
Subtotal		**5.3**	**5.0**
Cash		0.0	0.0
TOTAL		**100.0**	**100.0**

Conclusions

3.9 The absolute performance of Scottish Homes Pension Fund is positive over the 12 month period to 31 March 2016 with a return of 1.7%. Five year performance is 9.6% per annum.

3.10 The returns for Scottish Homes Pension Fund since inception to 31 March 2016 and over the last five years are in line with the benchmark, and over one year the return is slightly behind the benchmark.

3.11 Funding levels are monitored by the Fund regularly. The estimated actual funding level has improved over the year and was 92.3% at 31 March 2016, which is broadly in-line with the current target funding level.

3.12 Work is ongoing to update the funding agreement in consultation with the Scottish Government. Progress will be reported to Committee in due course.

Measures of success

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.

4.2 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

5.1 This report details the investment performance and funding level of the Scottish Homes Pension Fund. The investment performance has a significant impact on the funding level and potentially on the contributions required from the Scottish Government.

5.2 The financial impact for the Scottish Government is a key consideration. The proposed change to the funding guarantee 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

6.1 Investment strategy is a key determinant of funding level, risk 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 Panel is an important element of the governance of the pension fund investments.

Equalities impact

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

Sustainability impact

8.1 The Statement of Investment Principles (covered elsewhere on the agenda) sets out the Funds' approach as responsible asset owners, and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with it is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

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

9.2 Regular updates are provided to Scottish Government with ongoing liaison and consultation.

Background reading/external references

None

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Acting Executive Director of Resources

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Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed
Single Outcome Agreement	
Appendices	None

Pensions Committee

2.00 p.m., Monday, 27 June 2016

Risk Management Summary

Item number	5.11
Report number	
Executive/routine	
Wards	All

Executive summary

In line with the pension funds' ongoing risk management procedures, this paper provides an overview of the risk analysis for Q1 2016/17 for consideration by the Committee.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

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Report

Risk Management Summary

Recommendations

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

1.2 We recommend the Pensions Committee notes the Quarterly Risk Overview, having regard to any points raised by the Audit Sub-committee and the Pension Board.

Background

2.1 The pension funds' risk management procedures require us to:

2.1.1 maintain a detailed operational risk register which sets out all the risks identified and assessed by the officers on an ongoing basis, the degree of risk associated in each case and our action to mitigate these risks (the "**Operational Risk Register**"); and

2.1.2 produce a summary report of the risk register for the Pensions Committee and the Pensions Audit Sub-Committee which highlights the material risks facing the pension funds and identifies any new risks/concerns and the progress being made over time by the officers in mitigating the relevant risks (the "**Quarterly Risk Overview**").

Main report

3.1 The Operational Risk Register has been issued to the conveners of the Pensions Committee and the Pensions Audit-Sub Committee and the Independent Professional Observer.

3.2 The Quarterly Risk Overview, as at 17 May 2016, is set out in the appendix to this report for consideration.

Measures of success

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

4.2 Ultimately, risk management should lead to less third party exposure, an improved financial position and have a positive impact on the reputation of the pension funds.

Financial impact

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

Risk, policy, compliance and governance impact

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

Equalities impact

7.1 None.

Sustainability impact

8.1 None.

Consultation and engagement

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

Background reading/external references

None

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Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed
Single Outcome Agreement	
Appendices	Appendix 1 – Quarterly Risk Summary, as at 17 May 2016

Appendix 1

Lothian PENSION FUND

QUARTERLY RISK OVERVIEW

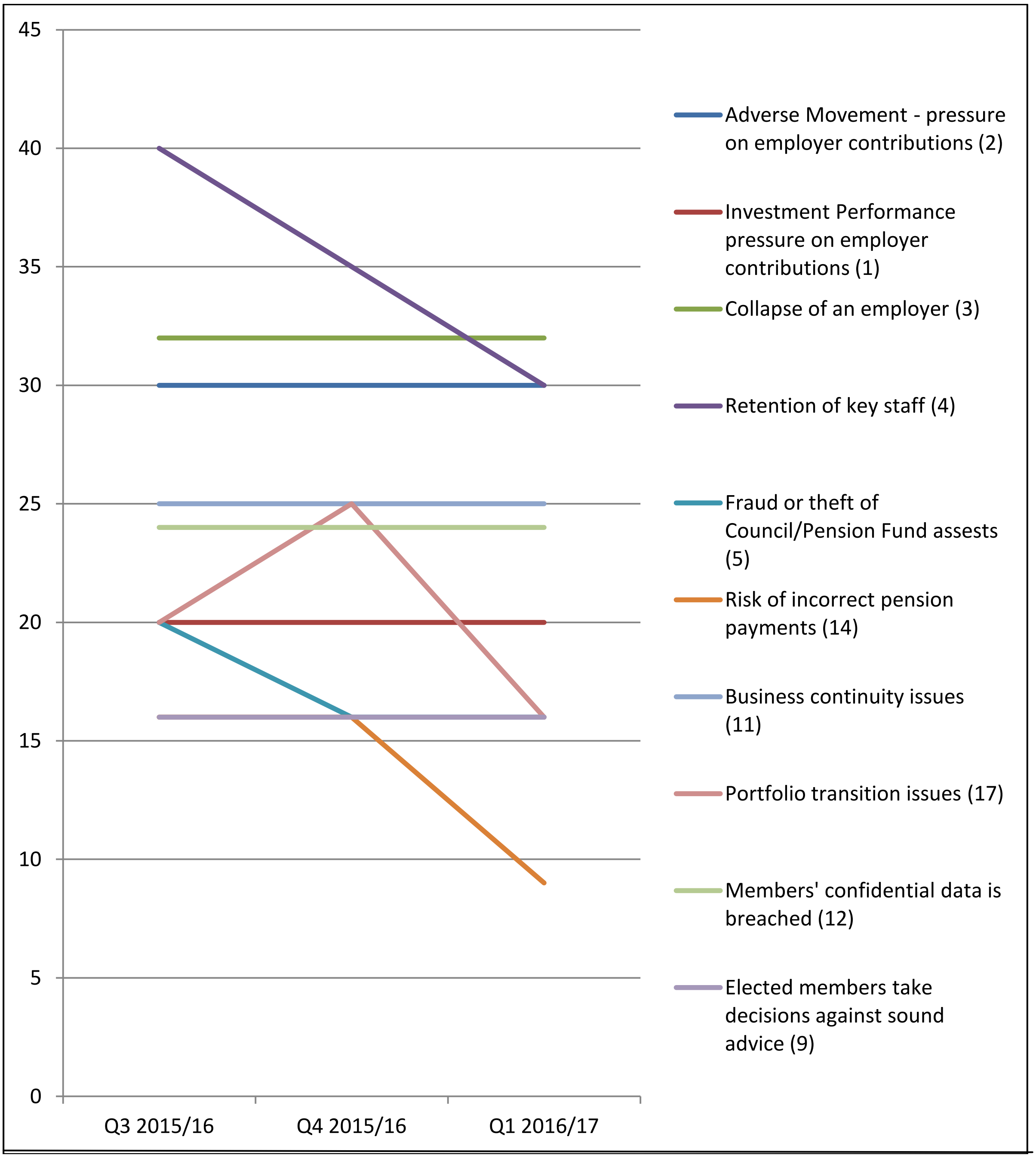
17 May 2016

UPDATE ON MOST NOTABLE RISKS

Risk & Reference Number	Update	Trend/ RAG
Adverse Investment performance leading to pressure on employer contribution (1)	Investment strategy for Lothian Pension Fund continues to be impemented. Implementation of the Lothian Buses Pension Fund strategy is being planned with the Investment Strategy Panel, together with the review of the merger of the Fund with Lothian Pension Fund.	**Static** ⬌
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions (2)	Work is ongoing, in consultation with the fund actuary, to implement the new unitisation system which will provide improved tracking of employer assets and liabilities, and different investment strategies. Other preparations are underway for the 2017 actuarial valuation including a review of the contribution stability mechnaism.	**Static** ⬌
Collapse/restructuring of an employer body leading to pressure on other employers (3)	The revised funding approach for employers close to exiting the Fund reduces the overall risk to the Fund and the other employers. 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. 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.	**Static** ⬌
Recruitment and retention of key staff (4)	This risk has reduced in recognition of introducing revised terms and conditions and bespoke HR policies and procedures appropriate for the investment business LPF is engaged in. 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.	**Decreased** ⬇

Risk & Reference Number	Update	Trend/ RAG
Regulatory Breach (20)	The Fund is continuing to monitor the changing regulatory landcape 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 & Wales. Preparations are ongoing in anticipation for the LPFI Limited's authoristaion by the Financial Conduct Authority. 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 arrangments accordingly.	**Static**
Business continuity issues (11)	The Council's transfer of IT service provision to CGI has had no impact but we await details as to the service specification in order to assess the likely impact on its core systems. The change of servers is scheduled for June and the financial system change for October 2016. 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. Preparations for the tender for pension administration software is progressing. Potential business continuity issues being considered as part of this process.	**Static**
Portfolio Transition Issues (17)	The more significant portfolio transition has been successfully completed. A summary report has been submitted to the Pensions Committee. Investment Strategy Panel has considered a detailed report.	**Decreased**
Acting out-with proper authority/delegations (23)	Sub-delegation and signing authorities to take into account the recent changes within the City of Edinburgh Council have been fully updated.	**Static**
Over-reliance on single service provider for core functions (31)	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.	**Static**
Claim or liability arising from any shared service arrangement between local authorities (27)	The Fund has engaged with Falkirk Council on its reporting and monitoring protocols to ensure that commercially sensitive information is not inappropriately disclosed.	**Decrease**

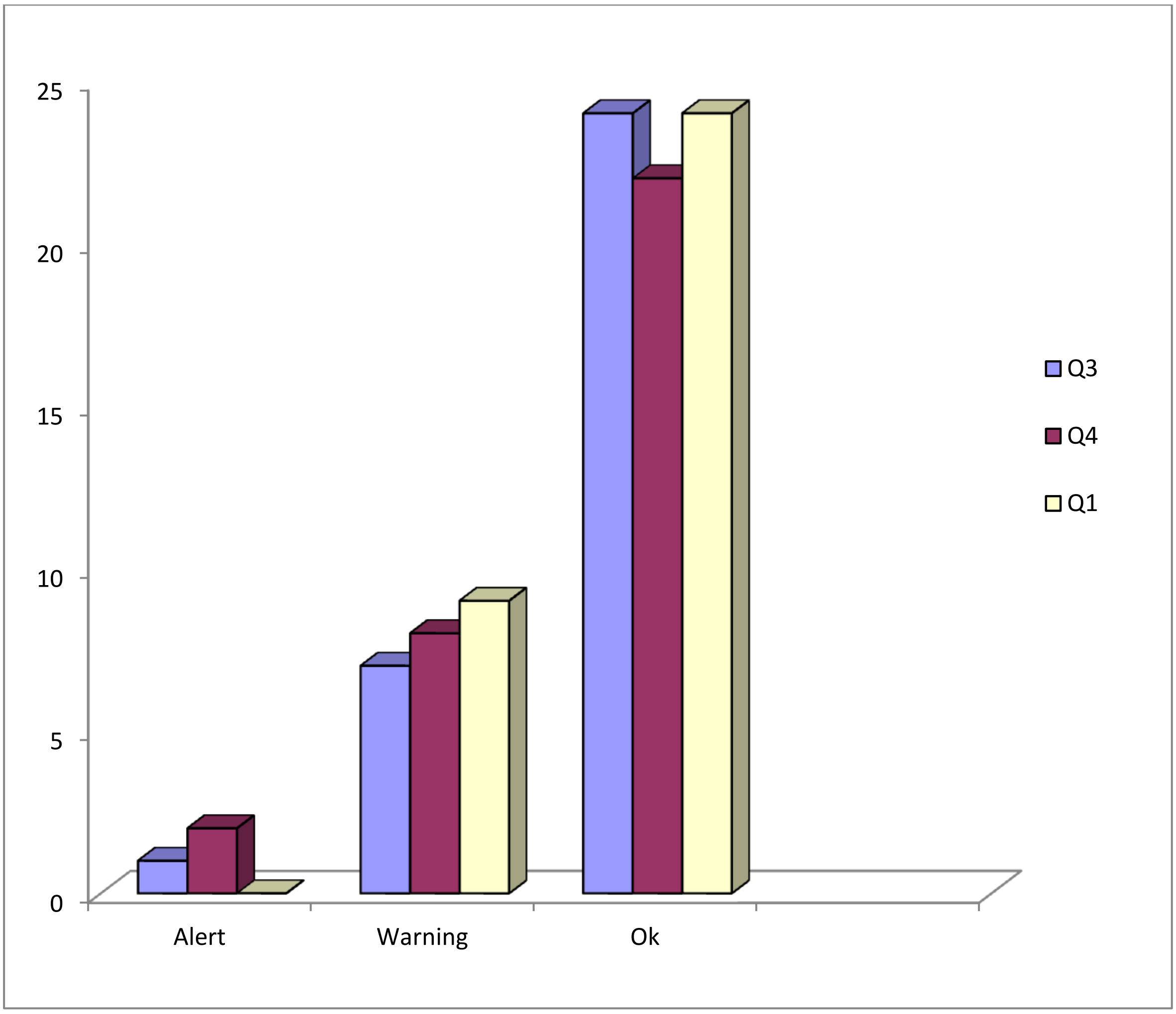
NOTABLE RISKS: PROGRESSION OF CURRENT RISK (ACCOUNTING FOR CONTROLS) IN LAST THREE QUARTERS



OTHER KEY POINTS

	Comments
New significant risks	None.
Other new risks	None.
New controls	None.
Eliminated risks	None.
Notable initiatives / actions	The Fund, in conjunction with the Investment Strategy Panel, continues to consider and monitor the potential risks surrounding market uncertainty in the lead up to and following the Brexit vote. (2) The team has visited other pension funds 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) Proactively pursuing employers for prompt delivery of membership information at year-end and monthly contribution returns in order to improve data quality and ensure benefits statements are issued before the new regulatory deadline (31 August) (29). Sub-delegations and monitoring are fully updated. (20) Recruitment of Legal & Compliance support ongoing. (32) 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)
Material Litigation	None.

All Risks: Status Overview



Q1 2016/17 All Risks: Impact and Likelihood Overview

Likelihood										
10										
9										
8				3						
7										
6					2, 4					
5					11, 20	7				
4				5, 8, 9, 17, 28, 29, 33	1, 6, 18, 19, 22, 25, 27, 32	12, 23, 30	31			
3			14	10, 24	16					
2			13							
1					21				15	
	1	2	3	4	5	6	7	8	9	10
					Impact					

Q4 2015/16 All Risks: Impact and Likelihood Overview

Likelihood \ Impact	1	2	3	4	5	6	7	8	9	10
10										
9										
8				3						
7					4					
6					2, 27					
5					11, 17, 20	7, 30				
4				5, 8, 9, 14, 28, 29, 33	1, 6, 18, 19, 22, 25, 32	12, 23	31			
3				10, 24	16					
2					13				15	
1					21					

Likelihood

Impact

Key: Risks by Number

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