Notice of meeting and agenda

Pensions Committee

2.00pm, Wednesday 28 September 2016

Dunedin Room, City Chambers, High Street, Edinburgh

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

Contact

Stuart McLean

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1. Order of business

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

2. Declaration of interests

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

3. Deputations

3.1 If any.

4. Minute

4.1 Minute of the Pensions Committee of 27 June 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 Audited Annual Report 2016 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, Annual Report by Audit Scotland - report by the Acting Executive Director of Resources (circulated)

5.5 Annual Report on LPFE Limited and LPFI Limited (circulated) - report by the Acting Executive Director of Resources (circulated)

5.6 Fiduciary Duty - report by the Acting Executive Director of Resources (circulated)

5.7 Update on Governance – report by the Acting Executive Director of Resources (circulated)

5.8 Funding Update and Preparation for 2017 Actuarial Valuation – report by the Acting Executive Director of Resources (circulated)

5.9 Employers Participating in Lothian Pension Fund – report by the Acting Executive Director of Resources (circulated)

5.10 2016 - 2018 Service Plan Update – 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.

Minutes

Pensions Committee

2.00pm, Monday 27 June 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.

1. Minutes

Decision

To approve the minute of the Pensions Committee of 15 March 2016 as a correct record.

2. Referrals and Recommendations from Pensions Audit Sub Committee

Councillor Rose advised the Committee of the discussion and decisions taken at the Pensions Audit Sub-Committee on 22 June 2016.

Decision

To note that the update.

(Minute of Pensions Audit Sub-Committee Committee 2 June 2016 (item 3)

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

Decision

To note the issues raised by the Pensions Board.

4. Agenda Planning

Details were provided of potential reports for future meetings of the Pensions Committee and Pensions Audit Sub Committee meetings in September and December 2016.

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Decision.

To note the agenda planning document.

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

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

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 was provided.

Decision

1) To 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.

2) To refer the report by the Acting Executive Director of Resources, for information, to the City of Edinburgh Council, in its role as administering authority of the Pension Funds

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

6. Scheme Advisory Board – Fiduciary Duty

Details were provided of various pieces of legal advice that would be used to develop a legal report and opinion (Opinion) that would be circulated to all 11 Funds in Scotland and would also be sent to the Scottish Government/SPPA for information.

Decision

1) To note the verbal update.

2) To note that 'Scheme Advisory Board – Fiduciary Duty' would be considered at a future meeting of the Pensions Committee.

7. Statement of Investment Principles

Details were provided on the revised Statement of Investment Principles (SIP) for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund (the Funds).

Decision

To adopt the revised Statement of Investment Principles.

(Reference – Pensions Committee 24 June 2015 (Item 1) – report by the Acting Executive Director of Resources, submitted.)

8. Investment Strategy Panel Activity

An update was provided on the activity of the Investment Strategy Panel which had focussed on the implementation of the investment strategies for the three pension funds. The Panel also oversees the performance and asset allocation of the investments.

Decision

1) To note the activities of the Investment Strategy Panel during the financial year 2015/16.

2) To review the investment strategy panel contract renewal dates with a view to staggering the process.

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

9. Annual Investment Update – Lothian Pension Fund

An update was provided on the investments and funding position of the Lothian Pension Fund to 31 March 2016. The Fund had produced a return of 6.5% over the year.

Decision

To note the performance, funding update and asset allocation of the Lothian Pension Fund

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

10. Annual investment Update – Lothian Buses Pension Fund

An update was provided on the investments and funding position of the Lothian Buses Pension Fund to 31 March 2016. The Fund had produced a return of 3.1% over the year.

Decision

To note the performance, funding update and asset allocation of the Lothian Buses Pension Fund.

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

11. Annual Investment Update – Scottish Homes Pension Fund

An update was provided on the investments and funding position of the Scottish Homes Pension Fund to 31 March 2016. The Fund had produced a return of 17% over the year.

Decision

To note the performance, funding update and asset allocation of the Scottish Homes Pension Fund.

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

12. Risk Management Summary

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

Decision

To note the Quarterly Risk Overview.

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

12. 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.

13. Actuarial valuation of employer contributions – Edinburgh World Heritage Trust

Details were provided regarding the affordability constraints faced by Edinburgh World Heritage Trust in meeting the minimum pension contributions for years 2016/17 and 2017/18.

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., Wednesday, 28 September 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 Committees.

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	

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Report

Agenda Planning

Recommendations

Committee is requested to:

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

1.2 Note 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.

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

March 2017

Pensions Committee
• Considerations and matters to be raised by the Pension Board regarding any items on the agenda • Annual plans and reports (internal and external)

- Governance Update
- Audit Sub-Committee Appointments
- Employers Participating in Lothian Pension Fund
- Service Plan Update
- Risk management summary

Future Pensions Committee and Audit Sub Committee dates:

Pensions Committee	**Pensions Audit Sub Committee**
• 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	• 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

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Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives
Single Outcome Agreement	
Appendices	Appendix 1 – 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.)	N/A	
	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., Wednesday, 28 September 2016

Audited Annual Report 2016 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, including Annual Report by Audit Scotland

Item number	5.4
Report number	
Executive/routine	
Wards	All

Executive summary

The unaudited Annual Report for the year ended 31 March 2016 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund has now been considered by the external auditor, Audit Scotland.

International Standard on Auditing (ISA) 260 requires the external auditor to communicate his findings to those charged with governance of the Funds. Accordingly, the "Audit Scotland 2015/16 annual audit report to Members and the Controller of Audit" is included at Appendix 1.

The review of the unaudited financial statements concluded that no numerical adjustments were required. Some presentational changes have been reflected in the full revised report at Appendix 2 – "Audited Annual Report 2016 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund".

Audit Scotland has provided an unqualified opinion that the financial statements give a true and fair view of the transactions of the funds during the year ended 31 March 2016, and of the amount and disposition at that date of their assets and liabilities.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

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Report

Audited Annual Report 2016 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, including Annual Report by Audit Scotland

Recommendations

Committee is requested to:

1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider;

1.2 Highlight any points that it would like to raise at the Pensions Committee on 28 September 2016;

1.3 Note the "Audit Scotland 2015/16 annual audit report to Members and the Controller of Audit" (at Appendix 1);

1.4 Approve the audited 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 (at Appendix 2).

1.5 Instruct the Committee Clerk to communicate, to the Chartered Institute of Public Finance and Accountancy (CIPFA), Audit Scotland and the Scheme Advisory Board (of the Local Government Pension Scheme in Scotland), the Committee's and Convenor's disquiet with the relaxation of the principle of full cost transparency of investment management fees, as explicit in CIPFA's revised guidance "Accounting for Local Government Pension Scheme Management Costs", dated March 2016.

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

Background

ISA 260 annual report by Audit Scotland

2.1 Under statutory accounting guidance issued by the Scottish Government, Administering Authorities are required to issue a separate Annual Report covering the Local Government Pension Scheme (LGPS) funds that they are responsible for. These Annual Reports are subject to a separate external audit.

2.2 International Standard on Auditing (UK and Ireland) 260 (ISA 260) requires the External Auditor to communicate his findings to those charged with governance of the Funds. This summarises any matters arising from the audit of the financial statements prior to the formal signing of the independent auditor's report.

2.3 As part of the standard, the External Auditor is required to provide his view of the following:

- Any significant qualitative aspects within the Funds' accounting practice;
- Any significant difficulties encountered during the audit;
- Any material weakness in the design, implementation or operating effectiveness of the system of internal control;
- Any significant matters arising from the audit discussed with management;
- Any representations that have been requested from management; and
- Any other matter that is significant.

2.4 Pensions Committee noted the Unaudited Annual Report 2016 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund at its meeting on 27 June 2016, with the Council noting this same report at its meeting on 30 June 2016.

2.5 As reported to Pensions Committee on 27 June 2016;

"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.......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". 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."

Main report

Audit Scotland 2015/16 annual audit report to Members and the Controller of Audit

3.1 The report by the external auditor on the financial statements is included at Appendix 1 – "Audit Scotland 2015/16 annual audit report to Members and the Controller of Audit", together with accompanying letter from David McConnell, MA CPFA, Assistant Director, Audit Scotland.

3.2 This report will be presented to Committee by Stephen O'Hagan, Senior Audit Manager, Audit Scotland.

3.3 "Significant findings from the audit in accordance with ISA260" at Table 1, Page 9 of the annual audit report details two issues identified. The first finding refers to “Investment management fees” and specifically that “Officers require to consider the new CIPFA guidance on how best to reflect the investment management fees within the financial statements going forward”. This point is included in the report’s “Appendix III, Action Plan No.1”.

3.4 The Chief Executive Officer, Lothian Pension Fund, has responded to this point. “CIPFA’s guidance quotes the Government’s criteria for the pooling of LGPS assets as follows: “To really drive savings within the Scheme, it is essential that these hidden costs are better understood and reported as transparently as possible. Although many of these costs are not paid out in cash, they do erode the value and so should also be scrutinised and the opportunities for savings explored.” The Funds believe that CIPFA’s revised guidance is inconsistent with the aim of transparency. The Pensions Committee, at its meeting on 28 September 2016 will be “recommended to instruct the Committee Clerk to communicate its disquiet, and that of the Convenor, on this matter not only to CIPFA, but also both to Audit Scotland and the Scheme Advisory Board (of the Local Government Pension Scheme in Scotland).”

3.5 The second “finding from the audit in accordance with ISA260” refers to the annual reconciliation of employee contributions receivable, “comparing the expected amount ....to the actual amounts received.” Reconciliation has been attained to within acceptable tolerance (0.3% of the contributions receivable from the seven largest employers). Audit Scotland has concluded that “this is not material and no further action is required”.

3.6 In addition to members of the Pensions Committee and Pensions Audit Sub-Committee, Audit Scotland has also sent the report to the Controller of Audit and has advised that the report will be published on its web-site in due course.

Audited Annual Report 2016 for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund

3.7 With the completion of the work by Audit Scotland, the Audited Annual Report 2016 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund has been finalised and is included at Appendix 2.

3.8 No numerical adjustments were required to be made on the unaudited financial statements following the Fund’s audit. Some minor presentational changes have also been incorporated.

3.9 Audit Scotland has provided an unqualified opinion that the financial statements give a true and fair view of the transactions of the funds during the year ended 31 March 2016, and of the amount and disposition at that date of their assets and liabilities.

CIPFA guidance “Accounting for Local Government Pension Scheme Management Costs”, revised March 2016, and its implications for transparency of investment costs

3.10 Committee is reminded of the relaxation to the principle of full cost disclosure of investment management fees, specifically in relation to complex external Fund of Fund arrangements, which has been explicitly reflected by CIPFA in its revised accounting guidance.

3.11 This is considered to be a retrograde step, and one which may have significant and unintended consequences in rendering comparability and public accountability of investment performance across the sphere of local government pension funds much more opaque.

3.12 Accordingly, Committee is recommended to instruct the Committee Clerk to communicate its disquiet, and that of the Convenor, on this matter not only to CIPFA, but also both to Audit Scotland and the Scheme Advisory Board (of the Local Government Pension Scheme in Scotland).

Measures of success

4.1 The prime objective of the Council, as administering authority of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, is to ensure an unqualified audit opinion of the Annual Report 2016. This has been achieved.

4.2 Planned management action in relation to the point raised by Audit Scotland is stated at Appendix 1 (Appendix III, Page 28 of that report).

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 financial statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 and also in compliance with the requirements of the Local Government Scotland Act 1973.

6.2 The annual report summarises the opinions and conclusions of Audit Scotland, in accordance with International Standards on Auditing (UK and Ireland) and the principles contained in the Code of Practice issued by Audit Scotland in May 2011. Appendix I (of the Audit Scotland report sets out the significant audit risks identified at the planning stage and how the auditor addressed each risk in arriving at his opinion on the financial statements. Appendix III is an action plan setting out the high level risks identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action / response".

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

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Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives
Single Outcome Agreement	
Appendices	Appendix 1 – Audit Scotland 2015/16 annual audit report to Members and the Controller of Audit, in accordance with International Standard on Auditing (UK and Ireland) 260 (ISA 260) Appendix 2 - Audited Annual Report 2016 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund

Lothian Pension Fund

2015/16 Annual audit report to Members and the Controller of Audit

September 2016

Key contacts

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

The Accounts Commission has appointed David McConnell as the external auditor of Lothian Pension Funds for the period 2011/12 to 2015/16. This report has been prepared for the use of City of Edinburgh Council as Lothian Pension Funds administrator and no responsibility to any member or officer in their individual capacity or any third party is accepted.

The information in this report may be used for the Accounts Commission's annual overview report on local authority audits published on its website and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

Contents

Key messages

Audit of financial statements	• An unqualified auditor's report was issued on the 2015/16 financial statements of Lothian pension, Buses and Scottish Homes Funds. • No adjustments were required to the Funds' financial statements.
Financial management and sustainability	• Lothian Pension and Lothian Buses Funds' net assets increased by 6.4% to £5,434 million and 2.2% to £394.4 million, respectively, at 31 March 2016. Scottish Homes Pension Fund net assets decreased by 2.9% to £150.3 million at 31 March 2016. • The Lothian Pension Fund currently receives more in contributions from employers and members than it pays in benefits to pensioners. The Lothian Buses and Scottish Homes Pension Funds receive less in contributions from employers and members than it pays in benefits to pensioners. • This is the first year of LPFE being operational and has resulted in consolidated financial statements of LPF. • Overall, satisfactory financial management arrangements are in place.
Governance and transparency	• Arrangements for the prevention and detection of fraud and corruption are satisfactory. • New governance arrangements have operated effectively during 2015/16 with the Pensions Committee and Pension Board meeting concurrently. • Appropriate systems of control were in place in 2015/16. • Training of councillors and board members continues to be important to effective governance going forward and a training programme is in place.

Best Value

- The Funds’ returns on investments for the 2015/16 financial year have met or exceeded relevant benchmarks.
- The Lothian Pension, Lothian Buses and Scottish Homes Funds have a ratio of management expenses to net assets (total expense ratio) of 0.66%, 0.45% and 0.15% respectively which compares well with other funds.

Outlook

- The global investment outlook remains volatile due to political and economic challenges including Brexit, a slowdown in the Chinese economy, weak growth in the Eurozone, recession in emerging markets and uncertainty about further interest rate rises in the USA.
- Scrutiny of investment performance and scheme management costs is likely to come under increasing scrutiny and Scottish Ministers have already expressed an interest in the views of the national scheme advisory board on fund structure and asset pooling. The Scheme advisory board have convened a working group with a view to producing an options paper in December.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Lothian Pension Funds (the Funds). The report is divided into sections which reflect our public sector audit model.
2. The management of the Funds is responsible for:
   - preparing financial statements which give a true and fair view
   - implementing appropriate internal control systems
   - putting in place proper arrangements for the conduct of its affairs
   - ensuring that the financial position is soundly based.
3. Our responsibility, as the external auditor of the Funds, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements; this does not relieve management of their responsibility for the preparation of financial statements which give a true and fair view.
5. **Appendix I** lists the audit risks that we identified in the annual audit plan we issued in March 2016. It also summarises the assurances provided by management to demonstrate that risks are being addressed as well as the conclusions of our audit work.
6. **Appendix II** is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that the Funds understands its risks and has arrangements in place to manage these risks. The Pension Committee and senior management should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.
7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
8. 2015/16 is the final year of the current five year audit appointment. From 2016/17 the auditor of the Funds will be Scott Moncrieff. In accordance with agreed protocols and International Standards on Auditing we will be liaising with the incoming auditors as part of this transition.
9. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

Audit of the 2015/16 financial statements

Audit opinion	• We have completed our audit and issued an unqualified independent auditor's report.
Going concern	• The financial statements of the Lothian Pension, Lothian Buses and Scottish Homes Funds have been prepared on the going concern basis. We are unaware of any events or conditions that may cast significant doubt on the pension funds' ability to continue as a going concern.
Annual report & other information	• We review and report other information published with the financial statements, including the management commentary, annual governance statement and governance compliance statement. We have nothing to report as a result of our review.

Submission of financial statements for audit

10. We received the unaudited financial statements on 10 June 2016, in accordance with the agreed timetable. The working papers were of a good standard and pension fund staff provided good support to the audit team which assisted the delivery of the audit to deadline.

Overview of the scope of the audit of the financial statements

11. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Pension Committee on 15 March 2016.

12. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2015/16 agreed fee for the audit was set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

13. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements and consequently had the greatest effect on the audit strategy, resources and effort.

14. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance. Appendix I sets out the significant audit risks identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

15. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

16. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, an item contrary to law).

17. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

18. We summarised our approach to materiality in our Annual Audit Plan and set materiality at 0.5% of net assets and 1% of total contributions received for each separate Fund. We set a lower level, known as performance materiality, when defining our audit procedures. Based on the unaudited financial statements, we revised our materiality for 2015/16 as illustrated at **Exhibit 1**.

Exhibit 1: Materiality levels.

Financial statements	Materiality £000s	Performance Materiality £000s
Lothian Pension Fund		
Net assets	27,170	20,380
Fund account	2,055	1,540
Reporting threshold - £100k		
Lothian Buses Pension Fund		
Net assets	1,970	1,480
Fund account	95	70
Reporting threshold - £15k		
Scottish Homes Pension Fund		
Net assets	750	565
Fund account	7	5
Reporting threshold - £1k		

Source: Lothian Pension Funds audited financial statements 2015/16

Evaluation of misstatements

19. There were no misstatements identified during the audit which exceeded our misstatement threshold. Therefore, no amendments have been made to the financial statements which impact upon either the net returns on investments for the year or the net assets position at 31 March 2016.

20. A number of presentational issues were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited financial statements.

Significant findings from the audit

21. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit, including:
    - The auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures.
    - Significant difficulties encountered during the audit.
    - Significant matters arising from the audit that were discussed, or subject to correspondence with management.
    - Written representations requested by the auditor.
    - Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

22. **Table 1** below details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

Table 1: Significant findings from the audit

Significant findings from the audit in accordance with ISA260

Investment management fees: The Funds' officers have previously worked closely with CIPFA on the development of guidance on accounting for pension scheme management costs. CIPFA introduced guidance to increase transparency of investment costs relevant to fund of funds and for 2015/16, LPF has continued to identify fund of funds transactions. However, during 2015/16 further guidance has been released which indicates that the Funds should only report direct costs. Going forward, officers have indicated that they plan to continue to provide this detailed analysis as they feel that it is fully transparent for investment costs.

Officers require to consider the new CIPFA guidance on how best to reflect the investment management fees within the financial statements going forward.

See Action Plan No.1

Contributions Received: Officers compile an annual reconciliation of the employee contributions received from the seven largest employers of the Lothian Pension Fund, comparing the expected amount per the pension administration system to the actual amounts received. As at 7 September 2016, the reconciliation indicated that contributions received were £0.113m more than anticipated within the Pension administration system. This equates to 0.3% of the contributions receivable by the fund for the seven employers.

Solution

Officers have confirmed that these should represent valid contributions and the reconciliation differences arose due to delays in the notification of the entry of new members to the scheme. We have concluded that this is not material and no further action is required.

Future accounting and auditing developments

Code of Audit Practice

23. A new Code of Audit Practice will apply to all audits from financial year 2016/17. There will be a focus on four areas:

- Financial sustainability
- Financial management
- Governance and transparency; and
- Value for money

24. The new Code increases the transparency of our work by making more audit outputs available on Audit Scotland's website. In addition, as well as the annual audit report, other significant outputs, such as the annual audit plan, will be published on Audit Scotland's website. This is irrespective of whether the body meets in public or makes documents such as Audit Committee papers routinely available on its own website.

Code of Practice on Local Authority Accounting

25. The financial statements of pension funds are prepared in accordance with the Code of Practice on Local Authority Accounting in the UK (the Code) which interprets and adapts International Financial Reporting Standards (IFRS) to the local authority context.

26. From 2016/17, the following changes to the code will apply:

- Amendments to the format of the accounts to be consistent with the new Financial Reports of Pension Schemes – A Statement of Recommended Practice 2015.
- New disclosure requirements for investments measured at fair value.
- Recommendations for a new disclosure on investment management transaction costs.

Financial management and sustainability – Lothian Pension Fund

Net Assets	Contributions vs benefits	Investment performance
Increase in net assets £327.8m 6.4%	Contributions received £205.5m	6.5% Return on investments 2015-16
Closing net assets £5,434m	Benefits paid £194m	9.5% Return on investments over 5 years

Financial management

27. In this section we comment on the pension fund's financial outcomes and assess financial management arrangements.

28. Pension fund finances are independently assessed every three years by the fund actuary. This assessment determines the employer contribution rates and deficit funding payments for the upcoming 3 year period and takes account of the strength of employer covenants and the fund's investment strategy.

29. Setting the fund's investment strategy and monitoring performance against it is a key part of financial management. Investment strategy is a complex area and has to take account of factors such as the overall fund deficit, cash flows from dealing with members and the maturity of fund membership. Balancing the risks and rewards from various asset types and approaches is something that the fund takes advice on from professional advisors.

30. The strategy of lowering risk was rewarded over 2015/16 as the Funds' produced the following returns compared to benchmark (See **Exhibit 2)**.

Exhibit 2: Investment returns compared to benchmark 2015-16

Fund	**1 year** **Return / benchmark**	**5 years** **Return / benchmark**	**10 years** **Return / benchmark**
Lothian	+6.5 % / +0.2%	+9.1% / +7.1%	+6.5% /+5.1%
Buses	+3.1% / +1.2%	+9.6% / +7.8%	+7.8% / +6.3%
Scottish Homes	+1.7% / +1.9%	+9.6% / +9.6%	+8.6% / +8.4%

Source: Lothian Pension Funds audited financial statements 2015/16

31. Getting the investment strategy right for the Funds is vitally important and often overshadows other aspects of financial management in relation to areas such as administration cost, for example. However, with financial pressures on pension funds and other employers these areas are coming under increased scrutiny.

Financial outcomes

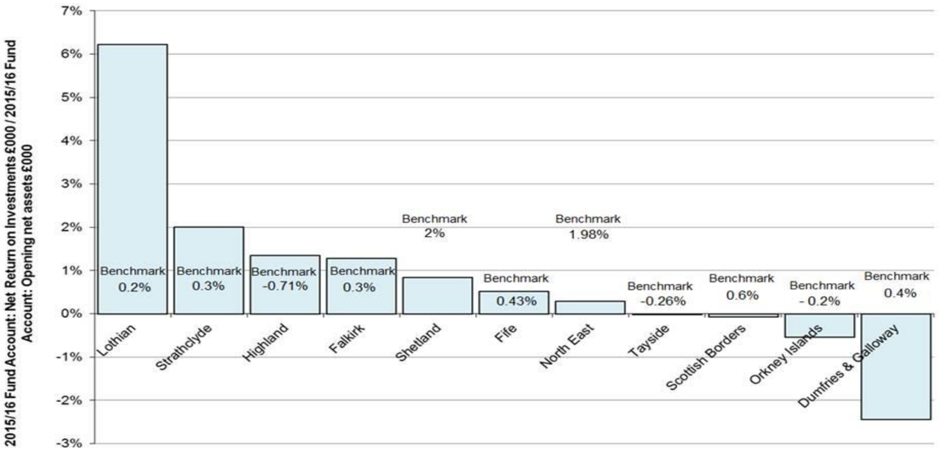
32. The Lothian Pension Fund reported an increase in net assets of £327.8 million (6.4%). This relates mainly to investment valuations, both realised and unrealised, which showed a significant increase on the year before (£5,106.2 million) and illustrates the volatility associated with investment returns. There was also a decrease of £7.9 million of net additions from dealing with members from 2014/15.

33. Lothian Buses reported an increase in net assets of £8.7 million and a decrease of £0.505 in net withdrawals from dealing with members compared to 2014/15.

34. Scottish Homes Pension Fund reported a decrease in net assets of £4.4 million and an increase of £0.206 million in net withdrawals from dealing with members compared to 2014/15.

35. Invest performance is the main constituent on movements in net assets. In terms of Investment performance, 2015-16 has not been a good year for Scottish pension funds, however, the Funds performance contrasts with the general trend noted at **Exhibit 3**.

Exhibit 3: Net return on investments 2015-16



Source: draft Scottish Pension Funds financial statements 2015/16

Financial management arrangements

36. As auditors, we need to consider whether the pension fund has established adequate financial management arrangements. We do this by considering a number of factors, including whether:

- the proper officer and fund manager have sufficient status within the council to be able to deliver good financial management
- financial regulations are comprehensive, current and adhered to
- reports monitoring performance against budgets are accurate and provided regularly to members
- monitoring reports do not just contain financial data but are linked to information about performance
- members provide a good level of challenge on significant variances and under performance.

37. We assessed the role and status of the proper officer against CIPFA's "Statement on the role of the Chief Financial Officer in Local Government" and concluded that the Funds' comply with the statement's five principles.

38. Our review noted that the proper officer (the Chief Finance Officer) has sufficient status to deliver good financial management of the Funds.

39. The Funds do not have their own financial regulations, however they comply with City of Edinburgh Council's (administering authority) financial regulations. Our review of the Council's financial regulations concluded that they are comprehensive and current. The financial regulations are available on the council's website.

40. Regular reporting on budget monitoring and investment performance updates is provided to the Pensions Committee members on a regular basis throughout the year.

41. Reports are comprehensive and we have observed a good level of review and scrutiny by board members. We have concluded that the Funds' overall financial management arrangements are satisfactory.

Financial sustainability

42. The Funds give their members a guarantee that in exchange for contributions during their employment, the fund will pay a pension until the end of each member's life.

43. There is a timing difference of many years between the receipt of contributions and the payment of pensions. Financial sustainability means that the fund maintains the capacity to meet the current and future needs of its members, despite changes of investment performance and life expectancy.

44. In assessing financial sustainability we are concerned with whether:

- the Funds liabilities are greater or smaller than the Funds' assets (the actuarial position)
- contribution rates strike an appropriate balance between the needs of the schemes and the needs of employers
- where there is a deficit, long term recovery measures are in place
- the Funds' investments have a profile of risk that is consistent with expected cash flows.

45. Effective investment strategy, investment management and regular actuarial review are crucial to sustainability.

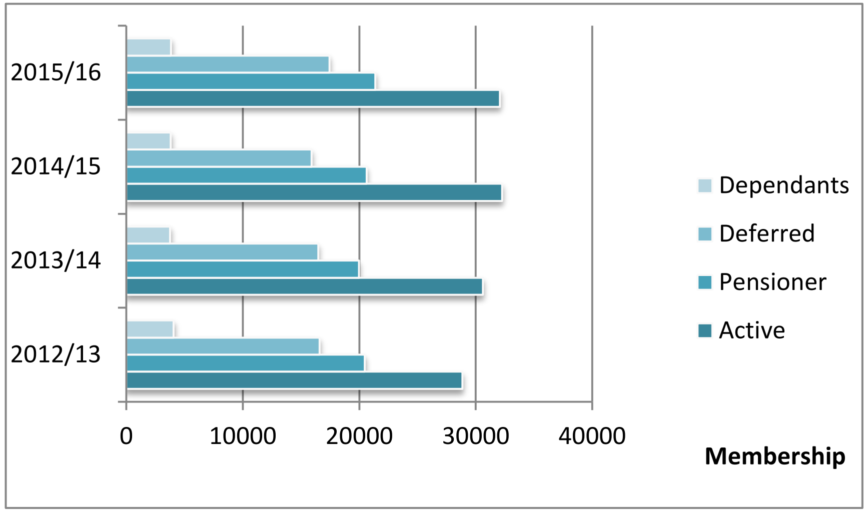
46. The Lothian Pension Fund is a multi-employer fund with schedule bodies and admitted bodies. Given the nature of these employers the funding risk associated with default is seen as relatively low and the fund currently plans to recoup deficits over a 20 year period for most of the employers liabilities.

47. The new LGPS includes a cost sharing arrangement which will cap employer costs in relation to current service and help ensure that the schemes remains affordable for employers.

48. Additionally, the retirement age for most LGPS members going forward is linked to the state retirement age and this may also act to limit scheme liabilities for active members.

49. The current membership profile is shown at **Exhibit 4**. The combined impact of active members outweighing pensioners and the set levels of contributions rates by the actuary means that contribution rates continue to exceed benefits payable.

Exhibit 4: Membership



Source: Lothian Pension Funds audited financial statements 2015/16

Exhibit 5: Employer contributions

Employer	Current service £m	Deficit funding contributions £m	Strain on the fund £m	Total £m
Lothian Pension	133.035	7.357	19.480	159.872
Lothian Buses	7.425	0	0.113	7.538
Scottish Homes	0.100	0.575	0	0.675

Source: Lothian Pension Funds audited financial statements 2015/16

50. The split of employer contributions between current service, past service and deficit funding is shown in **Exhibit 5**.

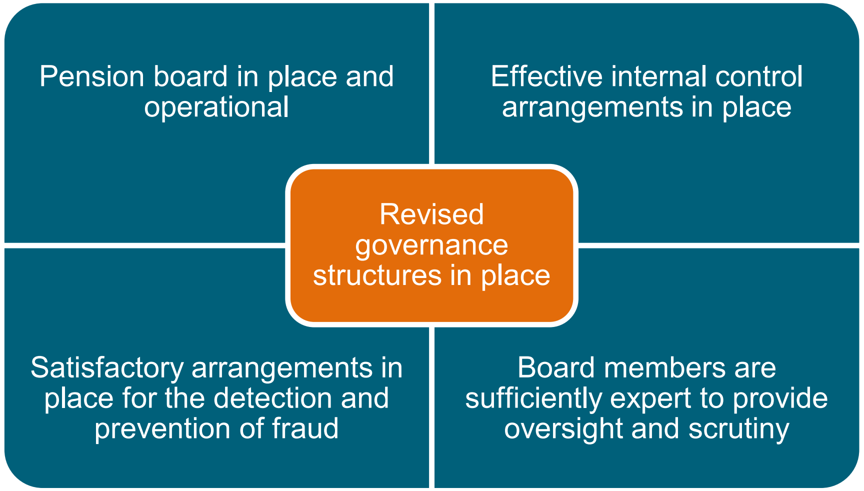
51. Contribution rates and fixed payments required to support the Funds back to its fully funded status will be re-reviewed by the Actuary following the next triennial funding valuation as at 31 March 2017.

Outlook

52. The financial outlook across the public sector and in local government in particular remains challenging. Recent revisions to the LGPS should help ensure that the scheme is affordable to employers going forward whilst the scheme remains attractive to employees.

53. It is perhaps inevitable that management costs and investment performance will come under increasing scrutiny given the financial pressures faced by employers and employees alike. As a result, pension funds may need to be more radical in their approaches to administration and investments going forward.

Governance and transparency



54. City of Edinburgh Council is the administering body for the Funds. The council has delegated responsibility for governance to the Pensions Committee.

55. Members of the Pensions Committee, supported by the pensions board, is responsible for establishing arrangements to ensuring the proper conduct of the affairs of the Funds in accordance with the law and proper standards and for monitoring the adequacy and effectiveness of these arrangements. We concluded that the council has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making.

56. As part of our work we reviewed various aspects of governance that apply to the fund including standing orders, financial regulations, Codes of Conduct for officers and members, anti-fraud and corruption arrangements, and arrangements for reporting to the Pension Regulator on breaches of regulation.

57. Members of the Funds should be able to hold the Funds to account for the services these provide. Transparency means that fund members should have access to understandable, relevant and timely information about how the fund is taking decisions and how it is using its resources.

58. Overall, we concluded that the council is open and transparent.

Governance structure

59. The corporate governance framework for the Funds is centred on the Pensions Committee which is supported by a Pensions Audit Sub-Committee. City of Edinburgh Council's Acting Executive Director of Resources has delegated authority for the implementation of the Funds' investment strategy.

60. Based on our observations and audit work our overall conclusion is that the governance arrangements within the Funds are operating effectively and are open and transparent.

Governance processes and committees

61. City of Edinburgh Council acts as the administering authority for the Funds. It is responsible for managing and administering the scheme for scheduled and admitted bodies.

62. The Council has delegated the administration, management and investment of the Funds to the Pensions Committee. The committee comprises councillors from City of Edinburgh Council and representatives from employers and members of the schemes.

63. The Public Service Pension Act 2013 introduced new governance arrangements for LGPS pension funds and from 1 April 2015, funds were required to introduce local pension boards. The remit of the Pension Board is to support the Pension Committee in compliance with regulations and with requirements imposed by the Pension Regulator. The Pension Board meets quarterly on the same cycle as the committee.

64. The Pension Board consists of five employer representatives and five union representatives. The Chair is alternated on an annual basis between the representatives. If at least half the members of the Pension Board disagree with a decision of the Pension Committee then they can request in writing that the Pension Committee review that decision. There have been no requests to review decisions in 2015/16.

65. A key aspect to the operating effectiveness of the Pensions Board is the retention of knowledge and understanding to support the role.

66. A register of training for committee members is maintained by the Funds' detailing a range of training opportunities and time spent training. Our review noted that all Pension Board and Pension Committee members undertook at least 3 days training during 2015/16.

67. As the Council is the administering authority for the Lothian Pension Funds the day to day administration of the Funds is carried out by the Investment and Pensions Division. The Chief Finance Officer has been delegated section 95 responsibility for the Funds.

Pension Regulator public service code

68. The Pension Regulator issued a code on the governance and administration of public service pension schemes in January 2015. The Funds have undertaken a high level review against the code in 2015-16 and have concluded that they are compliant in all major respects.

Investment Operations

69. The Pensions Committee and subsequently City of Edinburgh Council, agreed in October 2014 to the creation of two special purpose vehicles wholly owned and controlled by the council to be established for the purpose of seeking Financial Conduct Authority (FCA) authorisation for the activities of this team and directly employing certain key staff associated with the Funds investment function to minimise the risk of not retaining staff.

70. The employment of the internal investment team was transferred to LPFE Limited in May 2015 with revised terms and conditions of employment agreed including longer notice periods which have reduced the risk to the Funds.

71. LPFE Limited has also been established to support the investment programme of the in-house investment team by providing operational efficiencies and 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.

72. The impact of creating the special purpose vehicles in relation to the accounting treatment and presentation within the financial statements was discussed in detail with the Funds' officers during 2015/16.

73. Following accounting guidance provided by Scott-Moncrieff and Audit Scotland, it was agreed that the two companies should be consolidated into the Lothian Pension Fund with a recharge of costs to the other two pension funds,

74. Taking account of the group transactions, there is no material difference for LPF. The only key change being the retirement benefit obligation of £0.180 million within the group.

Annual Governance Statement and Governance Compliance Statement

75. The Code of Practice on local authority accounting in the United Kingdom 2014/15 has been amended to require the Funds Annual Report and Financial Statements to include both an annual governance statement and an annual compliance statement.

76. Our review of the 2015/16 Annual Governance Statement noted a positive development from previous years where it had been based primarily on the content of the council's Annual Governance Statement.

77. The governance compliance statement is designed to compare the Funds' governance arrangements against the standards set out in the guidance issued by the Scottish Ministers. We reviewed the governance compliance statement and are satisfied that it complies with the guidance issued by the Scottish Ministers.

78. The governance structures have been working well with no issues relating to openness, reporting or scrutiny. The information reported in the governance compliance statement is consistent with our knowledge and understanding of the Funds' governance arrangements, based on our audit knowledge, attendance at meetings, and review of papers and minutes.

Internal control

79. The Accounts Regulations 2014 require the Pension Committee to consider the findings of an annual review of the system of internal control and to approve the Annual Governance Statement for the Funds.

80. The Funds' financial systems are run alongside those of the City of Edinburgh Council. We obtained confirmation from the external auditors of the council that there were no significant weaknesses in the internal controls for those systems for 2015/16.

81. As part of our work we also took assurance from key controls within the Funds' financial systems. We concluded that no material weaknesses in the accounting and internal control systems were identified which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

Internal audit

82. Internal audit is an important element of the Funds governance structure. Internal audit provides the Pensions Sub-Audit Committee, Pension Committee members and management of the Funds' with independent assurance on risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where possible.

83. The internal audit service is provided by City of Edinburgh Council via a co-source arrangement with PricewaterhouseCoopers. Our review of internal audit concluded that it complies with the main requirements of the Public Sector Internal Audit Standards and has sound documentation standards and reporting procedures in place.

84. The Public Sector Internal Audit Standards require internal audit to deliver an annual internal audit opinion and report that can be used by the organisation to inform its governance statement.

85. The annual internal audit opinion should conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. It should also contain certain information, including a summary of the work that supports the opinion; a statement on conformance with the Public Sector Internal Audit Standards and the results of the quality assurance and improvement programme.

86. Internal Audit conducted three pension fund reviews during 2015/16 on immediate payments, pension compliance and externally managed investments. This work was considered in our assessment of the internal controls put in place by the Funds.

87. Internal Audit has not identified any fundamental weaknesses in the framework of governance, risk management and control. Therefore, Internal Audit provided an opinion in compliance with the above requirements, and it was presented to the Pensions Audit Sub Committee on 22 June 2016 along with other key assurance statements, as part of the consideration of the unaudited financial statements. Overall, we concluded that the internal audit service operates in accordance with Public Sector Internal Audit Standards.

Arrangements for the prevention and detection of fraud

88. The Funds comply with the relevant fraud and irregularity policies of City of Edinburgh Council and these have been reviewed as part of our audit of the Council. No issues have been identified for inclusion in this report.

Arrangements for the detection and prevention of fraud and corruption

89. Councillors and board members have received training on council policies in this area and have also considered the Pension Regulator toolkit on conflicts of interest.

90. There has been a proactive approach to the use of National Fraud Initiative data in relation to checks on deceased members' pensions. The Funds also promoted awareness of liberation fraud amongst its members.

91. The arrangements for the prevention and detection of corruption in the Funds are satisfactory and we are not aware of any specific issues that we need to record.

Transparency

92. The management commentary within the financial statements includes management's assessment of the financial performance of the fund, and the risks that are managed. It also includes indicators of administrative performance.

93. Financial monitoring reports are provided to attendees at the Pension Funds Sub-Audit Committee and Pension Board going forward. Information about the pension fund is published on the Funds' website and there is a good level of transparency around pension fund business. Overall we concluded that the Funds administration is open and transparent.

Outlook

94. The change to Career Average Related Earnings (CARE) and the introduction of new governance arrangements have been major changes for the pension fund which demand ongoing investment in terms of governance and administration. Changes to the state pension arrangements and the need for Guaranteed Minimum Pension reconciliations have also added to workloads.

95. Going forward the operation of cost sharing mechanisms may well increase levels of interest and scrutiny in pension fund business. We understand that preparations are underway for the Government Actuary Department (GAD) to undertake a review in relation to cost sharing on behalf of Scottish Ministers.

96. There is a move to the pooling of fund assets through collective investment vehicles south of the border and Scottish Ministers have already indicated that this is an area where the views of the national Scheme Advisory Board's may be requested in due course.

Best Value

97. The Funds have a duty to ensure best value in the provision of services and to report performance publicly so that pension fund members, employers and other stakeholders know the quality of service being delivered and what they can expect in the future.

98. The Funds have not been subject to a Best Value review however, it is covered by the overall Best Value arrangements of the administering authority, City of Edinburgh Council.

Investment performance

99. Investments are managed both by external fund mangers and the Funds' internal investment management team. Through the use of mandates, responsibility for the management of the Funds' investments has been divided up. **Exhibit 6** shows the allocation of investments to fund managers for the Lothian Pension Fund as at 31 March 2016.

100. Approximately 47% of the Lothian Buses Pension Fund is managed by in-house investment mangers, with the remainder allocated between 2 separate external investment managers, Baillie Gifford (43%) and Standard Life (10%).

101. Approximately 40% of the Scottish Homes Pension Fund investments are managed by in-house investment managers, with the remainder allocated between 2 separate external investment managers State Street (55%) and Standard Life (5%).

Exhibit 6: Fund managers' allocation2015-16 (Lothian Pension Fund)

Fund Manager	Market Value £'000	% of Total Fund Value
In-house Investment Managers	4,565,947	84.6
Harris	186,652	3.5
Nordea	223,912	4.1
Standard Life	422,452	7.8
Total	**5,398,963**	**100**

Source: Lothian Pension Funds audited financial statements 2015/16

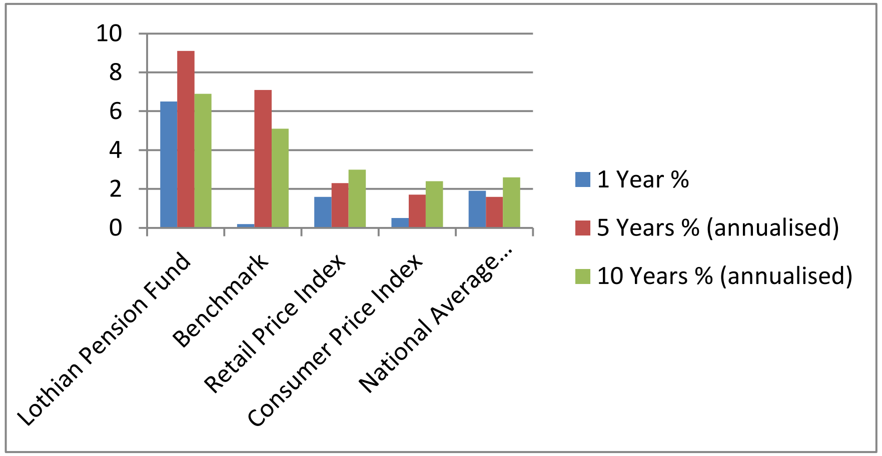
102. The main mechanism for measuring investment performance is through an analysis of the returns achieved by each of the Funds' fund managers. Each active Investment Manager has a defined performance benchmark and objective, against which performance will be measured. Their performance, in terms of achieving benchmarks, is subject to independent verification by an external specialist provider and is regularly reported to the Pensions Committee and investment strategy panel.

103. Investment returns of the Lothian Pension Fund have outperformed benchmark targets over the short, medium and longer term, as illustrated in **Exhibit 7**. The table also shows that over a period of one, five and ten years the pension fund has out performed the relevant measures of inflation.

104. Lothian Buses Pension Fund investment returns exceeded the required performance benchmark levels for 2015/16. The portfolio as a whole made returns of 3.1% against the benchmark target of 1.2%.

105. Scottish Homes Pension Fund investment returns did not meet the required performance benchmark levels for 2015/16. The portfolio as a whole made returns of 1.7% against the benchmark target of 1.9%.

Exhibit 7: Investment Performance – Lothian Pension Fund



Source: Lothian Pension Funds audited financial statements 2015/16

Administrative performance

106. The Funds' Administration Strategy was approved by the Pensions Committee in September 2013. It contains the standards which are required of the participating employers to ensure that the Funds meet their statutory obligations and are able to deliver services efficiently. The strategy contains a variety of performance measures against which the Funds and the participating employers are assessed.

107. In accordance with Local Government Regulations, the Funds' annual report discloses performance against the measures detailed in the Pension Administration Strategy. In relation to 2015/16 the Funds' performance was broadly in line with the annual targets set.

Investment strategies

108. The Funds' investment strategies 2012-17, as agreed by the Pensions Committee in October 2012, have continued to be implemented during 2015/16. The key objective of the Funds' investment strategies is to maximise the investment return within reasonable and considered risk parameters, as illustrated in **Exhibit 8**.

109. The Lothian Pension Fund had a higher position in equities and was lower in alternatives compared to the interim strategy at 31 March 2016.

Exhibit 8: Allocation of Investments to Investment strategy

Funds	Allocation 31 March 2016 %	Strategy 31 March 2016 %
Lothian Pension Fund		
Equities	67.8	67.0
Index-Linked Assets	7.0	7.0
Alternatives	24.0	25.0
Cash	1.0	1.0
Lothian Buses Fund		
Equities	60.0	58.5
Index-Linked Assets	12.0	14.0
Alternatives	26.0	27.5
Cash	2.0	0
Scottish Homes Fund		
Equities	30.2	30.0
Bonds	64.5	65.0
Property	5.3	5.0

Source: Lothian Pension Committee June 2016 - Annual Investment updates

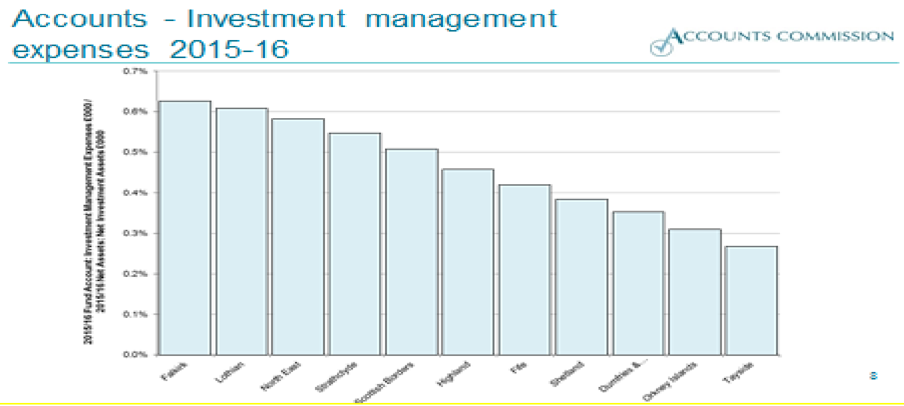
110. As illustrated in the table, a number of changes to existing allocations are required to bring into line with the agreed strategy and Funds are continuing to work towards this.

Management expenses

111. There are three main categories of management expense, with the largest being investment management costs. Other expenses are the cost of the administration services provided by the council and the governance fees for actuarial and audit services.

112. In 2015/16 the investment management costs of the Lothian Pension Fund rose from £25.951 million to £32.814 million. **Exhibit 9** shows provisional figures for total management costs for each Scottish pension fund based on unaudited financial statements.

Exhibit 9: Management costs as percentage of net assets of Scottish LGPS funds



Source: Draft Scottish Pension Funds financial statements 2015/16

113. At 0.66%, the Lothian Pension Fund's management costs are comparatively low, which contributes to long term asset growth.

114. It is noted at this stage that there is inconsistency in the level of cost transparency between funds and that management costs will be heavily influenced by the asset allocation of a Fund.

Outlook

115. Recent developments in English Local Government Pension Schemes (LGPS) have seen the introduction of a National LGPS Framework being introduced in effort to reduce the cost of procurement of the LGPS sector. The framework, being coordinated by Norfolk County Council, sought to appoint companies to advise on actuarial, governance and benefit matters and is being backed by 7 English LGPS.

116. With financial austerity within the public sector likely to continue and increased pressure from employers to keep costs and contributions down makes it imperative for funds to be able to demonstrate best value and continued improvement. Just as council's themselves are having to look to new models of service delivery pension funds may need to reconsider the costs and benefits of shared services, procurement exercises and asset pooling.

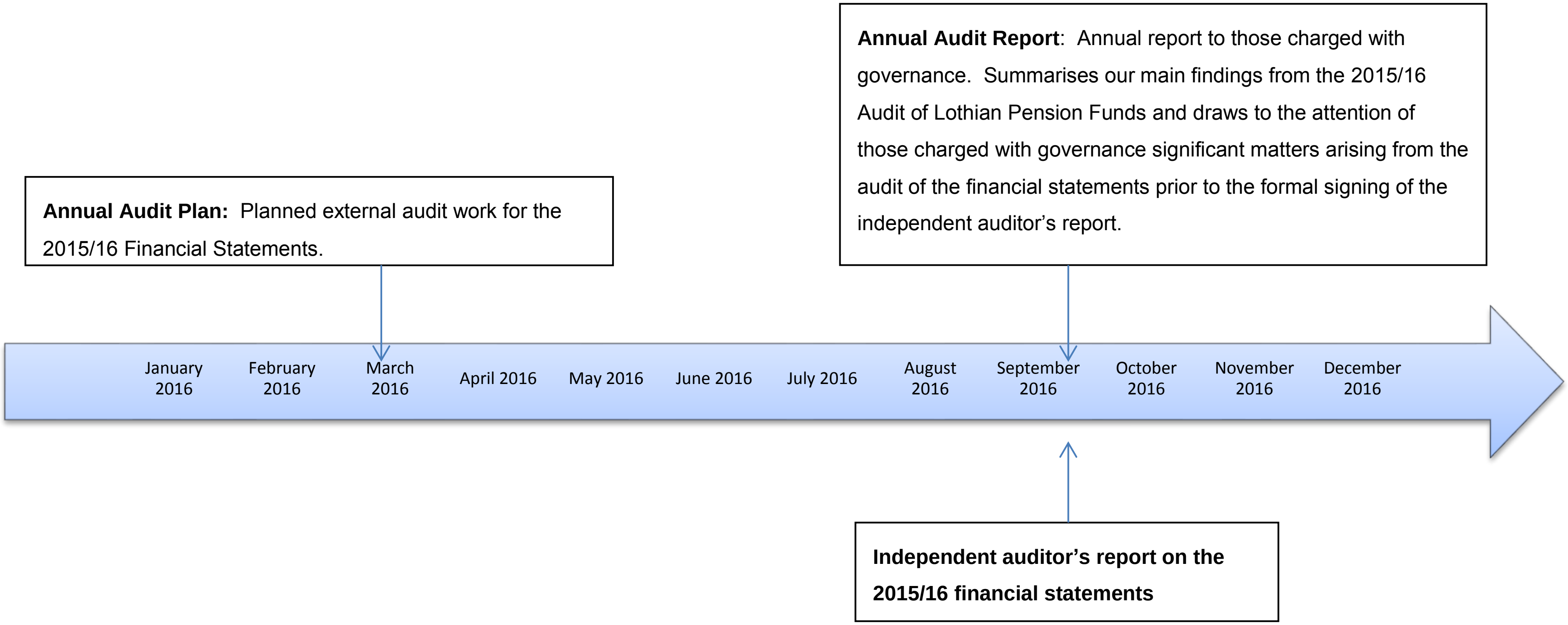
Appendix I: Significant audit risks

The table below sets out the financial statement audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
Management override of controls ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.	• Detailed testing of journal entries. • Review of accounting estimates for bias. • Evaluating significant transactions that are outside the normal course of business.	We undertook detailed testing of journal entries, accruals and prepayments. We also reviewed accounting estimates and transactions for appropriateness. We did not identify any incidents of management override of controls. **Satisfactory**
Group Accounting Investment and other senior staff have been transferred to a new company created to provide the Funds more flexibility in the terms and conditions on which staff are recruited and investment transactions. There is a risk that transactions between the Funds and the newly established company may not be recorded and disclosed in accordance with the accounting	• Substantive testing of transaction between the Funds and the newly established company. • Review of the disclosures made in the Funds' 2015/16 financial statements concerning the relationship between the Funds and the company against the requirements of 'The Code' and sector specific guidance.	We discussed the impact of preparing group accounts for LPFE with management during 2015/16. We also undertook detailed testing of transactions between LPF and LPFE and reviewed group disclosure notes. We did not identify any material issues. **Satisfactory**

Audit Risk	Assurance procedure	Results and conclusions
requirements of 'The Code'.		
Changes to LGPS The Public Service Pension Act 2013 and associated regulations replaced a final salary scheme with a career average revalued earnings (CARE) scheme from 1 April 2015. There is a risk of increased complexity of pension calculations and increased workload of the Funds Administration which may result in an increase in errors.	• Review of Funds performance reporting. • Substantive testing of pension calculations during financial statements audit.	We undertook detailed testing of pension calculations and no issues were noted. We also reviewed the Funds performance reported within the annual report and compared this to what has been reported to the Pensions Committee. No issues identified. **Satisfactory**
Annual governance statement The Funds Annual Governance Statement in the past has been based primarily on the content of the council's Annual Governance Statement. However, there is a risk that the disclosures are not focused on the governance arrangements of the Pension Funds.	• Review of compliance as part of the detailed financial statements review for 2015/16.	We undertook a detailed review of the governance statement to ensure that it complied with the regulations and was more in-line with a more specific pension fund annual governance statement. No significant issues identified. **Satisfactory**

Appendix II: Summary of Lothian Pension Funds local audit reports 2015/16



Appendix III: Action plan

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1.	21	**Issue**: The Funds are correctly compliant with the required CIPFA guidance 2014 disclosures which promoted greater transparency of investment management fees. However, the new CIPFA guidance that comes into force in 2016/17 has revised their opinion resulting in fees incurred which the Funds have no control should not now be incurred by the Funds. **Risk:** The Funds may not be compliant with the new CIPFA guidelines. **Recommendation:** The Funds should review their disclosure arrangements for investment management fees in light of the new guidance.	CIPFA's guidance quotes the Government's criteria for the pooling of LGPS assets as follows: "To really drive savings within the Scheme, it is essential that these hidden costs are better understood and reported as transparently as possible. Although many of these costs are not paid out in cash, they do erode the value of the assets available for investment and so should also be scrutinised and the opportunities for savings explored." The Funds believe that CIPFA's revised guidance is inconsistent with the aim of transparency. The Pensions Committee, at its meeting on 28 September 2016 will be "recommended to instruct the Committee Clerk to communicate its disquiet, and that of the Convenor, on this matter not only to CIPFA, but also both to Audit Scotland and the Scheme Advisory Board (of the Local Government Pension Scheme in Scotland).	n/a

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AUDIT SCOTLAND

Lothian Pension Fund

12 September 2016

Lothian Pension Funds
2015/16 Annual Audit Report

1. International Standard on Auditing (UK and Ireland) 260 (ISA 260) requires auditors to report specific matters arising from the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action. We are drawing to your attention matters for your consideration before the financial statements are approved and certified. We also present for your consideration our draft annual report on the 2015/16 audit which identifies significant findings from the financial statements audit. The section headed "Significant findings from the audit in accordance with ISA260" in the attached annual audit report sets out the issues identified. This report will be issued in final form after the financial statements have been certified.

2. Our work on the financial statements is now substantially complete. Subject to the satisfactory conclusion of any outstanding matters and receipt of a revised set of financial statements for final review, we anticipate being able to issue an unqualified auditor's report on 28 September 2016 (the proposed report is attached at Appendix A). There are no anticipated modifications to the audit report.

3. In presenting this report to the Pensions Audit Sub-Committee and the Pensions Committee we seek confirmation from those charged with governance of any instances of any actual, suspected or alleged fraud; any subsequent events that have occurred since the date of the financial statements; or material non-compliance with laws and regulations affecting the entity that should be brought to our attention.

4. We are required to report to those charged with governance all unadjusted misstatements which we have identified during the course of our audit, other than those of a trivial nature and request that these misstatements be corrected. We have no unadjusted misstatements to bring to your attention.

5. As part of the completion of our audit we seek written assurances from the Chief Finance Officer on aspects of the financial statements and judgements and estimates made. A draft letter of representation under ISA580 is attached at Appendix B. This should be signed and returned by the Chief Finance Officer with the signed financial statements prior to the independent auditor's opinion being certified.

APPENDIX A: Proposed Independent Auditor's Report

Independent auditor's report to the members of City of Edinburgh Council as administering body for Lothian Pension Funds and the Accounts Commission for Scotland

I certify that I have audited the financial statements of Lothian Pension Funds for the year ended 31 March 2016 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the fund accounts, the net assets statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 (the 2015/16 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Chief Finance Officer and auditor

As explained more fully in the Statement of Responsibilities, the Chief Finance Officer is responsible for the preparation of financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Chief Finance Officer; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the annual report and financial statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2015/16 Code of the financial transactions of the funds during the year ended 31 March 2016, and of the amount and disposition at that date of their assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2015/16 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

Opinion on other prescribed matter

In my opinion the information given in the management commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I am required to report by exception

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Annual Governance Statement has not been prepared in accordance with Delivering Good Governance in Local Government; or
- the Governance Compliance Statement does not comply with guidance from the Scottish Ministers.

I have nothing to report in respect of these matters.

David McConnell, MA, CPFA
Assistant Director
Audit Scotland
4th Floor South Suite
The Athenaeum Building
8 Nelson Mandela Place
GLASGOW
G2 1BT

Date: September 2016

APPENDIX B: Letter of Representation (ISA 580)

David McConnell
Assistant Director
Audit Scotland
4th Floor
8 Nelson Mandela Place
Glasgow
G2 1BT

Dear David

Lothian Pension Funds

Annual Accounts 2015/16

1. This representation letter is provided in connection with your audit of the financial statements of the Lothian Pension Funds for the year ended 31 March 2016 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial transactions of the funds during the year ended 31 March 2016, and of the amount and disposition at that date of its assets and liabilities.
2. I confirm to the best of my knowledge and belief, and having made appropriate enquiries of the relevant officers, the following representations given to you in connection with your audit of Lothian Pension Funds for the year ended 31 March 2016.

General

3. I acknowledge my responsibility and that of the Lothian Pension Funds for the financial statements. All the accounting records requested have been made available to you for the purposes of your audit. All material agreements and transactions undertaken by the funds have been properly reflected in the financial statements. All other records and information have been made available to you, including minutes of all management and other meetings.
4. The information given in the Annual Report to the financial statements and Management Commentary presents a balanced picture of the Lothian Pension Funds and is consistent with the financial statements.
5. I confirm that the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. I am not aware of any uncorrected misstatements other than those identified in the auditor's report to those charged with governance (ISA260).

Legality of Financial Transactions

6. The financial transactions of the funds are in accordance with the relevant legislation and regulations governing its activities.

Financial Reporting Framework

7. The financial statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 and in accordance with the requirements of Local Government (Scotland) Act 1973, the Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003, including all relevant presentation and disclosure requirements.

8. Disclosure has been made in the financial statements of all matters necessary for them to show a true and fair view of the transactions and state of affairs of the funds for the year ended 31 March 2016.

Accounting Policies & Estimates

9. All material accounting policies adopted are as shown in the Statement of accounting policies and general notes included in the financial statements. The continuing appropriateness of these policies has been reviewed since the introduction of IAS 8 and on a regular basis thereafter, and takes account of the requirements set out in the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

10. The significant assumptions used in making accounting estimates are reasonable and properly reflected in the financial statements. There are no changes in estimation techniques which should be disclosed due to their having a material impact on the accounting disclosures.

Actuarial Assumptions

11. The pension assumptions made by the actuary in the IAS19 report on the funds have been reviewed and I can confirm that they are consistent with management's own view.

Fraud

12. I have considered the risk that the financial statements may be materially misstated as a result of fraud. I have disclosed to the auditor any allegations of fraud or suspected fraud affecting the financial statements. There have been no irregularities involving management or employees who have a significant role in internal control or that could have a material effect on the financial statements.

Corporate Governance

13. I acknowledge, as the officer with responsibility for the proper administration of the funds financial affairs under section 95 of the Local Government (Scotland) Act 1973, my responsibility for the corporate governance arrangements and internal controls. I have reviewed the Annual Governance Statement and the disclosures I have made comply with the guidance from the Scottish Ministers and in accordance with Delivering Good Governance in Local Government. Also, I have reviewed the Corporate Governance Compliance statement and the disclosures I have made comply with the guidance from the Scottish Ministers. There have been no changes in the corporate governance arrangements or issues identified, since the 31 March 2016 which require disclosure.

Related Party Transactions

14. All transactions with related parties have been disclosed in the financial statements. I have made available to you all the relevant information concerning such transactions, and I am not aware of any other matters that require disclosure in order to comply with the requirements of IAS24, as interpreted by the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

Investment Assets and Current Assets

15. On realisation in the ordinary course of the funds business the investment and current assets in the net asset statement are expected, in my opinion, to produce at least the amounts at which they are stated. In particular, adequate provision has, in my opinion, been made against all amounts owing which are known or may be expected to be irrecoverable.

Investment Liabilities and Current Liabilities

16. All liabilities have been provided for in the books of account as at 31 March 2016.

Contractual commitments

17. All outstanding call payments due to unquoted limited partnership funds have been fully included in the accounts for the period to 31 March 2016.

Employer / Employee Contributions

18. A high level analysis is carried out at the year end comparing the total monthly contributions in the pension system with the amounts recorded in the financial ledger. In addition, monthly checks are performed on contributions received from employers during the year with any unexpected differences followed-up and investigated.

Events Subsequent to the Date of the Net Asset Statement

19. There have been no material events since the date of the net asset statement which necessitate revision of the figures in the financial statements or notes thereto including contingent assets and liabilities.

20. Since the date of the net asset statement no events or transactions have occurred which, though properly excluded from the financial statements, are of such importance that they should be brought to your notice.

Yours sincerely

John Burns

Chief Finance Officer (Section 95 Officer for pensions)

Appendix 2

Audited 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 pension 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 required 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 £149million 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 and controlled by the City of Edinburgh Council as the administering authority of the Funds, 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. These companies have been consolidated into Lothian Pension Fund's financial statements as Lothian Pension Fund Group.

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

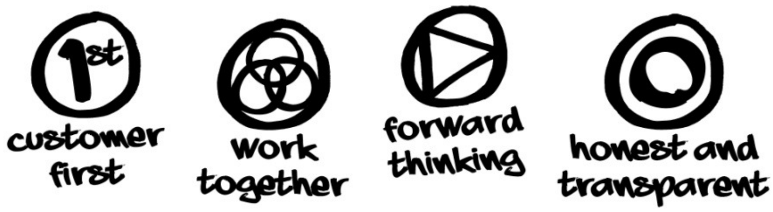
The changes to the pension scheme, pension taxation allowances and new pension freedoms make the administration of the Local Government Pension Scheme more complex and more difficult for members to understand. We will continue to develop communications, including different communications channels, strive 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
28 September 2016

Clare Scott
Chief Executive
Lothian Pension Fund
28 September 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, VisitScotland)

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 was achieved on 24 June 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, including longer notice periods which have reduced risk to the Funds. In-sourcing of investment management over recent years has delivered significant savings to the Funds.

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.

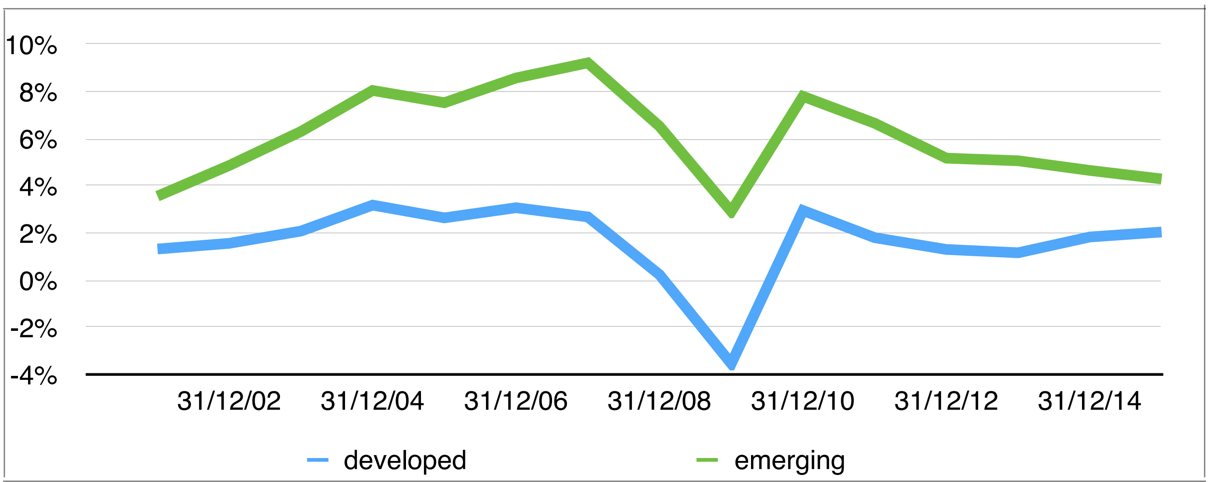
Investment Strategy Panel

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

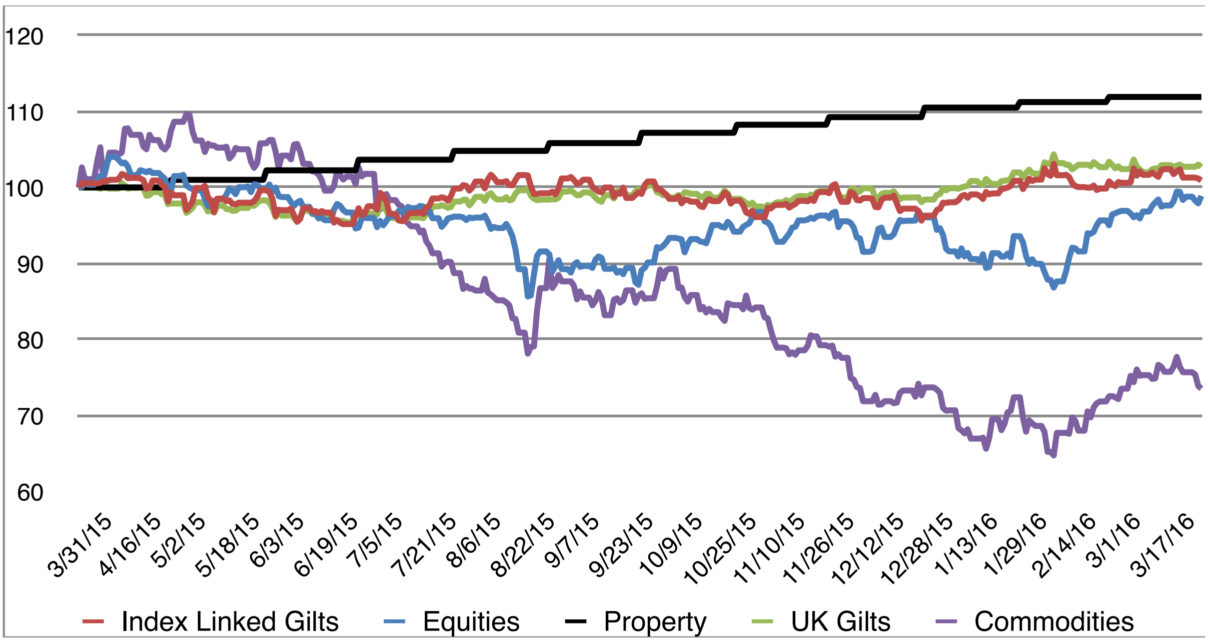
UK economic growth moderated somewhat in 2015, slowing from 2.9% in 2014 to 2.4% in 2015. The recovery in the labour market continued with unemployment falling to a 10 year low of 5%. Despite this, wage growth has remained subdued, with average earnings staying around 2%. The big surprise of 2015 was 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%.

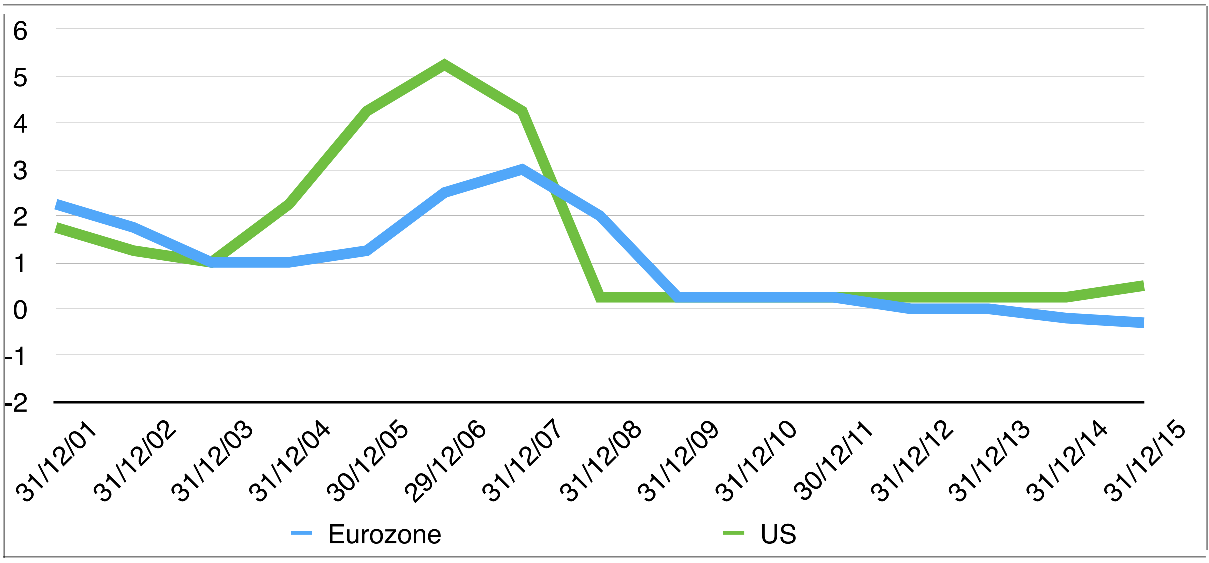
One Year Asset Class Returns – Major Markets (rebased to 100)



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.



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.

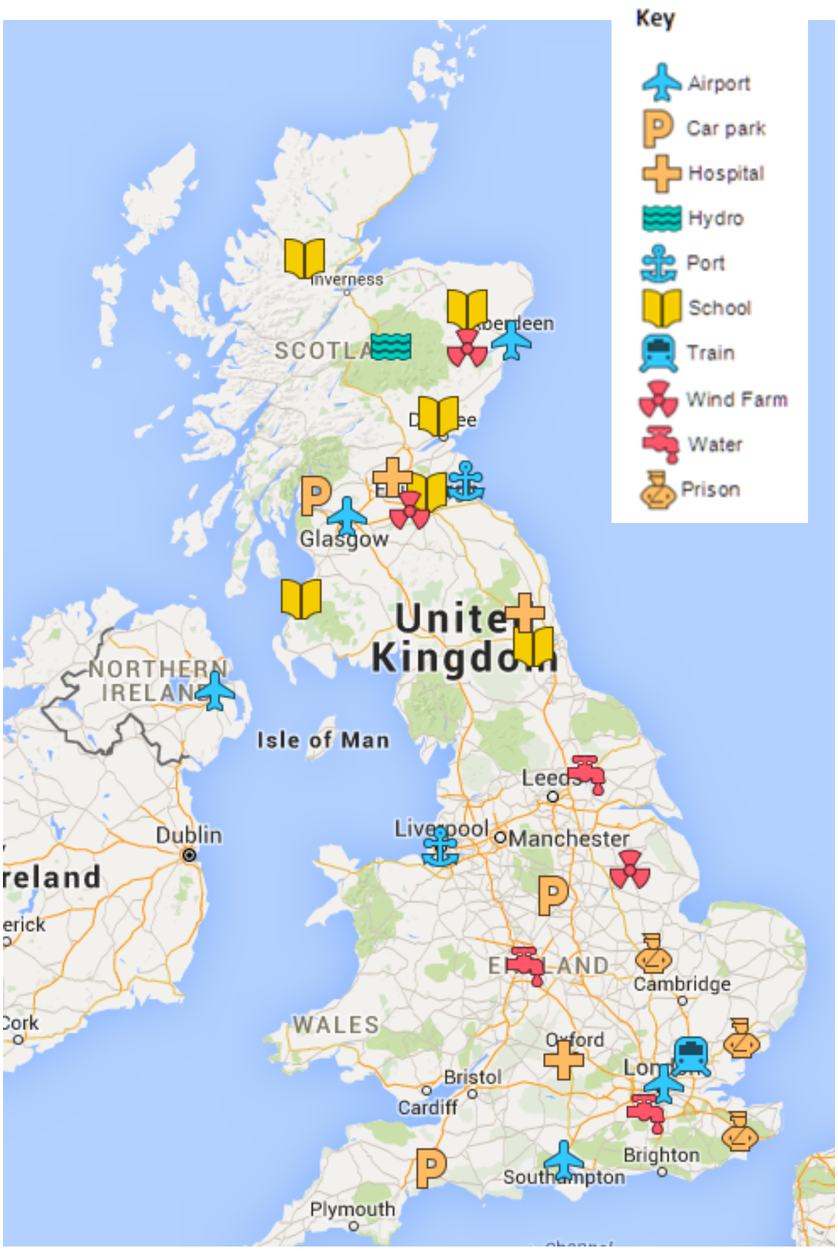
For Scottish Homes Pension Fund, the review concluded that a less prescriptive investment and funding strategy would allow a higher-yielding investment strategy and a more flexible approach to setting contributions. The current investment strategy adjusts asset allocation based on the evolution of the 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.

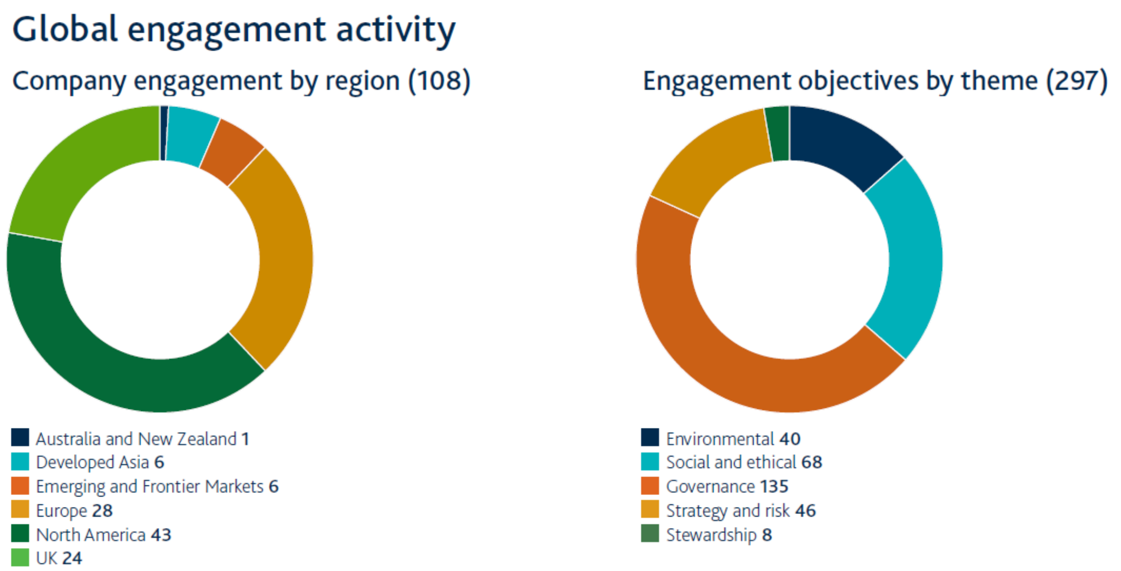
Responsible investment

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.

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 June 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."

There 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 will continue to maintain this principle in its financial statements and it will disclose all investment cost in its financial statements, therefore not complying with the revised CIPFA guidance which comes into effect from 1 April 2016. The Fund feels that the principle of full transparency on its investment management cost should be maintained, and has demonstrated in the below table the difference in reporting between CIPFA's recommendations and full transparency for its 2015/16 investment costs.

	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.

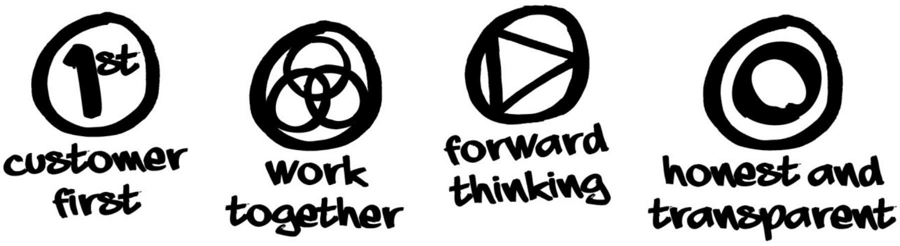
As at 31 March 2016, the most significant risks (after taking account of risk reduction controls), as assessed using a score out of 10 by the Investment and Pensions Service Management Team, were as follows:

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 gained 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.”

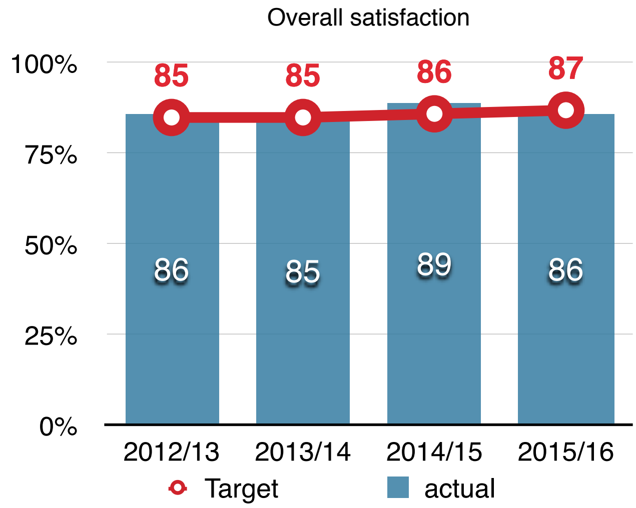
Customer satisfaction

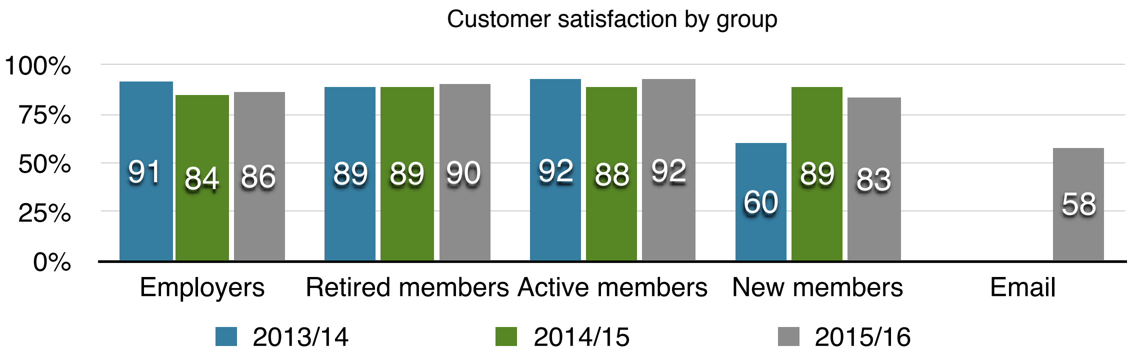
Our overall customer satisfaction over the year was 86%, just below the target of 87%. The chart on the left shows actual satisfaction against target since 2012/13.

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

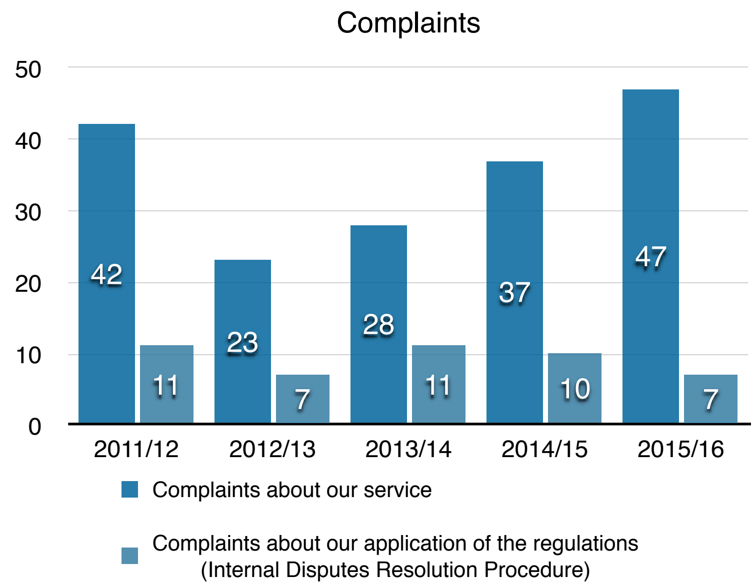
We monitor the complaints we receive on a monthly basis. We respond promptly to any complaints, investigate them and learn from them to improve the service. We categorise our complaints in two ways:

- 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

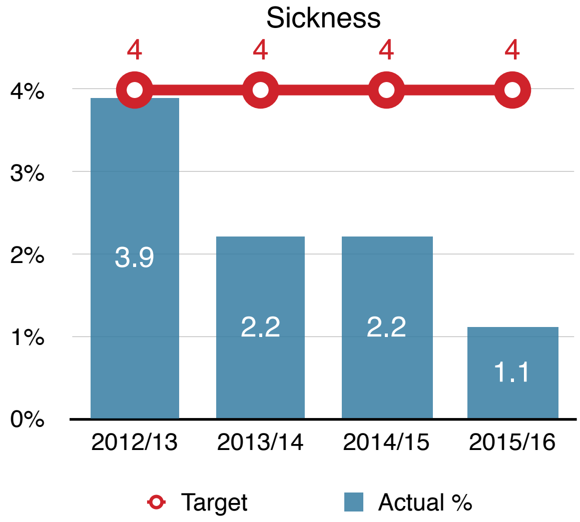
Our people are at the very heart of our business and we work together to deliver our service.

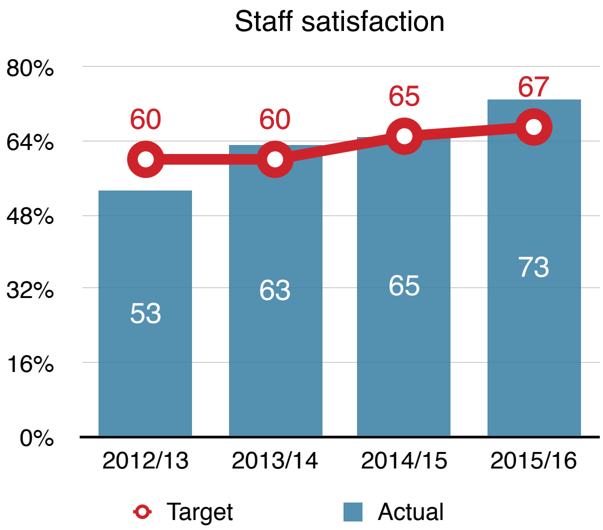
	Target	Actual
All staff complete at least two days training	Yes	Yes
Level of sickness absence	4%	1.1%
Staff survey satisfaction	67%	73%

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.

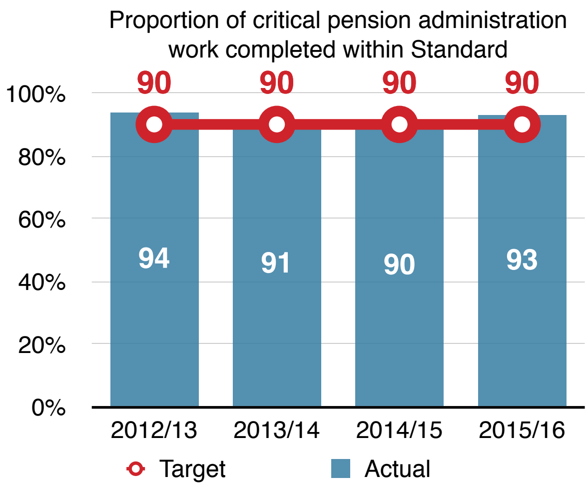
forward thinking

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 in 2011. The Funds also paid over £145million 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

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.

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.

Management commentary approved by:

....	....	....	....
COUNCILLOR ALASDAIR RANKIN **Pensions Committee Convener** **The City of Edinburgh Council** **28 September 2016**	**ANDREW KERR** **Chief Executive** **The City of Edinburgh Council** **28 September 2016**	**CLARE SCOTT** **Chief Executive** **Lothian Pension Fund** **28 September 2016**	**JOHN BURNS** **Chief Financial Officer** **Lothian Pension Fund** **28 September 2016**

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
Scottish Police Authority	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

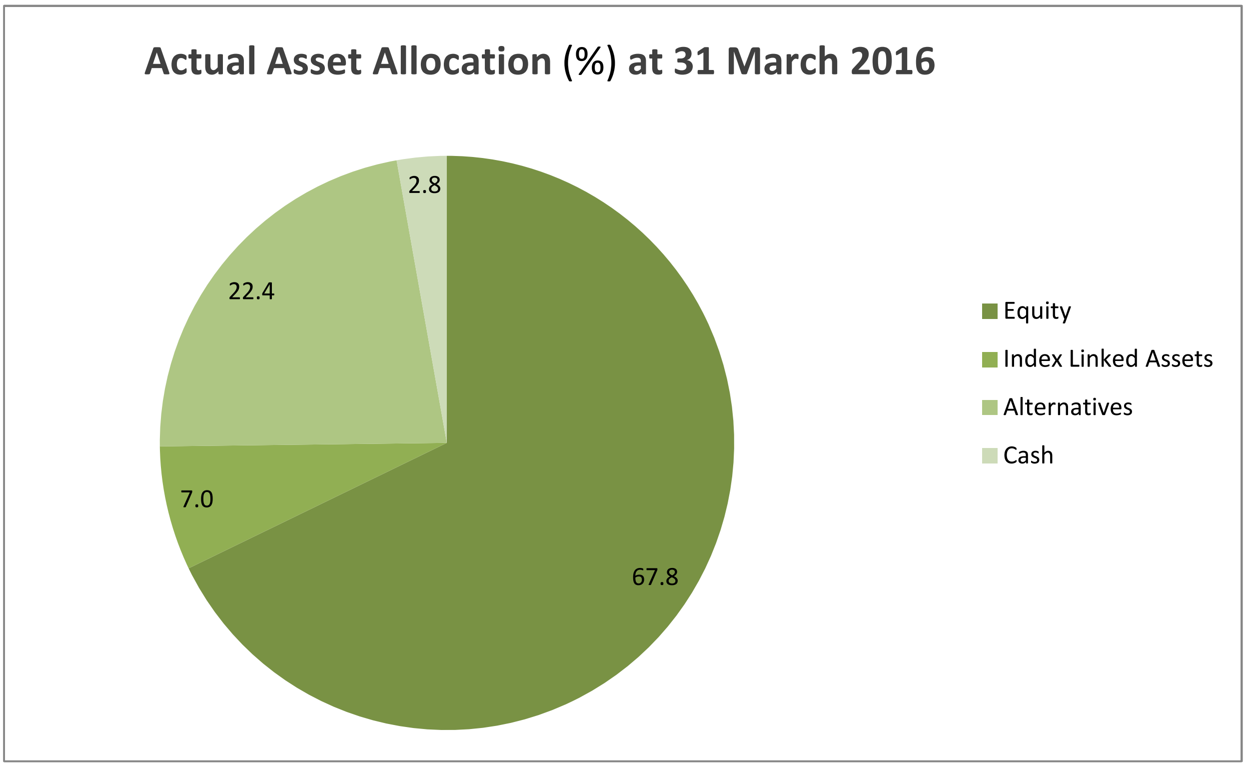
Following completion of the 2014 Actuarial Valuation, the Investment Strategy Panel and Pensions Committee reviewed the Fund's investment strategy in light of developments in pension fund membership, expected cash flow, funding level, investment risk and returns.

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.

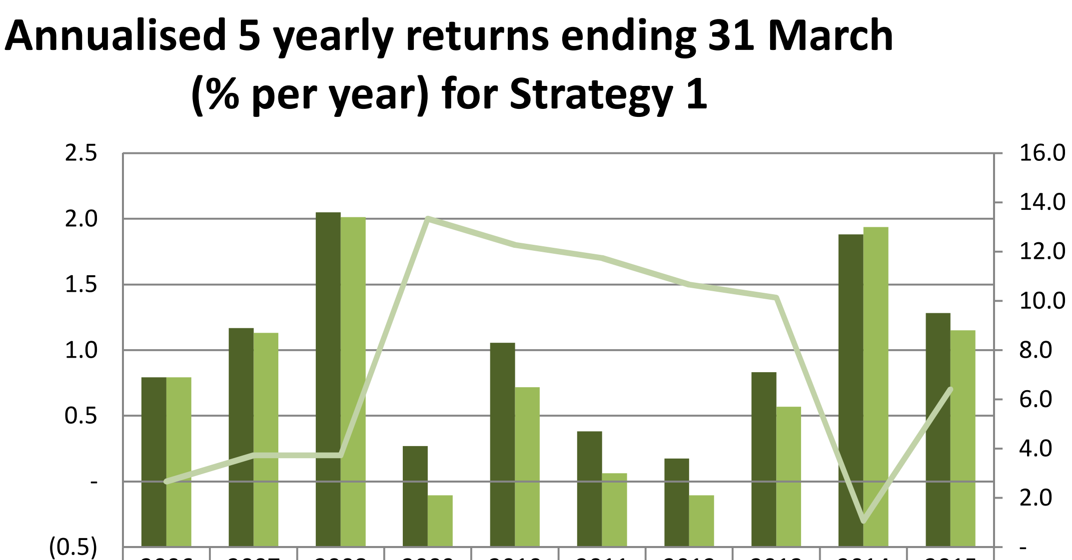
The Fund has achieved returns in excess of the strategic allocation over the last year and over the longer term timeframes shown in the table. The benchmark return shown in the table is the strategic allocation and comprises equity, index-linked gilts and cash indices as well as an inflation-linked index 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 2016 (% 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



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Fund	6.9	8.9	13.6	4.1	8.3	4.7	3.6	7.1	12.7	9.5
Benchmark	6.9	8.7	13.4	2.1	6.5	3.0	2.1	5.7	13.0	8.8
Relative (LHS)	-	0.2	0.2	2.0	1.8	1.7	1.5	1.4	(0.3)	0.7

Lothian Pension Fund Group

Fund Account for year ended 31 March 2016

This statement shows a summary of the income and expenditure that the Pension Fund has generated and consumed in delivering the Local Government Pension Scheme. Included is the income generated from employers' and employees' contributions and investment income, as well as the cost of providing benefits and administration of the Fund.

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 Group

Net Assets Statement as at 31 March 2016

This statement provides a breakdown of type and value of all net assets at the year end.

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**

The unaudited accounts were issued on 27 June 2016 and the audited accounts were authorised for issue on 28 September 2016.

JOHN BURNS FCMA CGMA
Chief Finance Officer, Lothian Pension Fund
28 September 2016

<u>Notes to the net asset statement</u>

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

Notes to the Accounts

1 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 Audited £000	Adjustment £000	2014/15 Restated £000
Investment income	122,404	472	122,876
Investment management expenses	(26,941)	(472)	(27,413)

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

Notes to the Accounts

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

	Restated 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 which comes into effect from 1st April 2016. 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

	Restated 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

	Restated 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.

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.

Notes to the Accounts

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 £000	Level 2 £000	Level 3 £000	Total £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.

Notes to the Accounts

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.

Notes to the Accounts

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	268,740

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').

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.

Notes to the Accounts

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

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	1,107	992
	1,379	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 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.

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.

Notes to the Accounts

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.

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:

	31 March 2014	
Financial assumptions	% 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	Queen Margaret University	CAB
Donaldson’s Trust	CAB	Queensferry Churches Care in the Community Project	CAB
East Lothian Council	SB	Royal Edinburgh Military Tattoo	CAB
EDI Group Ltd	CAB	Royal Society of Edinburgh	CAB
Edinburgh Business School	CAB	Scotland’s Rural College (SRUC)	SB
Edinburgh College	SB	Scotland's Learning Partnership	CAB
Edinburgh Cyrenians Trust	CAB	Scottish Adoption Agency	CAB
Edinburgh Development Group	CAB	Scottish Fire and Rescue Service	SB
Edinburgh International Festival Society	CAB	Scottish Futures Trust	CAB
Edinburgh Leisure	CAB	Scottish Legal Complaints Commission	CAB
Edinburgh Napier University	CAB	Scottish Mining Museum	CAB
Edinburgh Rape Crisis Centre	CAB	Scottish Police Authority	SB
Edinburgh World Heritage Trust	CAB	Scottish Schools Education Research Centre (SSERC)	CAB
ELCAP	CAB	Scottish Water	SB
Enjoy East Lothian	CAB	SESTRAN	SB
Family & Community Development West Lothian	CAB	Skanska UK	TAB
Family Advice and Information Resource	CAB	St Andrew’s Children’s Society Limited	CAB
Festival City Theatres Trust	CAB	St Columba’s Hospice	CAB
First Step	CAB	Stepping Out Project	CAB
Forth and Oban Ltd	TAB	Streetwork UK Ltd	CAB
Four Square (Scotland)	CAB	University of Edinburgh (Edin College of Art)	CAB
Freespace Housing Association	CAB	Victim Support Scotland	CAB
Granton Information Centre	CAB	Visit Scotland	SB
Handicabs (Lothian) Ltd	CAB	Waverley Care	CAB
Hanover (Scotland) Housing Association	CAB	Weslo Housing Management	CAB
Health in Mind	CAB	West Granton Community Trust	CAB
Heriot-Watt University	SB	West Lothian College	SB
Homeless Action Scotland	CAB	West Lothian Council	SB
Homes for Life Housing Partnership	CAB	West Lothian Leisure	CAB
HWU Students Association	CAB	Wester Hailes Land and Property Trust	CAB
Improvement Service (The)	CAB	Young Scot Enterprise	CAB
Into Work	CAB	Youthlink Scotland	CAB
ISS UK Ltd	TAB		

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.

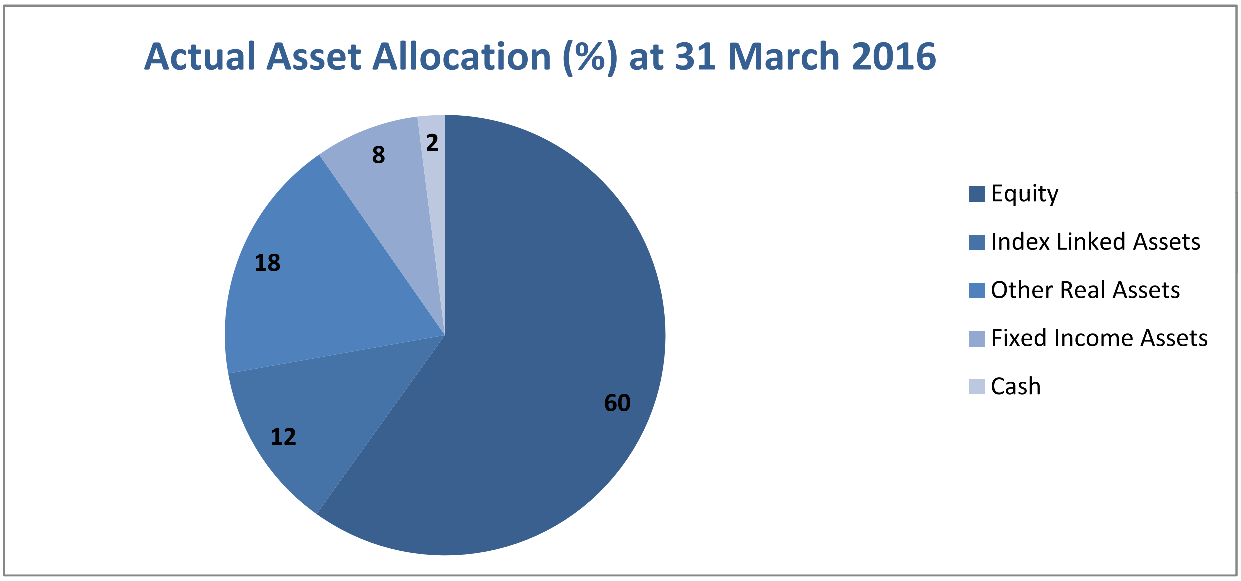
The Pensions Committee approved a revised Investment Strategy 2016-21 for Lothian Buses Pension Fund in March 2016. The main changes from the previous Investment Strategy are a reduction in equities from 55% to 40%, an increase in index-linked assets from 15% to 20% and the creation of a distinct fixed 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

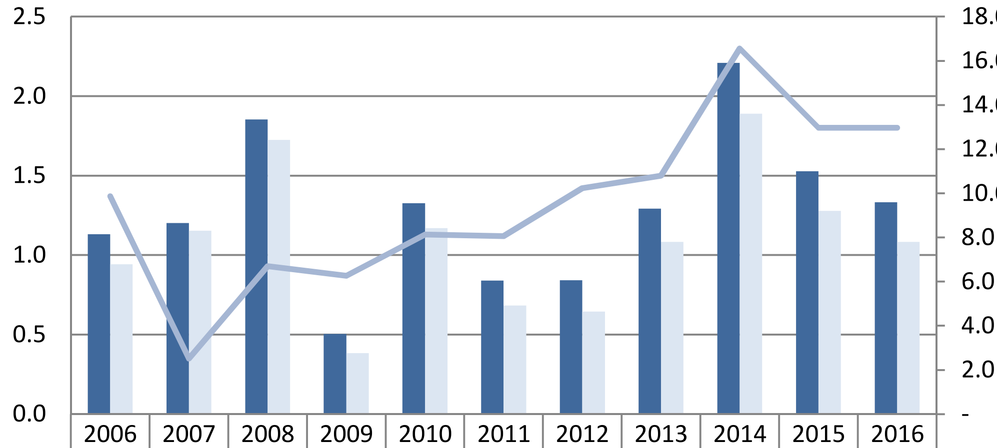
*estimate

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.

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



	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

This statement shows a summary of the income and expenditure that the Pension Fund has generated and consumed in delivering the Local Government Pension Scheme. Included is the income generated from employers' and employees' contributions and investment income, as well as the cost of providing benefits and administration of the Fund.

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

This statement provides a breakdown of type and value of all net assets at the year end.

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**

The unaudited accounts were issued on 27 June 2016 and the audited accounts were authorised for issue on 28 September 2016.

JOHN BURNS FCMA CGMA
Chief Finance Officer, Lothian Pension Fund
28 September 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 Audited £000	Adjustment £000	2014/15 Restated £000
Investment income	8,346	80	8,426
Investment management expenses	(1,320)	(80)	(1,400)

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

	Restated 2014/15 £000	2015/16 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

Notes to the Financial Statements

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 which comes into effect from 1st April 2016. 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

	Restated 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

	Restated 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

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)
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

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 £000	Level 2 £000	Level 3 £000	Total £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 £000	Level 2 £000	Level 3 £000	Total £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.

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.

Notes to the Financial Statements

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.

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.

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.

Notes to the Financial Statements

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	1,107	992
	1,379	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 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.

Notes to the Financial Statements

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.

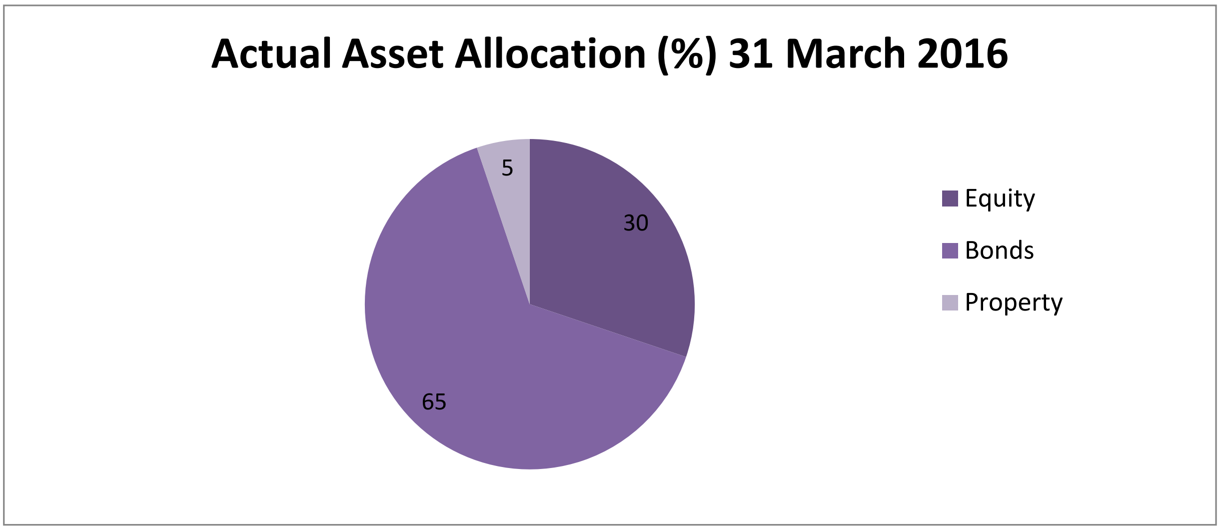
Year [1]	Target Funding Level %	Target Equity Allocation %
2014	91.5	30
2017	93.0	25
2020	94.5	20
2023	95.5	15
2026	96.5	10

[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.

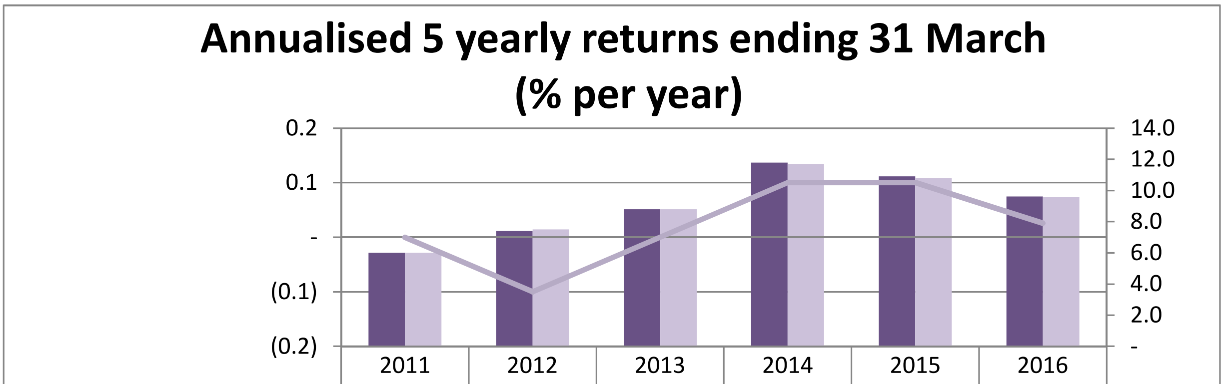
The Fund's annualised performance over the year and longer-term periods is shown in the table below. The Fund has performed broadly in line with its benchmark over all time periods.

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

This statement shows a summary of the income and expenditure that the Pension Fund has generated and consumed in delivering the Local Government Pension Scheme. Included is the income generated from employers' and employees' contributions and investment income, as well as the cost of providing benefits and administration of the Fund.

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

This statement provides a breakdown of type and value of all net assets at the year end.

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**

The unaudited accounts were issued on 27 June 2016 and the audited accounts were authorised for issue on 28 September 2016.

JOHN BURNS FCMA CGMA
Chief Finance Officer, Lothian Pension Fund
28 September 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	9.2
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

Notes to the Financial Statements

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	168,713	128,483
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].

Notes to the Financial Statements

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.

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

Notes to the Financial Statements

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

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	1,107	992
	1,379	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 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.

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.

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

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 (see 2j (iii) above for more details on the valuation methodology).

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.

I confirm that these Annual Accounts were approved for signature by the Pensions Committee at its meeting on 28 September 2016.

COUNCILLOR ALASDAIR RANKIN
Pensions Committee Convener
28 September 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
28 September 2016

Independent Auditor's Report

Independent auditor's report to the members of City of Edinburgh Council as administering body for Lothian Pension Funds and the Accounts Commission for Scotland

I certify that I have audited the financial statements of Lothian Pension Funds for the year ended 31 March 2016 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the fund accounts, the net assets statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 (the 2015/16 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Chief Finance Officer and auditor

As explained more fully in the Statement of Responsibilities, the Chief Finance Officer is responsible for the preparation of financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Chief Finance Officer; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the annual report and financial statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2015/16 Code of the financial transactions of the funds during the year ended 31 March 2016, and of the amount and disposition at that date of their assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2015/16 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

Independent Auditor's Report

Opinion on other prescribed matter

In my opinion the information given in the management commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I am required to report by exception

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Annual Governance Statement has not been prepared in accordance with Delivering Good Governance in Local Government; or
- the Governance Compliance Statement does not comply with guidance from the Scottish Ministers.

I have nothing to report in respect of these matters.

David McConnell, MA, CPFA
Assistant Director
Audit Scotland
4th Floor South Suite
The Athenaeum Building
8 Nelson Mandela Place
GLASGOW
G2 1BT
28 September 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.

This statement also covers the organisations (LPFE Limited and LPFI Limited (dormant as at 31/3/16)) included in the pension funds group accounts.

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. Internal Audit are due to review LPFE Limited's governance arrangements in 2016, while the companies financial statements have been audited by Scott-Moncrieff. LPFI Limited is currently dormant. 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.

- 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.

Annual Governance Statement

- 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.

Annual Governance Statement

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 reviewed the arrangements and is satisfied that the Code continues to be adequate and effective. Governance arrangements will continue to be monitored and self-assessment information provided to the Governance, Risk and Best Value Committee on an annual basis.

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.

Annual Governance Statement

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."

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
28 September 2016

ANDREW KERR
Chief Executive of the City of Edinburgh Council
28 September 2016

HUGH DUNN
Acting Executive Director of Resources of the City of Edinburgh Council
28 September 2016

CLARE SCOTT
Chief Executive Officer of the Lothian Pension Fund
28 September 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.

COUNCILLOR ALASDAIR RANKIN
Pensions Committee Convener
28 September 2016

ANDREW KERR
Chief Executive of the City of Edinburgh Council
28 September 2016

HUGH DUNN
Acting Executive Director of Resources of the City of Edinburgh Council
28 September 2016

CLARE SCOTT
Chief Executive Officer of the Lothian Pension Fund
28 September 2016

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

Pensions Committee

2.00 p.m., Wednesday, 28 September 2016

Annual Report on LPFE Limited and LPFI Limited

Item number	5.5
Report number	
Executive/routine	
Wards	All

Executive summary

Further to the establishment of LPFE Limited and LPFI Limited, as wholly owned and controlled subsidiaries of the City of Edinburgh Council, in support of the administration of the pension funds that it administers, this report provides an update on the business and operation of those entities. This is in accordance with the revised remit of the Pensions Audit Sub-committee which gives it the power to scrutinise the Council companies associated with the pension fund.

Regular reports will ensure compliance with the existing governance requirements of both companies under their own constitutions and broadly align the governance processes for these companies with new procedures overseen by the Council's Companies Hub for other Council companies.

Most notably:

- The first set of audited annual accounts for LPFE Limited have been finalised and are attached for the Committee's information.
- LPFI Limited has now received authorisation from the Financial Conduct Authority to allow it to support the administration of the pension funds on certain regulated matters within its business plan.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

EDINBVRGH
THE CITY OF EDINBURGH COUNCIL

Report

Annual Report on LPFE Limited and LPFI Limited

Recommendations

Committee is requested to:

1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider;

1.2 Note that the remit of the Pensions Audit Sub-committee has been amended by Council to include scrutiny of the Council companies associated with the pension fund; and

1.3 Note the LPFE Limited annual accounts and the updates on LPFE and LPFI provided in this report.

Background

2.1 The Pensions Committee has previously considered and approved the establishment of a new corporate structure to facilitate the more efficient administration of the pension funds for which the City of Edinburgh Council (CEC) is responsible.

2.2 This is the first report to Committee on the corporate structure and Committee may wish to consider whether the content is sufficient.

2.3 The structure, including two limited companies LPFI Limited (LPFI) (*regulated investments*) and LPFE Limited (LPFE) (*staffing*), was established in 2015/16 and relevant members of staff were transferred into LPFE in May 2015.

2.4 Risk analysis for both LPFI and LPFE has been incorporated within the Fund's existing processes and quarterly reporting to the Committee (see separate paper).

2.5 Both LPFE and LPFI have and will continue to be subject to review by internal audit.

Main report

LPFE Limited

3.1 LPFE was incorporated on 11 February 2015 and commenced trading on 1 May 2015, when the employment of relevant members of the Fund's staff was transferred to it. LPFE has since provided investment staff resource to the group responsible for administering the Funds, which includes CEC, LPFE itself and LPFI (**LPF Group**).

3.2 LPFE receives certain administrative support services from CEC (information compliance, office support, IT etc.), external Human Resources services from 121 HR Solutions and payroll services from Scott Moncrieff. In addition, Scott Moncrieff has been appointed as LPFE's auditor, payroll provider and to provide certain tax advisory services. The expenses in relation to LPFE are contained with the finances of the Lothian Pension Fund. The 2015/16 budget for Lothian Pension Fund contained a £250k provision for a loan facility provided from CEC to LPFE for the purposes of short term working capital support. Cash is drawn-down from the loan facility (not beyond the £250k provision) when required and interest is charged on the net amount drawn down, with the rate linked to the Royal Bank of Scotland base rate.

3.3 HMRC has now confirmed that, in light of the group arrangement, any profit arising from services between LPFE and CEC will be deemed to be covered by the mutual trading rules and so not subject to corporation tax.

3.4 The LPFE Board is made up of the following:

Role	Person	Dates to/from
Executive Director of Corporate Governance/Resources (Chair of LPFE)	*Alastair Maclean* Hugh Dunn (currently acting in this role)	*Incorporation to 19/2/16* Incorporation to date
Convener of the Pensions Committee	Alasdair Rankin	24/2/15 to date
City of Edinburgh Council's Head of Finance	Hugh Dunn	Incorporation to date
City of Edinburgh Council's Head of HR	*Linda Holden* *Martin Glover* Katy Miller	*Incorporation to 10/12/15* *10/12/15 to 19/8/16* To be appointed
Chief Executive of Lothian Pension Fund	Clare Scott	Incorporation to date

3.5 It is intended that following the conclusion of CEC's structural review and appointments, a further appointment will be made to the board to cover the vacancy of either the Director of Resources or Head of Finance role depending on the outcome of CEC's process.

3.6 The LPFE board has met regularly since the company commenced trading to monitor ongoing business and establish the company's HR systems, policies and procedures.

3.7 All staff transferred to LPFE on existing terms and conditions. Following a review of remuneration including benchmarking undertaken by PWC, a revised remuneration strategy was put in place in December 2015.

3.8 Revised contracts have been put in place and now include clauses on confidentiality, non-competition and non-soliticitation. A new Staff Handbook has also been created which consolidates and simplifies the policies which were transferred from the Council.

3.9 At the most recent meeting of the Board on 20 June 2016, LPFE's first set of audited financial accounts was considered and approved. A copy of these accounts is detailed at Appendix 1 to this report for your information.

3.10 LPFE has been admitted as an employer to the Lothian Pension Fund to ensure continuity of pension provision. The Board has recently considered and approved an employer discretions policy as part of its admission process to the Fund.

3.11 From 1 May 2016, LPFE also became a party to the secondment arrangement with Falkirk Council whereby it and CEC together now provide certain limited staff secondment services to Falkirk Council Pension Fund in relation to LPFE and other staff.

3.12 Future business of the LPFE Board includes:

- the approach to future remuneration reviews, including consideration of individual and Fund performance and benchmarking with comparable roles in the private sector;
- determining what action is required to be taken regarding any conflict of interest associated with Scott Moncrieff, who are expected to be appointed as external auditor in the near future; and
- the potential for other members of the Lothian Pension Fund staff to transfer to LPFE Limited.

LPFI Limited

3.13 LPFI was also incorporated on 11 February 2015, but has remained inactive until such time as it received the necessary permissions from the Financial Conduct Authority (FCA) to carry out its primary function of providing regulated investment advisory and arranging services to CEC. This will, initially, primarily involve services around the LPF Group's activities in transacting collaboratively in the private markets with other institutional investors and also in relation to any derivative/foreign exchange hedging being done for the benefit of the Fund.

3.14 The LPFI Board is made up of the following:

Role	Person	Dates to/from
Executive Director of Corporate Governance/Resources (Chair of LPFI)	*Alastair Maclean* Hugh Dunn	*Incorporation to 19/1/16*** 19/1/16 to date
Chief Executive of Lothian Pension Fund	Clare Scott	Incorporation to date
Chief Risk Officer of Lothian Pension Fund	Struan Fairbairn	Incorporation to date
Chief Finance Officer of Lothian Pension Fund	John Burns	Incorporation to date
Chief Investment Officer	Bruce Miller	Incorporation to date
***A different date to LPFE due to the timing of the respective board meetings to formally remove and ratify the appointment.*		

3.15 The LPFI Board has agreed that it is appropriate to appoint a Non-Executive Director to the Board to support the strategic development of LPFI and also to ensure best practice governance and oversight of the business, and the Board itself. This also means that LPFI will be compliant with the United Kingdom's Corporate Governance Code in this regard. A candidate has been identified for this role.

3.16 As LPFI has, to date, not traded, it will be submitting a dormant accounts submission to Companies House within the next few months.

3.17 HMRC has now confirmed that, in light of the group arrangement, any profit arising from services between LPFI and CEC will be deemed to be covered by the mutual trading rules and so not subject to corporation tax.

3.18 As previously reported to Committee, LPFI received its authorisation from the FCA on 24 June 2016 and so is now a regulated entity with its eleven members of staff also being individually regulated with certain regulatory functions appropriate to their roles.

3.19 Immediately prior to receiving authorisation from the FCA, and as part of that process, LPFI issued a further 40,000 shares of £1 each to CEC to satisfy its regulatory capital requirements. Due to the unprecedented currency exchange movements that preceded the Brexit vote, LPFI issued a further £4,000 of regulated capital to CEC to act as a buffer against any further negative movement in the Sterling-to-Euro exchange rate that might result in LPFI being in breach of its regulatory capital requirements.

3.20 LPFI has appointed Moore Stephens (a partner firm of Scott Moncrieff) to provide it with ongoing administrative support in relation to its annual filing requirements with the FCA and, separately, to provide *ad hoc* regulatory and training support.

3.21 Future business of the LPFI Board includes:

- to approve the final governance steps to be implemented following receipt of FCA authorisation and immediately prior to it commencing to trade (e.g. putting in place the personal indemnity insurance policy, internal training and other administrative/systems matters). LPFI expects to commence trading in October 2016;
- as LPFI has appointed Scott Moncrieff to provide it with audit and tax advisory services, the board will need to determine what action is required to be taken regarding any conflict of interest associated with Scott Moncrieff, having recently also being appointed as external auditor with effect from 31 March 2017; and
- consider and, if thought appropriate, support the implementation of a revised structure to provide shared investment services to the Falkirk Council Pension Fund (see also the paper on Collaboration).

Measures of success

4.1 The Committee are appropriately informed and up to date as to the ongoing business and operations of the LPF Group, including its corporate subsidiaries LPFE and LPFI.

Financial impact

5.1 None.

Risk, policy, compliance and governance impact

6.1 To satisfy the reporting requirements to City of Edinburgh Council, as the sole shareholder of both LPFE Limited and LPFI Limited.

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

A link to LPFI's details on the FCA's register - https://register.fca.org.uk/ShPo_FirmDetailsPage?id=001b000003LFGGaAAP

A link to LPFI's details on Companies House - https://beta.companieshouse.gov.uk/company/SC497542

A link to LPFE's details on Companies House - https://beta.companieshouse.gov.uk/company/SC497543

Hugh Dunn

Acting Executive Director of Resources

Contact: Clare Scott, Chief Executive Officer Lothian Pension Fund

E-mail: clare.scott@edinburgh.gov.uk | Tel: 0131 469 3865

Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives
Single Outcome Agreement	
Appendices	LPFE Limited's audited annual accounts to 31 March 2016

LPFE Limited

Financial Statements

For the period from incorporation to 31 March 2016

Registered number SC497543

LPFE LIMITED

Financial statements

For the period ended 31 March 2016

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LPFE LIMITED

Company information

Board of Directors:	Hugh Dunn Clare Scott Alasdair Rankin Martin Glover
Company Secretary:	D.W. Company Services Limited
Bankers:	The Royal Bank of Scotland plc
Auditor:	Scott-Moncrieff Exchange Place 3 Semple Street Edinburgh EH3 8BL

The directors present their report and audited financial statements for the period from 11 February 2015, the date of incorporation, to 31 March 2016.

Principal activity

The principal activity of the company is the provision of seconded staff to the City of Edinburgh Council and LPFI Limited in support of the administration of the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund ("the Funds") and, separately, to Falkirk Council in their capacity as the administering authority of the Falkirk Council Pension Fund. All pension funds are part of the Local Government Pension Scheme in Scotland.

Results, Dividends and Mutual Trading Surplus

The loss for the year after tax was £60,454 and after allowing for items included under "Other comprehensive income" a loss of £142,454. The directors do not recommend payment of dividend.

The company's aim is to make a modest trading surplus before adjustments required under IFRS. After allowing for an addition to costs of £26,697 in respect of accrued holiday pay and £62,000 for adjustments to pension costs under IAS19, the underlying trading profit is £28,243. The additional costs recognised under "Other comprehensive income" amounting to £82,000 all relate to further adjustments required by IAS19 and the related deferred tax.

Under the mutual agreement with the City of Edinburgh Council, the company is required to consider if any of profit arising from the mutual trade can be returned to the Council. Although there was an underlying trading profit of £28,243, Company Law requires that only "distributable profits" are available for distribution. The company's auditor has confirmed that the various adjustments required under IFRS do need to be taken into account when determining if profits are distributable. As a result there are no distributable profits available for return to the Council in respect of the period.

Business Review

The company was incorporated on 11 February 2015 and commenced trading on 1 May 2015. On that date, 11 investment and managerial staff transferred their employment from the City of Edinburgh Council to the company.

The company is wholly owned by the City of Edinburgh Council and has entered into a shareholder agreement with the Council to appropriately address certain governance matters. The company also has a loan facility provided by the City of Edinburgh Council for the purpose of the provision of short term working capital.

Staffing services are provided to the City of Edinburgh Council 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.

The company has entered into appropriate admission arrangements with the City of Edinburgh Council with respect to the 11 transferring individuals continuing to be members of the Lothian Pension Fund and in relation to its obligations as an employer in that fund.

HMRC has agreed that any profits arising as a result from trade between the company and the City of Edinburgh Council will be covered by the "Mutual Trading" rules and so not subject to Corporation Tax.

The company also has a secondment agreement with the Falkirk Council to provide investment staff to assist with certain aspects of the administration of the Falkirk Council Pension Fund as part of a mutually beneficial collaboration between those LGPS funds.

Future prospects

The company's future prospects are primarily linked to the needs of the City of Edinburgh Council in its administration of the Funds. The company is securely funded by the City of Edinburgh Council which means that it is in a position to adapt to any future staffing requirements.

Directors

The directors who served during the period were:

Hugh Dunn	(appointed 11 February 2015)
Linda Holden	(appointed 11 February 2015 and resigned 10 December 2015)
Alastair Maclean	(appointed 11 February 2015 and resigned 19 February 2016)
Clare Scott	(appointed 11 February 2015)
Alasdair Rankin	(appointed 24 February 2015)
Martin Glover	(appointed 10 December 2015)

Statement of directors' responsibilities

The directors are responsible for preparing the financial statements in accordance with applicable laws and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of its results for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Disclosure of information to auditor

As far as each of the directors at the time the report is approved are aware:

a) there is no relevant information of which the company's auditor is unaware, and
b) the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditor is aware of the information.

Auditor

The auditor, Scott-Moncrieff, is deemed to be reappointed under Section 487 (2) of the Companies Act 2006.

Small company provisions

This report has been prepared in accordance with the special provisions for small companies under Part 15 of the Companies Act 2006.

This report was approved by the board and signed on its behalf by:

Date: 20 June 2016

Hugh Dunn
Chairman

LPFE LIMITED

Independent auditor's report to the members of LPFE Limited

For the period ended 31 March 2016

We have audited the financial statements of LPFE Limited for the period ended 31 March 2016 which comprise the Statement of Profit or Loss and Other Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Statement of Cash Flows and related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective Responsibilities of the Directors and the Auditor

As explained more fully in the Statement of directors' responsibilities set out on page 3, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the Audit on the Financial Statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on Financial Statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2016 and of its results for the period then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on Other Matter(s) Prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the period for which the financial statements are prepared is consistent with the financial statements.

Matters on Which We Are Required to Report by Exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- the company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit;
- the directors were not entitled to prepare the financial statements in accordance with the small companies regime and take advantage of the small companies' exemption in preparing the directors' report; or
- the directors were not entitled to take advantage of the small companies exemption from the requirement to prepare a strategic report.

Nick Bennett, Senior Statutory Auditor
For and on behalf of Scott-Moncrieff, Statutory Auditor
Exchange Place 3
Semple Street
Edinburgh
EH3 8BL

Date: 20 June 2016

LPFE LIMITED

Statement of Profit or Loss and Other Comprehensive Income

For the period ended 31 March 2016

	Note	2016 £
Revenue	1e	904,074
Gross profit		904,074
Administrative expenses		(959,895)
Loss from operations	2	(55,821)
Finance costs	3	(9,968)
Loss before income tax expense		(65,789)
Corporation tax expense	4	5,335
Loss for the period		(60,454)
Other comprehensive income:		
Those that are not recyclable net of tax:		
Recognition of opening retirement benefit obligation	15	(281,000)
Actuarial gains on retirement benefit obligation in period	15	163,000
Deferred tax on retirement benefit obligation	10	36,000
Total comprehensive income for the period		(142,454)

The accompanying notes on pages 10 to 26 form part of these financial statements

LPFE LIMITED

Statement of Financial Position

As at 31 March 2016

	Note	As at 31 March 2016 £
Non-current assets		
Deferred tax asset	10	36,000
		36,000
Current assets		
Trade and other receivables	7	129,681
Cash and cash equivalents	8	5,065
Total current assets		134,746
Total assets		170,746
Equity and Liabilities		
Equity attributable to equity holders of the parent		
Share capital	11	1
Retained earnings	12	(142,454)
		(142,453)
Liabilities		
Non-current liabilities		
Retirement benefits obligation	15	180,000
Total non-current liabilities		180,000
Current liabilities		
Trade and other payables	9	133,199
Total current liabilities		133,199
Total liabilities		313,199
Total equity and liabilities		170,746

The financial statements were authorised for issue by the Board of Directors on 20 June 2016 and where signed on its behalf by:

, Director

Registered number SC497543

The accompanying notes on pages 10 to 26 form part of these financial statements

LPFE LIMITED

Statement of Changes in Equity

As at 31 March 2016

	Note	Share Capital £	Retained Earnings £	Total £
Loss for the year		-	(60,454)	(60,454)
Other comprehensive income				
Share capital issued		1	-	1
Recognition of opening retirement benefit obligation	15	-	(281,000)	(281,000)
Actuarial gains on retirement benefit obligation in period	15	-	163,000	163,000
Deferred tax on retirement benefit obligation	10	-	36,000	36,000
Balance at 31 March 2016		1	(142,454)	(142,453)

The accompanying notes on pages 10 to 26 form part of these financial statements

LPFE LIMITED

Statement of Cash Flows

For the period ended 31 March 2016

	2016 £
Cash flow from operating activities	
Loss for the period	(60,454)
Adjustments for:	
Defined benefit pension – current service cost	174,000
Defined benefit pension – employer contributions	(121,000)
Defined benefit pension – finance costs	9,000
Finance costs	968
Changes in assets and liabilities:	
Increase in receivables and other financial assets	(123,524)
Increase in payables	133,005
Increase in provisions	-
Cash flows from operations	11,995
Interest paid	(774)
Net cash flows from operating activities	11,221
Cash flow from investing activities	
Net cash flows from investing activities	-
Cash flow from financing activities	
Share capital issued	1
Movement in loan facility	(6,157)
Net cash flows from financing activities	(6,156)
Net increase in cash and cash equivalents	5,065
Cash and cash equivalents at beginning of period	-
Cash and cash equivalents at end of period	5,065
Cash at bank and in hand	5,065

1. Statement of significant accounting policies

The financial statements of LPFE Limited have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, IFRIC Interpretations and the Companies Act 2006, as applicable to companies reporting under IFRS.

Standards issued but not yet effective

Standards issued but not yet effective up to the date of issuance of LPFE Limited's financial statements are listed below. LPFE Limited intends to adopt these standards when they become effective.

The directors do not expect that the adoption of the following standards and interpretations in future reporting periods will have a significant impact on the group's financial statements.

- IAS 1 'Presentation of Financial Statements'. The standard has been amended twice. The first amendment arises from the issue of IFRS 9. The main changes deal with the abolition of the available for sale category of financial assets, amend the presentation and disclosure of gains and losses arising on financial assets stated at amortised cost, and take account of the revised reclassification rules under IFRS 9 as compared with IAS 39. These changes take effect at the same time as IFRS 9 is applied. The second amendment is part of the disclosure initiative and is effective for annual periods beginning on or after 1 January 2016. The minor amendments address a number of areas which include the disclosure of significant accounting policies, the application of materiality to financial statements, the presentation of sub-totals, information to be presented in the other comprehensive income section of the performance statement and the structure of the financial statements. Entities are required to present significant accounting policies that form part of a complete set of financial statements, rather than a summary of significant accounting policies.

- IAS 16, 'Property, Plant and Equipment'. There are two amendments to the standard. The first amendment clarifies the suitability of using a revenue-based method of depreciation. The amendment is effective prospectively for annual periods beginning on or after 1 January 2016. The IASB has clarified that a depreciation method based on revenue is not an appropriate method in determining a pattern in which the asset's future economic benefits are consumed. The amendment clarifies that those factors have no impact on the way the asset is consumed, but instead could indicate technological or commercial obsolescence of the asset that reflects a reduction of the future economic benefits of the asset. The second amendment defines and brings bearer plants into the scope of IAS 16 rather than IAS 41. The amendment is effective retrospectively for periods beginning on or after 1 January 2016.

- IAS 19, 'Employee Benefits'. The annual improvements project clarifies the discount rate to be used in regional markets, and is effective for annual periods beginning on or after 1 January 2016. The amendment clarifies that the discount rate to be used for post-employment benefit obligations must be assessed at a currency level and not a country/regional market level when determining the rate based on high quality corporate bonds or government bonds when there is no deep market in high quality corporate bonds in that currency.

- IAS 27, 'Separate Financial Statements'. The IAS 27 amendment addresses the measurement of investments in separate entity financial statements. The amendment is effective for annual periods beginning on or after 1 January 2016. The amendment reinstates a previous option to allow an entity to measure its investments in subsidiaries, associates or joint ventures in the separate financial statements applying the equity method of accounting, this option is in addition to the cost and fair value method currently allowed. The accounting policy choice must be applied to each class of investment. The amendment also clarifies that when an investor becomes or ceases to be an investment entity such a change in accounting must start from the date the change in status occurs.

- IAS 39, 'Financial Instruments: Recognition and Measurement'. A major change to IAS 39 arises out of IFRS 9. The amendments primarily remove items from the scope of the standard, insofar as they are dealt with by IFRS 9. However, these changes apply only when IFRS 9 is adopted.

1. Statement of significant accounting policies (continued)

- IFRS 7, 'Financial Instruments: Disclosures'. There are a number of changes to IFRS 7. Firstly a major change to IFRS 7 arises out of IFRS 9. There are significant changes to the standard, reflecting the replacement of the four categories of financial asset under IAS 39 with the three under IFRS 9. All of the IFRS 7 disclosures by category of financial asset have had to be altered to reflect the new categorisation. There are also changes associated with the potentially different measurement bases applied by IFRS 9. IFRS 7 also has a number of disclosures which deal with the transition from IAS 39 to IFRS 9 for financial assets, and will be required only for the year of change. Secondly the annual improvements project clarifies the concept of continuing involvement in transferred financial assets for disclosure purposes. This amendment applies for periods beginning on or after 1 January 2016. Continuing involvement does not exist in a transferred financial asset when the entity does not have an interest in the future performance of the transferred financial asset nor the responsibility to make payments in respect of the financial asset in the future. The amendment clarifies the latter requirement relating to making a "payment" in respect of the financial asset. Payment in this context does not include cash flows of the transferred financial asset that are collected by the entity and remitted to the transferee.

- IFRS 9, 'Financial Instruments'. The IASB has completed IFRS 9 Financial Instruments, the replacement for IAS 39, dealing with the classification, recognition and measurement, de-recognition, impairment and hedge accounting (except for macro hedging). Macro hedging (described as dynamic risk management) is now being considered as a separate project, and a standard dealing with that matter will be issued in due course. The new standard is effective for accounting periods beginning on or after 1 January 2018.

Objective and Scope
IFRS 9 has the objective of establishing principles for the financial reporting of financial assets and liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of the entity's future cash flows. The scope of the standard is similar to that of IAS 39, however, there are some changes:

- it is now made clearer that the exclusion for forward contracts for business combinations applies;
- only to such combinations which are within the scope of IFRS 3;
- loan commitments now fall within the scope of the impairment requirements (as well as the de-recognition;
- requirements, which also applied under IAS 39); and
- entities may now, at inception, irrevocably designate a contract to buy or sell a non-financial item that would normally be excluded from the scope if this eliminates or reduces a recognition inconsistency (or accounting mismatch).

Recognition and de-recognition
IFRS 9 does not make any substantive changes to the IAS 39 requirements in respect of recognition and de-recognition of financial assets or liabilities, instead more disclosures are required by IFRS 7 on de-recognition.

Classification of Financial Assets
The four categories of financial asset set out in IAS 39 do not survive into IFRS 9. Instead there are three categories:

- at amortised cost;
- at fair value through other comprehensive income; and
- at fair value through profit or loss.

1. Statement of significant accounting policies (continued)

Classification of Financial Liabilities
The requirements in respect of classification of financial liabilities of IAS 39 have, largely, been carried forward without change into IFRS 9. However, consistent with the change in the treatment of unquoted equity investments, the standard does change the treatment of derivative liabilities that are linked to, and must be settled by delivery of, unquoted equity instruments.

Embedded Derivatives
IFRS 9 has, with some rewording, basically taken the definition of an embedded derivative from IAS 39 without substantive change. It does, however, change the accounting consequences of identifying embedded derivatives, quite substantially in some cases. Where there is an embedded derivative then under this standard then the host contract is an asset that falls within the scope of IFRS 9 and the embedded derivative is not separated but the entire contract is accounted for under IFRS 9. This will normally mean that the contract is stated at fair value.

Reclassification of Financial Assets
Reclassification is allowed if, and only if, the entity changes its business model for managing financial assets, or specific portfolios of financial assets. Where this occurs, the change in accounting treatment is applied on a prospective basis only, from the reclassification date. There is no change to the treatment of any gains, losses or interest amounts that have previously been recognised.

Measurement
With one main exception, financial assets and liabilities are initially recorded at their fair value (at trade date, if relevant). In the case of items which will not be carried at fair value through profit or loss, this is then adjusted for directly attributable acquisition costs. The main exception is trade receivables which do not contain a significant financing component, which are initially recorded at transaction price. After recognition, financial assets are carried at a value measured in accordance with their classification, as set out above. Impairment requirements also need to be reflected for items at amortised cost or at fair value through other comprehensive income. Similarly, financial liabilities are measured in accordance with their classification.

Impairment
IFRS 9 moves to an expected loss model of accounting for impairments compared with IAS 39 incurred loss model. Under the new model, expected credit losses are recognised from the point at which a financial asset is initially recognised.

Hedge Accounting
IFRS 9 contains hedge accounting conditions that are more liberal than those of IAS 39. Whilst hedge accounting remains optional, the simplicity that IFRS 9 introduces is likely to extend its use.

Transitional Provisions
While IFRS 9 is a fairly straightforward standard, its transitional provisions are complex. The basic requirement is that IFRS 9 is to be applied retrospectively, but there is a very wide range of exceptions to this general principle. In particular, there is no requirement to restate prior periods.

- IFRS 10, 'Consolidated Financial Statements'. The amendment clarifies the application of the consolidation exemption for investment entities.

- IFRS 12, 'Disclosure of Interests in Other Entities'. The standard has been amended as part of the IFRS 10 consolidation exemption for investment entities amendment and is effective retrospectively for accounting periods beginning on or after 1 January 2016, with early application permitted. The amendment ensures consistency with IAS 27, in that disclosure is to be provided in accordance with IFRS 12, when an investment entity measures all its subsidiaries in its financial statements at fair value through profit or loss in accordance with the IFRS 10 investment entity consolidation exemption.

1. Statement of significant accounting policies (continued)

Basis of preparation

These financial statements are presented in Sterling (£) as that is the company's functional currency and the currency in which the majority of the company's transactions are denominated.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the company's accounting policies.

The following significant accounting policies have been adopted in the preparation of this report:

a. Going concern

The directors are of the opinion that the company has adequate resources to enable it to undertake its planned activities for a period of at least one year from the date that the financial statements are approved.

b. Current and deferred corporation tax

The company is a mutual trader and is therefore not liable to corporation tax on surpluses generated from mutual trade. The tax charge for the period is based on the profit for the year 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 balance sheet 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 income 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 income 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.

1. Statement of significant accounting policies (continued)

c. Impairment

The carrying value of all assets are reviewed for impairment at each reporting date, with the recoverable amount being estimated when events or changes in circumstances indicate that the carrying value may be impaired.

The recoverable amount of all assets is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which it belongs, unless the asset's value in use can be estimated to be close to its fair value.

An impairment exists when the carrying value of the asset or cash-generating units exceeds its estimated recoverable amount. The asset or cash-generating unit is then written down to its recoverable amount.

d. Cash and cash equivalents

For the purposes of the statement of cash flows, cash includes cash on hand and at call deposits with banks or financial institutions, investments in money market instruments maturing within less than two months and is net of bank overdrafts.

e. Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty.

Revenue is derived wholly from the provision of seconded staff in the United Kingdom. Revenue is recognised upon the delivery of the service to the customers.

All revenue is stated net of the amount of value added tax (VAT).

f. Value added tax

Revenues, expenses and assets are recognised net of the amount of value added tax (VAT), except:

i. Where the amount of VAT incurred is not recoverable from the taxation authority, it is recognised a part of the cost of acquisition of an asset or as part of an item of expense; or
ii. For receivables and payables, which are recognised inclusive of VAT.

The net amount of VAT recoverable from, or payable to, the taxation authority is included as part of receivables or payables.

Cash flows are included in the statement of cash flows on a gross basis. The VAT component of cash flows arising from investing and financing activities which is recoverable from, or payable to, the taxation authority is classified as operating cash flows.

1. Statement of significant accounting policies (continued)

g. Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Trade payables are recognised at cost.

h. Share capital

Ordinary shares are classified as equity.

i. Employee benefits

The company contributes to a defined benefits scheme operated on behalf of its employees.

The employees of LPFE Limited participate in the Lothian Pension Fund, which is part of the Local Government Pension Scheme in Scotland and is administered by the City of Edinburgh Council.

The current service cost for the period is charged to the Statement of Profit or Loss and Other Comprehensive Income. The assets of the scheme are held separately from those of the company in independently administered funds. The company has fully adopted the accounting principles as required by International Accounting Standard 19 – Employee Benefits.

The liability recognised in the balance sheet in respect of 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 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 equity in other comprehensive income in the period in which they arise.

Past-service costs are recognised immediately in income, 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.

j. Financial instruments

Financial assets and financial liabilities are recognised when the Company has become party to the contractual provisions of the instrument.

Trade receivables
Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is recognised in the statement of comprehensive income.

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1. Statement of significant accounting policies (continued)

j. Financial instruments (continued)

Trade payables
Trade payables are initially recognised at fair value and subsequently at amortised cost using the effective interest method.

Financial liabilities
Financial liabilities are classified according to the substance of the contractual arrangements entered into.

An instrument will be classified as a financial liability when there is a contractual obligation to deliver cash or another financial asset to another enterprise.

Loans
All interest bearing loans and other borrowings are initially recorded at fair value, which represents the fair value of the consideration received, net of any issue costs associated with other borrowings. Interest bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs.

Finance charges, including premiums payable on settlement or redemption, are accounted for on an amortised cost basis to the statement of comprehensive income using the effective interest method, being recognised in the statement of comprehensive income over the term of such instruments at a constant rate on the carrying amount of the instrument to the extent that they are not settled in the year in which they arise.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

k. Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amount and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

l. Critical accounting estimates and judgements

The directors evaluate estimates and judgements incorporated into the financial report based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data, obtained both externally and within the company.

Key estimates – defined benefit pension obligation

IAS 19, Employee Benefits requires that certain assumptions are made in order to determine the amount to be recorded for retirement benefit obligations and pension plan assets. These are mainly actuarial assumptions such as expected inflation rates, long-term increase in health care costs, employee turnover, expected return on plan assets and discount rates. Substantial changes in the assumed development of any one of these variables may significantly change the Group's retirement benefit obligation and pension assets (see note 15).

2. Loss from operations

	2016 £
Loss from operations has been determined after deducting:	
Auditors' remuneration:	
Audit services	4,750
Non-Audit services	2,250

3. Finance costs

	2016 £
Loan interest payable to group entities (note 14)	968
Pension interest costs (note 15)	9,000
	9,968

4. Corporation tax expense

	2016 £
Current tax credit for the period	(5,335)
Deferred tax	-
Corporation tax credit for the period	(5,335)

The credit for the year can be reconciled to the loss per the income statement as follows:

	2016 £
Loss for the year before taxation	(65,789)
Loss for the year at the effective rate of corporation tax of 20%	(13,158)
Effects of:	
Expenses not deductible for tax purposes	7,872
Group relief surrendered	5,286
Due from group entities for losses surrendered	(5,335)
Current tax credit	(5,335)

5. Employee Benefits Expense

The average number of persons employed by the company during the period was 11.

The aggregate payroll costs of these persons were as follows:

	2016
	£
Wages and salaries	649,120
Social security costs	67,389
Defined benefit pension obligation - current service cost	174,000
	890,509

6. Directors' Remuneration

One director received emoluments from the company during the period. The director's emoluments for the period were as follows:

	2016
	£
Aggregate emoluments	78,384
Employer pension contributions	16,068

The director had an accrued pension of £13,919 (1 May 2015: £11,891) and a lump sum of £10,973 (1 May 2015: £10,585) at the end of the period.

7. Trade and other receivables

	2016
	£
Trade receivables	-
Other debtors	27,295
Amounts due from group entities	102,366
Prepayments and accrued income	20
	129,681

The directors consider the fair value of receivables to be in line with their carrying values.

8. Cash and cash equivalents

	2016
	£
Cash at bank and in hand	5,065

9. Current liabilities

	2016 £
Social security and other taxes	96,116
Accruals and deferred income	36,775
Trade payables	308
	133,199

10. Deferred tax

	2016 £
Deferred tax asset	
Charge for the year to profit or loss	
Charge for the year to other comprehensive income	36,000
At 31 March 2016	36,000

The elements of deferred tax are as follows:

	2016 £
Pension scheme liability	36,000
	36,000

11. Share Capital

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

One ordinary share of £1 was issued at par value on incorporation.

12. Reserves

	Retained Earnings £
Loss for the period	(60,454)
Transfer of opening retirement benefit obligation	(281,000)
Actuarial gains on retirement benefit obligation	163,000
Deferred tax on retirement benefit obligation	36,000
At 31 March 2016	(142,454)

13. Ultimate controlling party

By virtue of its controlling interest in the company's equity capital, the City of Edinburgh Council is the ultimate controlling party. The company's immediate parent is Lothian Pension Fund and the company's individual accounts are consolidated into Lothian Pension Fund's consolidated accounts.

Group accounts are available to the public from the following address:

Acting Executive Director of Resources
City of Edinburgh Council
Waverley Court
Edinburgh
EH8 8BG

14. Related party transactions

	2016 £
Lothian Pension Fund (pension fund administered by ultimate parent):	
Sale of services during the period	819,720
Receivables at the period end	90,874
City of Edinburgh Council (ultimate parent):	
Loan facility balance (receivable) at the period end	6,157
Interest payable during the period	968
Interest payable but not yet paid at the period end	194

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.

During the year the company surrender the losses of £5,335 to Lothian Buses Limited, another group company.

Total compensation paid in relation to key management personnel during the period was as follows:

	2016 £
Short-term employee benefits	318,192
Post-employment benefits - employer pension contributions	65,228
	383,420

Key management personnel had accrued pensions totalling £68,004 (1 May 2015: £57,741) and lump sums totalling £92,156 at the end of the period (1 May 2015: £86,021).

15. Retirement benefits obligation

On 1 May 2015 the company 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 Lothian Pension Fund, which is administered by the City of Edinburgh Council, is part of the Local Government Pension Scheme in Scotland. This is a pension scheme providing benefits based on final pensionable pay, contributions being charged to the profit or loss so as to spread the cost of pensions over employees' working lives. The contributions are determined by a qualified actuary.

The valuation of the pension fund is carried out triennially. The most recent actuarial valuations of plan assets and the present value of the defined benefit obligation were carried out as at 31 March 2014 by Hymans Robertson LLP. 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.

Scheme assets

The company's share of the fair value of the scheme'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:

	%	31 March 2016 £'000	%	1 May 2015 £'000
Equity Securities:				
Consumer	15%	319	15%	277
Manufacturing	12%	247	12%	209
Energy and Utilities	8%	167	10%	181
Financial Institutions	8%	178	8%	140
Health and Care	7%	139	7%	129
Information Technology	6%	126	6%	106
Other	6%	120	5%	96
Debt Securities:				
UK Government	6%	135	6%	104
Other	3%	53	2%	45
Private Equity:				
All	4%	92	5%	88
Real Estate:				
UK Property	9%	179	8%	143
Investment Funds and Unit Trusts:				
Commodities	0%	6	0%	6
Bonds	1%	17	0%	5
Infrastructure	7%	139	6%	101
Other	2%	50	2%	37
Derivatives:				
Foreign exchange	0%	0	1%	11
Cash and Cash Equivalents:				
All	6%	130	8%	148
	100%	2,097	100%	1,826

15. Retirement benefits obligation (continued)

The amounts recognised in the statement of financial position are determined as follows:	**2016 £'000**
Fair value of plan assets	2,097
Present value of scheme liabilities	(2,277)
Net pension (liability)/asset	(180)

The movement in the defined benefit obligation during the period was as follows:

	2016 £'000
At 1 May 2015	2,107
Current service cost	174
Interest cost on obligation	69
Plan participants contributions	54
Benefits paid	0
Actuarial losses arising from changes in financial assumptions	(378)
Actuarial losses arising from changes in demographic assumptions	0
Other actuarial losses/(gains)	251
At 31 March 2016	2,277

The movement in the fair value of plan assets during the period was as follows:

	2016 £'000
At 1 May 2015	1,826
Benefits paid	0
Interest income on plan assets	60
Contributions by employer	121
Contributions by member	54
Contributions in respect of unfunded benefits	0
Unfunded benefits paid	0
Return on assets excluding amounts included in net interest	36
At 31 March 2016	2,097

The amounts recognised in the Statement of Profit or Loss are as follows:

	2016 £'000
Interest received on pension scheme assets	(60)
Interest cost on pension scheme liabilities	69
Finance cost/(income)	9
Current service cost	174
	183

15. Retirement benefits obligation (continued)

Amounts recognised in Other Comprehensive Income:

	2016
	£'000
Transfer of opening retirement benefit obligation on 1 May 2015	(281)
Actuarial gains due to remeasurement of the defined benefit obligation	127
Return on assets (excluding amounts included in profit or loss)	36
	(118)

The principal actuarial assumptions used in this valuation were:

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

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.

Mortality rates:

Life expectancy is based on the Fund's Vita Curves 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.

Based on these assumptions, the average future life expectancies at age 65 are summarised below:

	Male	**Female**
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.

16. Financial Risk Management

The company's financial instruments consist mainly of deposits with banks and accounts receivable and payable.

The company did not enter into any transactions that would be classed derivative financial instruments during the period.

The totals for each category of financial instruments, measured in accordance with IAS 39 and detailed in the accounting policies, are as follows:

	Note	2016 £
Financial Assets		
Cash and cash equivalents	8	5,065
Trade and other receivables	7	129,681
Total Financial Assets		134,746
Financial Liabilities		
Financial liabilities at amortised cost:		
Trade and other current payables	9	133,199
Total Financial Liabilities		133,199

Financial Risk Management Policies

The company aims to manage its overall capital structure to ensure it continues to operate as a going concern. The company's capital structure represents the equity attributable to the shareholders of the company together with cash equivalents.

The Board is charged with the overall responsibility of establishing and monitoring the company's risk management policies and processes in order to identify, analyse and monitor the risks that are faced by the company. The company does not enter into or trade financial instruments for speculative purposes.

The main risks that the company is exposed to through its financial instruments are credit risk, liquidity risk and market risk. These are managed as follows:

a. Credit risk

Exposure to credit risk relating to financial assets arises from the potential non-performance by counterparties of contractual obligations that could lead to a financial loss to the company.

The maximum exposure to credit risk, excluding the value of any collateral or other security, at balance sheet date to recognised financial assets, is the carrying amount, net of any provisions for impairment of those assets, as disclosed in the Statement of Financial Position and notes to the financial statements. As at 31 March 2016 none of the company's financial assets were past due or impaired.

Credit risk is managed and reviewed regularly by senior management. It mainly arises from amounts owed by customers.

16. Financial Risk Management (continued)

a. Credit risk (continued)

The nature of the company's is business means that it currently only has two customers. By far the largest customer is the City of Edinburgh Council and the company is securely funded by the Council. The smaller customer is Falkirk Council. Given the financial stature of both Councils the credit risk faced by the company is considered to be very small.

b. Liquidity Risk

Liquidity risk arises from the possibility that the company might encounter difficulty in settling its debts or otherwise meeting its financial obligations as they fall due. The company manages this risk through the following mechanisms:

- preparing forward-looking cash flow analysis in relation to its operational, investing and financing activities; and
- ensuring that adequate unutilised borrowing facilities are maintained.

The tables below reflect an undiscounted contractual maturity analysis for financial liabilities.

Financial liability and financial asset maturity analysis

	Note	Within 1 Year 2016 £	1 to 5 Years 2016 £	Total 2016 £
Financial liabilities due for payment				
Trade and other payables	9	(133,199)	-	(133,199)
Total expected outflows		(133,199)	-	(133,199)
Financial assets — cash flows realisable				
Cash and cash equivalents	8	5,065	-	5,065
Trade, term and loan receivables	7	129,681	-	129,681
Total anticipated inflows		134,746	-	134,746
Net inflow of financial instruments		1,547	-	1,547

Cash flows realised from financial assets reflect management's expectation as to the timing of realisation. Actual timing may therefore differ from that disclosed. The timing of cash flows as presented in the table (to settle financial liabilities) reflects the earliest contractual settlement dates.

16. Financial Risk Management (continued)

The company has been granted a £250,000 unsecured revolving loan facility by its parent, The City of Edinburgh Council. The ceiling of the facility has been set at a level to ensure sufficient cash is available to meet the company's short-term cash flow needs, should there be a delay in the City of Edinburgh Council settling invoices for seconded staff.

c. Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the company's financial position. The company has no direct exposure to movements in foreign exchange or equity prices, and has very little exposure to interest rate movements, due to the low level of borrowing. The company monitors this risk but the directors are of the opinion that it is very unlikely to have a significant effect on the company's financial position.

Pensions Committee

2.00 p.m., Wednesday, 28 September 2016

Fiduciary Duty

Item number	5.6
Report number	
Executive/routine	
Wards	All

Executive summary

The Scheme Advisory Board (**SAB**) of the Scottish Local Government Pension Scheme has sought a legal report and opinion on Pension Committees in Scotland exercising their fiduciary duty (**the Opinion**). The opinion has now been shared with the eleven Scottish administering authorities, together with guidance from the SAB, and sent to the Scottish Ministers for information.

The Opinion essentially reaffirms the position taken by Senior Counsel in England & Wales and essentially confirms that the advice is also applicable in Scotland. This in turn reinforces the approach taken by the pension funds to date.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Report

Fiduciary Duty & Update on Governance

Recommendations

That Committee:

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

1.2 notes the Legal Opinion and Report on Fiduciary Duty (**Opinion**) and the guidance from the Scheme Advisory Board (**SAB**) and its importance in investing pension fund monies;

1.3 notes that the Opinion and guidance from the SAB reaffirm the present approach taken by the Committee to exercising its fiduciary duty generally and as regards its investment strategy;

1.4 refers this report to the Corporate Policy and Strategy Committee of the City of Edinburgh Council.

Background

2.1 Councils, as administering authorities for the Local Government Pension Scheme and as public bodies, face significant scrutiny and lobbying on certain types of investments of the pension funds. The shares of tobacco and arms-producing companies are commonly cited as securities in which the pension funds should not invest for ethical reasons. In June 2015, on the instruction of the City of Edinburgh Council, the Pensions Committee considered the potential impact to the Funds of divesting the shares of fossil fuel companies at a meeting where Friends of the Earth Scotland lobbied for disinvestment.

2.2 In April 2014, the Local Government Association on behalf of the Local Government Pension Scheme (**LGPS**) Shadow Scheme Advisory Board in England and Wales obtained legal opinion on fiduciary duty.

2.3 The Law Commission (England & Wales) also produced a report on “Fiduciary Duties of Investment Intermediaries” in 2014.

2.4 The Committee are aware that, because these developments did not specifically take into account Scots law, the Scheme Advisory Board for the Scottish LGPS (**SAB**) has sought a legal opinion on the matter.

Main report

3.1 The Scheme Advisory Board (**SAB**) has issued the legal opinion on fiduciary duty, together with its own guidance, to the administering authorities of the LGPS in Scotland and to the Scottish Ministers for information.

3.2 A copy of the Opinion and guidance from the SAB has already been circulated to the members of the Committee and Pension Board, but is also attached as Appendix 1 to this report for completeness and ease of reference.

3.3 The Opinion reaffirms the position taken by Senior Counsel in England & Wales, Nigel Giffin and others, so that the position in Scotland is effectively aligned. The Opinion also provides helpful clarification on a number of other important matters, including:

a. **Non-financial factors:** that non-financial factors may be taken into consideration as part of any investment decision making process, provided that:-

   (i) there is no policy in place limiting the scope of potential investments purely on the grounds of non-financial considerations. A decision regarding any particular investment should not be made where the diversification of potential investments has been compromised; and

   (ii) the proposed investment is expected to generate financial returns similar to those expected from other investment opportunities available in the market at that time offering similar risk and return characteristics.

b. **Environmental, Social and Governance (in assessing risk and return):** that, more specifically, when considering investments, Pensions Committees may look at environmental, social and governance (**ESG**) issues where the financial performance of that investment may be adversely impacted as a result of any particular ESG factor (e.g. as part of its risk and return assessment/diligence). The investment returns may, therefore, be restricted on the grounds of ESG factors where the investment returns to the fund may be negatively impacted by such factors.

c. **Beneficiaries:** that the fiduciary duty is owed by Pensions Committees to the employers and members in the relevant pension fund and that there is not a sufficiently direct link to the taxpayer (specifically for the purposes of this legal duty) to extend that duty directly to the taxpayers themselves.

d. **Canvassing beneficiaries' views:** that Pensions Committees should exercise their fiduciary duty having, where appropriate, taken professional advice and that (in the view of Scottish Counsel) it would not be appropriate to canvas the views of the beneficiaries (e.g. members and employers) before such decisions are taken.

e. **Public law:** that while a Council's duty under public law could potentially overlap with its fiduciary duty in acting in its separate capacity as administering authority of a pension fund, as such statutory obligations (such as in the Climate Change or Equalities legislation) are usually couched in “non-obligatory” terms, this is not likely to be an issue in practice. This is further underlined both by Scottish and English Counsel who emphasise that such non-obligatory public law statutory duties (e.g. to achieve something in the most “sustainable” manner) should only be brought into consideration where the decision or choice of investments was neutral from an investment perspective. Otherwise, they should not have a bearing on a Pension Committee exercising its separate legal duty to the beneficiaries of the pension fund(s) it administers. The Opinion does qualify this by making it clear that where there was an express statutory direction on a matter placing a legal obligation on Pension Committees, they would of course need to have regard to that. However, there would be clear legal and other conflicts, among other issues, with such prescriptive legislation appearing in non-pension specific statutes and so this is perhaps an unlikely scenario.

Measures of success

4.1 Pension funds are invested in accordance with the law.

Financial impact

5.1 There is no direct financial impact as a result of this report. However the investment of the pension funds has a significant impact on the financial position of the pension fund and the participating employers.

Risk, policy, compliance and governance impact

6.1 The Opinion and guidance on fiduciary duty are important governance considerations for the administration of the pension funds. Non-compliance could leave the Council and pension funds open to challenge or otherwise have an adverse impact on the Council, the pension funds and their stakeholders.

Equalities impact

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

Sustainability impact

8.1 There is no sustainability impact as a result of 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

Local Government Association on behalf of the Local Government Pension Scheme (LGPS) Shadow Scheme Advisory Board in England and Wales obtained legal opinion on fiduciary duty
http://www.lgpsboard.org/images/PDF/Publications/QCOpinionApril2014.pdf

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Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives
Single Outcome Agreement	
Appendices	Appendix 1 – Legal Report and Opinion on Fiduciary Duty and Guidance from Scheme Advisory Board

The Scottish Local Government Pension Scheme
c/o the Head of Service,
Convener of the Pensions Committee and Chair of the Pension Board of the respective Scottish LGPS Fund

24 June 2016

Fiduciary Duty

The Scheme Advisory Board (**SAB**) has been considering the application of the legal principles of Fiduciary Duty by the Pensions Committees of the Local Government Pension Scheme (**LGPS**) in Scotland. In doing so it has, following a tender exercise, appointed specialist legal advisors in this sector to produce a legal report and opinion (**Opinion**) which builds on the extensive advice from industry experts already obtained in this area but also provides clarity of the position under Scottish law.

We therefore attach the Opinion to assist your Pensions Committee and Pension Board in applying this fundamental principle in practice. We believe the Opinion is helpful in that it reaffirms the substantial majority of advice already obtained on this matter, and its consistent application in Scotland, but also provides further clarification on a number of important matters.

The SAB is acutely aware of the need for the Scottish LGPS to have the flexibility to apply these principles to specific circumstances and the latitude that this will necessarily require. With that in mind, the SAB would request that Pensions Committees and Pensions Boards have regard to the following when exercising their fiduciary duties in relation to their investment programmes and, more generally, in ensuring best practice stewardship of their assets:

1. *The Opinion of 11 February 2016 enclosed with this letter.*

2. *The expectation that Funds within the Scottish LGPS will:*

    a. *have long-term investment horizons which are appropriately aligned to their member and employer stakeholders and investment strategies that (when taken as a whole) reflect this;*

    b. *dedicate sufficient time and resource, taking advice from suitably expert and reputable advisors where appropriate, to properly inform their asset allocation, investment and manager selection decisions;*

    c. *exercise sufficient levels of attention, care and diligence, taking advice from suitably expert and reputable advisors where appropriate, in appraising particular investment opportunities. It is recognised that due to the large amount of potential investment opportunities available, Funds will necessarily require to manage their*

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SCOTTISH LOCAL GOVERNMENT PENSION SCHEME ADVISORY BOARD

resource to focus on those opportunities that are best aligned to their asset allocation and investment strategy;

d. *have due regard to any conflicts of interest when appraising particular investment opportunities and/or manager mandates;*

e. *have appropriate governance arrangements in place to effectively implement and review their investment strategies; and*

f. *incorporate Environmental, Social and Corporate Governance (ESG) factors as an active and embedded principle of risk and return assessment in managing and determining its investment portfolio and ensuring that any managers appointed by the Funds are doing likewise. Dedicating sufficient time and resource to monitoring the proper application of ESG factors in the manner set out above.*

These guidelines are deliberately broad to ensure that they do not conflict with the legal principles or analysis and take into account the fact that this is a complex area where the detail will necessarily be required to be considered on a case by case basis by Pensions Committees and Pension Boards. Nevertheless, they are also viewed as being sufficiently detailed to ensure that Funds will be required to take a responsible approach, grounded in industry best practice, to administering their investment programmes and in exercising their fiduciary duty. Importantly, the SAB is keen to guard against extremes or selective interpretation of the legal principles by Pension Committees and Pension Boards, for instance which might unduly restrict the consideration of ESG and other wider factors which the Opinion makes clear may influence the choice of investments so long as that does not risk material financial detriment to the Fund (with some more detailed advice and parameters included to assist Funds in assessing this).

Yours sincerely

Jonathan Sharma

Hayley Wotherspoon

Dave Watson

The Joint Secretaries of the Scottish Scheme Advisory Board

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Report for National Scheme Advisory Board

Pinsent Masons

Report on legal duties of LGPS Pensions Committees in relation to the investment of LGPS Funds

1. Introduction

This Report has been prepared for the benefit of the National Scheme Advisory Board ("**SAB**") for the Scottish Local Government Pension Scheme (the "**LGPSS**") and considers the application of fiduciary and other duties owed by Pensions Committees in relation to investment of LGPSS pension funds.

This Report refers to and summarises various pieces of legal advice which have been obtained for the benefit of LGPS funds in England and Wales and its Scheme Advisory Board. The Report then highlights where the two jurisdictions are aligned and where there are differences between the two jurisdictions.

The references marked throughout the Report can be found in section 7.

Finally, the Report sets out the views of our own QC, Craig Connal QC, ("**Scottish Counsel**") where we felt it would be of benefit to instruct a Scottish counsel to advise on these issues.

2. Background

The LGPSS consists of various pension funds administered by local authorities which provide pension schemes for local government and other eligible workers in Scotland. The LGPSS is established and governed by statute, and is similar in terms of legal structure to the English Local Government Pension Scheme (the "**LGPSE**").

The LGPSS and the LGPSE are not established as trust funds, and those who administer them are not trustees. It is therefore not immediately clear whether the duties of trustees in relation to investment apply also to the investment committees of the LGPSE and the LGPSS. In addition, the Pensions Committees of the LGPSE and the LGPSS (each multi-employer occupational pension funds) arguably owe a fiduciary duty to (i) the pension scheme members (beneficiaries); and (ii) the admitted employer bodies (which have financial exposure through their obligation to pay contributions and meet any liabilities) within the respective funds. The Pensions Committees may also be subject to certain public law duties in this regard. Advice has been received by the Local Government Association on these points from Nigel Giffen QC[1] in relation to the LGPSE, and in this Report we consider the extent to which that advice is applicable in Scotland to the LGPSS.

Directive 2003/41/EC[2] (the "**IORP Directive**") imposes obligations on EU Member States in relation to the activities and supervision of institutions for retirement provision. Among other things the Directive sets out in Article 18 the general requirement that Member States should require retirement institutions to invest in accordance with the "prudent person" rule, and more specific requirements concerning suitability of investments. Advice has been received by the Local Government Association on this point from Michael Furness QC[3]. in relation to the LGPSE, and in this Report we consider whether that advice is equally applicable to the LGPSS.

3. Executive Summary

- Although the LGPSS is not itself a trust, the duties of the Pensions Committee in Scotland are of a fiduciary nature. Accordingly, any decision (investment or otherwise) made by a Pensions Committee which may affect a party to whom the fiduciary duty is owed, should be made having regard to the best interests of that party.

- Administering authorities owe fiduciary duties to scheme employers and scheme members both generally and specifically in relation to investment matters.

- Article 18(1) of the IORP Directive[4], including the requirement to invest in accordance with the "prudent person" rule in the best interest of members and beneficiaries, does apply to the LGPSS and the Investment Regulations (defined herein) should be construed to include the relevant principles.

- Non-financial factors (including social, environmental or ethical considerations) may be taken into consideration as part of any investment decision making process, provided that:-

  (i) there is no policy in place limiting the scope of potential investments purely on the grounds of Non-Financial Considerations (as defined in Section 5 herein). A decision regarding any particular investment should not be made where the diversification of potential investments has been compromised; and

  (ii) the proposed investment is expected to generate financial returns similar to those expected from other investment opportunities available in the market at that time offering similar risk and return characteristics.

- When considering investments, Pensions Committees may look at environmental, social and governance (ESG) issues where the financial performance of that investment may be adversely impacted as a result of any particular environmental, social or governance factor. The investment options may be restricted where the investment returns to the fund may be negatively impacted by such environmental, social or governance factors.

- Given the uncertainties in relation to the LGPSE, we sought confirmation and clarification from Scottish Counsel on:-

  (i) whether he agrees with our analysis that the IORP Directive applies directly to the LGPSS;

  (ii) how Article 18 in particular interacts with the Investment Regulations and whether the Regulations must be considered as subject to and overridden by Article 18; and

  (iii) how the relevant case law is likely to be interpreted by a Scottish court in relation to the LGPSS.

  His advice is highlighted throughout this Report and reinforces the above conclusions, making no notable distinctions between the treatment of the LGPSE (under the laws of England and Wales) and the LGPSS (under Scots law).

- Neither we nor Scottish Counsel have identified any material points which, in our view, would require further analysis by counsel.

4. Duties of Pensions Committee Members

In this section we consider the legal obligations on Pensions Committee members in relation to the investment of LGPSS assets.

In particular we consider obligations under:-

- common law;

- public law;

- the Local Government (Management and Investment of Funds) (Scotland) Regulations 2010 (the "**Investment Regulations**")[5] ;and

- the IORP Directive.

We also seek to clarify to whom Pensions Committee members owe a fiduciary duty.

4.1 Duty of care at common law

The 1999 Joint Report of the Law Commission and the Scottish Law Commission (Law Com Report No 260, Scot Law Com Report No 172)[6] stated that:-

- trustees are under a duty to invest trust funds in their hands, subject to their overriding obligation to administer the trust in accordance with its terms.

- in performing their duty to invest trust funds, trustees must exercise proper care. The standard is that of the ordinary prudent man of business acting in the management of his own affairs.

- prudence requires more than mere honesty, good faith and sincerity. A level of proficiency and competence is expected of a trustee. However, quite what that level is will vary from case to case.

The Scottish case of *Martin v City of Edinburgh Council*[7] in 1987 is, in our view, the best authority available for the proposition that administering authorities owe a fiduciary duty to the beneficiaries of the LGPSS. Although on its facts the case concerned certain public and charitable funds held by the council in trust, Scottish Counsel considers that the analysis in that case is equally applicable to other situations where persons, such as local authorities have responsibility for investing funds for the benefit and/or the interests of third parties. In his opinion, referred to in Section 5, Nigel Giffin QC took a similar view.

In the *Martin* case Lord Murray stated that:-

- there was a legal duty on trustees to apply their minds to the best interests of the beneficiaries;

- there was an obligation to take appropriate professional advice in relation to a proposed investment decision; and

- failure to comply with these duties resulted in a breach of trust.

He stated:-

"…I conclude that the pursuer has proved a breach of trust by the council in pursuing a policy of disinvesting in South Africa without considering expressly whether it was in the best interests of the beneficiaries and without obtaining professional advice on this matter. That is sufficient for the decision of this case and it turns entirely on the general principles of law applicable to trusts in Scotland. In short the trustees acting on behalf of the council misdirected themselves in failing to comply with a prime duty of trustees, namely, to consider and seek advice as to the best interests of the beneficiaries, and so they are in breach of trust."

This case sets out the core obligations which apply to fiduciaries in relation to the investment of trust funds. In Scottish Counsel's view the case also supports the proposition that those obligations apply equally to those entrusted with investing LGPSS assets, even though the LGPSS is not itself a trust. Scottish Counsel considers that the investment duty of the Pensions Committee, and of those administering the funds, is a fiduciary one.

4.2 Public law duties

What is set out above considers (in inevitably simplified form) the general obligations encumbent under common law on public authorities. Different considerations arise (or may arise) in the event of obligations being imposed on decision-makers through the form of statutory public duties (outwith the specific pensions arena). In his opinion, Mr Giffin QC considers that point using as examples duties under The National Health Service Act 2006 (applicable in England and Wales) and The Equality Act 2010 (applicable throughout the UK). He points out that the duties in these statutes (and others are likely to be in similar terms) are couched in non-obligatory language. In the former what is “considered appropriate” for improving health and in the latter to have “due regard” to equalities considerations. In essence he then concludes that, at most, this might require a consideration to be brought into the equation when an investment or similar decision was being made and where the choice was neutral from an investment perspective. In other words, if the investment considerations pointed only in one direction, an obligation to “have regard” to other considerations would not require a different decision. Mr Giffin concludes that such situations are expected to be rare. We agree.

Accordingly, we conclude that in most circumstances the issue will not arise and where it does only where a decision on investment is otherwise neutral from an investment perspective. To take a Scottish example, the Climate Change (Scotland) Act 2009 imposes duties to exercise functions in a way “best calculated” to contribute to delivery of climate change targets and in a manner considered “most sustainable”. We see no reason why such generalised duties would not be treated in a similar way to the approach suggested by Mr Giffin. In the event of a decision neutral from an investment perspective which is viewed as significantly more sustainable, the sustainability obligation might come into play. What if the statute was more direct and less of an exhortation? If a circumstance arose where the investment body was satisfied that it fell within the ambit (usually a definition of public bodies) of the particular statutory obligation and that statutory obligation was worded in such a way as to direct action in one way only, then in our view the investment decision would require to be made in accordance with that direct statutory requirement. The law would require to be obeyed and it could not then be said that the investment decision taken in obedience to that law was in breach of a fiduciary or other general duty.

In our view, however, such circumstances are unlikely to arise, given the existence of special statutory and regulatory regimes directed at the proper functioning of pension arrangement.

Our overall conclusion is accordingly that public law duties are in practice unlikely to add much to the considerations which would arise in any event under the ambit of fiduciary duties and that statutory intervention is unlikely in practice (outwith the specialist pension field) to impact significantly on these decisions.

4.3 The Investment Regulations

The Investment Regulations set out the statutory obligations on the LGPSS in relation to investment. They are similar in terms to the current English equivalent[8] although we note that the concept of the "prudent man" will be legislated for explicitly in England & Wales as part of the proposed 2016 changes to the LGPSE investment regulations (see below).

Regulation 11[9] sets out the core obligations, which are (in summary):-
- to formulate a policy for the investment of fund money, with a view-

(a) to the advisability of investing fund money in a wide variety of investments; and

(b) to the suitability of particular investments and types of investments.

- to invest, in accordance with its investment policy, any fund money that is not needed immediately to make payments from the fund.

- to obtain proper advice at reasonable intervals about its investments.

- to consider such advice in taking any steps in relation to its investments.

These obligations do not contain any specific reference to a "prudent man" test, which is one of the common law duties of trustees in relation to investment, and is a key provision in IORP and, we anticipate, will underpin guidance behind the new investment regime for the LGPSE (which may be adopted in Scotland in due course depending on the attitude of Scottish Ministers following advice from the SAB).

The Department for Communities and Local Government (the "**DCLG**") is currently consulting[10] on the possible revocation and replacement of the English equivalent of the Investment Regulations. It notes (at paragraphs 2.12 to 2.22):-

- the suggestion that Article 18(1) of IORP (see below) should be transposed into the LGPSE investment regulations

- that the investment regulations applicable to private sector pension schemes did transpose Article 18(1)

- that the LGPS is not subject to trust law, but that those administering it are in a similar position to trustees

- those in local government responsible for making investment decisions must also act in accordance with ordinary public law principles, in particular, the ordinary public law principles of reasonableness. They risk challenge if a decision they make is so unreasonable that no reasonable person acting reasonably could have made it. (This analysis is consistent with the comments in paragraph 8 of opinion of Nigel Giffen QC).

The consultation on this point concludes by saying that:-

"Ministers are satisfied that the Scheme is consistent with the national legislative framework governing the duties placed on those responsible for making investment decisions. The position at common law is also indistinguishable from that produced by the 2005 Regulations applicable in respect of trust-based schemes."

In the absence of any clear reference in either the Investment Regulations or their English equivalent to the "prudent man" principle it is difficult to see how Ministers can be quite so confident about that conclusion, particularly when the private sector legislation has specifically transposed the requirements of Article 18(1) of IORP.

The consultation comments are nevertheless of interest since they seem to be in contrast to the views expressed by Michael Furness QC in relation to IORP (referred to in the next section). We would therefore draw your attention to the comments of Scottish Counsel below.

4.4 Article 18(1) of the IORP Directive

The IORP Directive applies to "institutions for occupational retirement provision". The full text of Article 18(1) is set out in section 7.

The key provisions for present purposes in relation to investment are that:-

- Member States must require institutions located in their territories to invest in accordance with the "prudent person" rule

- the assets must be invested in the best interests of members and beneficiaries

- in the case of a potential conflict of interest, the investment must be made in the sole interest of members and beneficiaries.

- assets shall be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole.

If these provisions apply to the LGPSS then they impose an additional set of requirements which the LGPSS pension funds and those administering them require to observe. It should be noted though that the DCLG in its consultation document appears to be of the view that the LGPSE is already consistent with the requirements of the private sector investment regulations which transpose Article 18(1).

The question of whether the IORP Directive applies to the LGPSE was the subject of an opinion by Michael Furness QC in 2007. He concluded that:-

- the entire Directive applies to the LGPSE;

- Article18 specifically applies to the LGPSE in any event; and

- the LGPSE is not compliant with Articles 8[11] and 18 of the Directive.

We do not consider that the position of the Investment Regulations in Scotland is materially different from that of the English Regulations considered by Mr Furness in his opinion. The reasoning in his opinion seems to us to apply to the position in Scotland as it applies in England.

It seems that what Mr Furness is saying is that the IORP Directive does apply to the LGPSE, that it therefore ought to be operating in accordance with it, but that the national legislation which applies to it is inconsistent with the IORP Directive. (See in particular paragraphs 20 to 23 of his opinion.)

On the other hand, DCLG seems to take the view that the obligations under the IORP Directive already apply to the LGPSE, and that no specific legislative changes are needed for the LGPSE to be compliant with the IORP Directive. This is one area of uncertainty where in our view, it was helpful to obtain further advice from our own Scottish Counsel.

4.5 To whom do Pensions Committee members owe a fiduciary duty?

Nigel Giffin QC was of the view that administering authorities owed a fiduciary duty to both scheme employers and scheme members on the basis, in summary, that if the fund performs poorly it could result in:
- the requirement for higher employer contributions; and
- the potential loss of discretionary powers being exercised in favour of the member and/or legislative changes requiring higher member contributions.

In the English case of *Charles Terence Estates Ltd v Cornwall Council*[12], the court confirmed, having regard to previous cases[13], that the council had fiduciary duties to council tax payers, although that case related to lease arrangements rather than pension arrangements.

Whilst councils may have a fiduciary duty to tax payers where a decision by them has a direct impact on tax payers, as was the case in *Charles Terence Estates Ltd* and the cases to which it referred, in our view, the position can be distinguished from the duties on Pensions Committees in relation to their pension arrangements. There is not, in our view, a sufficiently direct relationship between the LGPSS and tax payers which would result in Pension Committees having a fiduciary duty to tax payers, or to take actions which are in the best interests of those tax payers.

Accordingly, on the basis that a poor investment decision may result directly in adverse consequences for (i) scheme employers; and (ii) scheme members, it is our view, which is shared by Scottish Counsel, that Pensions Committee members of the LGPSS owe a fiduciary duty to both of those entities both in general and in the context of investment decisions. Such duty is not, however, owed to the tax payer.

In certain circumstances, it may be difficult to balance these duties as there may be competing interests. In such circumstances, the Pensions Committee should consider both parties' interests and treat each of them fairly and equitably, but not necessarily equally where favouring one party over another can be justified. Further legal advice may be required in cases of uncertainty.

Scottish Counsel's opinion

Counsel's view is that the Scottish courts are likely to agree with opinions regarding fiduciary duties that have been received in relation to the LGPSE – i.e. that fiduciary duties do apply to those who hold funds in a fiduciary capacity, such as the LGPSS.

He is also of the view that as a point of principle, Scottish courts will not take a different approach to the application of the IORP Directive – i.e. that whilst the IORP Directive has not been explicitly transposed into the Investment Regulations, the Directive should be treated as being directly applicable to the LGPSS and the Investment Regulations should be read as subject to the principles set out on the IORP Directive and Article 18 in particular.

Given that the prudent man principle is well enshrined in Scots law, the reference to "prudent person" in the IORP Directive is less significant.

5. Scope for consideration of non-financial factors

Regulation 12(2)(f) of the Investment Regulations requires administering authorities to maintain a statement of investment principles which sets out, among other things, "the extent to which social, environmental or ethical considerations are take into account in the selection, retention and realisation of investments".

In isolation, this provision could be construed as entitling investment decisions to be made purely with regard to non-financial matters and so we sought the opinion of Scottish Counsel on this matter to establish the extent to which non-financial matters can of themselves influence investment decisions other than as a factor of assessing their impact on investment risk and return in the usual way.

An investment policy, such as an ethical investment policy, is one which is not guided solely by financial criteria, but takes into account non-financial considerations independent from the investment risk and return analysis ("**Non-Financial Considerations**").

On the basis that Article 18(1) of the IORP Directive applies to the LGPSS (or in any event that the prudent man principle applies under Scots law) and therefore that investment and other decisions must be exercised by the LGPSS in a 'fiduciary' capacity, we now consider the extent to which the LGPSS is entitled to consider Non-Financial Considerations when reaching decisions regarding investment and otherwise.

One of the leading cases on investment duties is the English case of *Cowan v Scargill*[14] in 1984. The general principles set out by Megarry V-C in this case in relation to investment decisions are that:

- the starting point is to exercise powers in the best financial interests of the beneficiaries;

- when considering what investments to make, the fiduciary's personal interests and views should be put aside;

- the ordinary prudent man test applies in making investment decisions;

- where the fiduciary is opposed to an investment for non-financial reasons, the fiduciary should not refrain from making the investment by reason of those views;

- Megarry V-C could see no reason to hold that different principles apply to pension fund trusts as apply to other trusts; and

- Trustees must do the best they can for the benefit of their beneficiaries, and not merely avoid harming them.

The conclusion is that in deciding how to invest pension scheme assets, moral and ethical principles should be put aside.

Nicholls V-C in another English decision *Harries v Church Commissioners*[15] in 1992 stated in summary that 'trustees must act prudently' and:

- investment decisions may be made on moral grounds, so long as that course of action "would not involve a risk of significant financial detriment"
- otherwise, investment decisions should not be made on non-financial grounds

Nigel Giffin QC summarised these cases and reached the view that the LGPSE can:

- have regard to non-financial considerations where that does not run the risk of material financial detriment to the fund; and

- the LGPSE should not place its own wider interest (whether its own or those of the areas inhabitants) above those of the scheme employer (i.e. the LGPSE must be "blind to its own interests").

The decision in the Scottish case of *Martin v City of Edinburgh* in 1987 (referred to in section 4.1 of this Report) is also relevant to these considerations.

In relation to taking non-financial matters into account, Lord Murray states (in summary):

- the position in Scotland is that trustees must act prudently and in the best interest of the beneficiaries;

- the fiduciary must recognise that he has his own preferences and principles but that he should "nonetheless do his best to exercise fair and impartial judgment on the merits of the issue before him"; and

- trustees must not simply adhere to a policy where that policy restricts the choice of investment.

In relation to the procedure to make investment decisions, the Law Commission has stated that in relation to trust arrangements "…the trustees may consider the views of their beneficiaries when making investment decisions, but there is no need for them to do so. Trustees must make the ultimate decisions."

In our view, the fiduciary duties on Pensions Committees both in relation to investment matters and more generally should be exercised by the Pensions Committees on whom the duties are bestowed, having taken professional advice (such as investment advice) where appropriate. It would not be appropriate, in our view, to canvas the views of the beneficiaries before such decisions are taken.

Scottish Counsel's opinion

Having considered the relevant cases outlined above and the opinions of Nigel Giffin QC and Michael Furness QC, Scottish Counsel's view is that the LGPSS should exercise its investment duties in a fiduciary capacity.

Counsel was also of the view that the decision in *Harries* should be limited to its own specific facts and that trustees (and by extension Pensions Committees) are required to do more than simply ensure that the investment "would not involve a risk of significant financial detriment".

In summary, Scottish Counsel's view on the application of Non-Financial Considerations to the LGPSS is that:-

- there should be no policy in place that would restrict the choice of investments available to the LGPSS, including those based purely on the grounds of Non-Financial Considerations, other than restrictions under the Investment Regulations and by law. However, when making an investment decision, Pensions Committees may take environmental, social and governance (ESG) considerations into account in relation to that investment if the financial performance of that investment may be impacted as a result of any particular environmental, social or governance factor;

- any policy which specifically excludes the choice of investment purely based on Non-Financial Considerations will be contrary to the Pensions Committees' fiduciary duties and should be set aside before any investment decision is made; and

- Pensions Committees should seek to obtain the best returns for the fund while acting prudently. Investments should be made with the intention of achieving the best financial position for the fund whilst balancing risk and return considerations. Provided there is compliance with the above, social, environment and/or ethical considerations may be taken into account.

6. Implications for SAB and Pensions Committees

Pension Boards were established under the Public Service Pensions Act 2013[16] and the Local Government Pension Scheme (Governance) (Scotland) Regulations 2014. Pension Boards are responsible for assisting the administering authorities in relation to ensuring compliance with legislative and other requirements relating to the governance and administration of the LGPSS.

The Scheme Advisory Board (SAB) was also established under the Public Service Pensions Act 2013[17] and the Local Government Pension Scheme (Governance) (Scotland) Regulations 2014. The purpose of the SAB is to provide advice to the Scottish Ministers and to the Pension Boards and managers of the LGPSS in relation to the effective and efficient administration and management of the LGPSS.

In summary, it is our view that Pensions Committees in Scotland owe a fiduciary duty to the scheme employers and the scheme members in general and specifically in relation to investment matters. Those duties should be exercised in the best interests of the beneficiaries and in relation to investment decisions, should aim to achieve the best financial position for the fund, balancing risk and return in the usual way.

The Pensions Committees should seek appropriate professional advice before exercising their investment powers. In relation to investment decisions, they should not have a policy in place which would limit their investment options and all decisions should be made on a "prudent man basis. However, Pensions Committees may take environmental, social and governance (ESG) factors into consideration in relation to any investment decision, if the financial performance of that investment may be impacted by one or more of those factors.

SAB should have procedures in place to monitor the Pensions Committees to ensure the effective and efficient administration and management of the LGPSS in accordance with legislative requirements and the recommendations in this report and to advise the Pensions Committees where these have not been met.

7. References

References are in the order they appear in this Report.

[1] Opinion by Nigel Giffin QC dated 25 March 2014

QCOpinionApril2014.p
df

[2] IORP Directive
Directive 2003/41/EC

[3] Opinion by Michael Furness QC dated 24 May 2007

QCMF.pdf

[4] Article 18(1) of IORP Directive

Investment rules
1 Member States shall require institutions located in their territories to invest in accordance with the "prudent person" rule and in particular in accordance with the following rules:
(a) the assets shall be invested in the best interests of members and beneficiaries. In the case of a potential conflict of interest, the institution, or the entity which manages its portfolio, shall ensure that the investment is made in the sole interest of members and beneficiaries;

(b) the assets shall be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole.
Assets held to cover the technical provisions shall also be invested in a manner appropriate to the nature and duration of the expected future retirement benefits;

(c) the assets shall be predominantly invested on regulated markets. Investment in assets which are not admitted to trading on a regulated financial market must in any event be kept to prudent levels;

(d) investment in derivative instruments shall be possible insofar as they contribute to a reduction of investment risks or facilitate efficient portfolio management. They must be valued on a prudent basis, taking into account the underlying asset, and included in the valuation of the institution's assets. The institution shall also avoid excessive risk exposure to a single counterparty and to other derivative operations;

(e) the assets shall be properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings and accumulations of risk in the portfolio as a whole.
Investments in assets issued by the same issuer or by issuers belonging to the same group shall not expose the institution to excessive risk concentration;

(f) investment in the sponsoring undertaking shall be no more than 5% of the portfolio as a whole and, when the sponsoring undertaking belongs to a group, investment in the undertakings belonging to the same group as the sponsoring undertaking shall not be more than 10% of the portfolio.
When the institution is sponsored by a number of undertakings, investment in these sponsoring undertakings shall be made prudently, taking into account the need for proper diversification.

Member States may decide not to apply the requirements referred to in points (e) and (f) to investment in government bonds.

[5] The Local Government (Management and Investment of Funds)(Scotland)Regulations 2010
http://www.legislation.gov.uk/ssi/2010/233/body/made

[6] Scottish Law Commission: Report on Trust Law 2014 (No 239)
http://www.scotlawcom.gov.uk/files/4014/0904/0426/Report_on_Trust_Law_SLC_239.pdf

[7] *Martin v City of Edinburgh Council* [1989]PLR, [1988] SLT 329

[8] the Law Commission report (No 350) on the Fiduciary Duties of Investment Intermediaries; http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties.pdf

[9] Regulation 11 of the Investment Regulations

11 Investment policy and investment of pension fund money
(1) An administering authority must formulate a policy for the investment of its fund money.

(2) The authority's investment policy must be formulated with a view -
(a) to the advisability of investing fund money in a wide variety of investments; and

(b) to the suitability of particular investments and types of investments.

(3) The authority must invest, in accordance with its investment policy, any fund money that is not needed immediately to make payments from the fund.

(4) The authority may vary its investments.

(5) The authority must obtain proper advice at reasonable intervals about its investments.

(6) The authority must consider such advice in taking any steps in relation to its investments.

[10] the Department for Communities and Local Government Consultation on the Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009
Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009: consultation

[11] Article 8 of the IORP Directive

Legal separation between sponsoring undertakings and institutions for occupational retirement provision

Each Member State shall ensure that there is a legal separation between a sponsoring undertaking and an institution for occupational retirement provision in order that the assets of the institution are safeguarded in the interests of members and beneficiaries in the event of bankruptcy of the sponsoring undertaking.

[12] *Charles Terence Estates Limited v Cornwall Council* [2012] EWCA Civ 1439

[13] *Hazell v Hammersmith LBC* [1992] 2 AC 1;
Bromley LBC v Greater London Council [1983] 1 AC 768

[14] *Cowan v Scargill* [1985] Ch 270

[15] *Harries v Church Commissioners for England* WLR 1241

[16] Section 5 of the Public Service Pensions Act 2013

[17] Section 7 of the Public Service Pensions Act 2013

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9. Disclosure

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Pinsent Masons LLP
11 February 2016

Pensions Committee

2.00 p.m., Wednesday, 28 September 2016

Update on Governance

Item number	5.7
Report number	
Executive/routine	
Wards	All

Executive summary

Changes to the Pension Board Constitution and the Attendance and Training Policy are proposed in line with the legal opinion on fiduciary duty and to address some minor typographical errors.

The Fund has recently appointed three new employer representatives to the Pension Board:

- Sharon Dalli, Pensions Manager for the Scottish Police Authority;
- Alan Williamson, Chief Operating Officer at Edinburgh College and;
- Paul Ritchie, HR Partner from East Lothian Council.

The Local Government Association has sought legal opinion which has confirmed that members of the Pension Board do not fall into the scope of the Council's indemnity provisions. The Fund is investigating a newly designed policy specifically to provide protection to the Pension Board.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Report

Update on Governance

Recommendations

That Committee:

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

1.2 approves the Constitutional Updates; and

1.3 notes and ratifies the recent appointments of three new employer representatives to the Pension Board and the contribution of previous employer representatives, Linda Macdonald and Rucelle Soutar.

Background

2.1 The Pension Board has been established pursuant to the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 (the "**2015 Regulations**") and the Public Service Pensions Act 2013 with a remit is to oversee the operation and decisions of the Committee from a compliance perspective.

2.2 The Fund's Nomination and Appointments Policy states that the Pension Board will comprise of five member representatives and five employer representatives and sets out the process for the nomination and appointment of such members.

2.3 Uncertainty as to whether members of a pension board are officials who fall within the scope of s council's own indemnity provisions has been raised in England and Scotland over the last two years. Legal opinion has been sought by the LGC and James Goudie QC has now opined on the matter.

Main report

3.1 **Pension Board membership:** The Fund has received three Pension Board resignations from their employer representatives since June; Simon Belfer from Napier University, Linda Macdonald from Handicabs and Rucelle Soutar from the Royal Edinburgh Military Tattoo. The employer vacancy was advertised during July and the Fund received three applications from our employers. Further to the current policy, the review panel (consisting of Councillor Rankin, Clare Scott and Sarah Smart) reviewed all the applications and accepted all three. The Fund has now appointed three new employer representatives who are, Sharon Dalli, Pensions Manager for the Scottish Police Authority, Alan Williamson, Chief Operating Officer at Edinburgh College and Paul Ritchie, HR Partner from East Lothian Council.

3.2 **Constitutional points:** A routine review of the Fund's governance policy documents highlighted the need to make three changes. The first change relates to paragraph 1.3. of the Pension Board Constitution, which states that '*members shall have a collective duty to act independently in the interests of the members and employer bodies in the Funds and also the taxpayers*. In light of the recent legal opinion on fiduciary duty it is proposed that the wording "and also the taxpayers" is deleted.

3.3 Two typographical errors within the Attendance and Training Policy have been identified within the Committee and Pension Board's Training and Attendance Policy. Paragraph 1.2 states that the Board and Committee must undertake '*no less than three days (21 hours) of training in each calendar year*'. Similarly paragraph 3.1 of the Training and Attendance Policy sets out the importance of attendance to Pension Board meetings that are held concurrently with the quarterly meetings of the Pension Committee and that Pension Board members '*shall not miss any more than two such additional meetings in any calendar year'* In both cases, the Fund measures training in each financial year and not each calendar year therefore the policy should be amended accordingly.

3.4 **Pension Board personal indemnity insurance:** Further to the Committee's previous consideration of this matter, the Local Government Association (**LGA**) has sought legal opinion which has confirmed that members of the Pension Board do not fall into the scope of a Councils indemnity provisions. Following on from this advice Aon insurance and partners have designed a pension liability policy specifically to provide protection to local pension boards. We are presently liaising with Aon to obtain a quotation for consideration and approval, together with an analysis of the associated risk to be covered (which is currently viewed as being minimal). We will also canvas the market for any other equivalent products from other insurers.

Measures of success

4.1 Pension Board operations comply with the law.

Financial impact

5.1 There is no direct financial impact as a result of this report.

Risk, policy, compliance and governance impact

6.1 Pension Board's purpose is to assist in ensure ongoing compliance of the pension funds.

Equalities impact

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

Sustainability impact

8.1 There is no sustainability impact as a result of 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

Pension Board Constitution, Nominations & Attendance Policy and Training & Attendance Policy are available on the Fund's website
http://www.lpf.org.uk/lpf1/info/40/how_the_fund_works/30/how_the_fund_works/9

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Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives
Single Outcome Agreement	
Appendices	

Pensions Committee

2.00 p.m., Wednesday, 28 September 2016

Funding Update and Preparation for 2017 Actuarial Valuation

Item number	5.8
Report number	
Executive/routine	
Wards	All

Executive summary

Despite good growth in the investments of Lothian Pension Fund and Lothian Buses Pension Fund since March 2014, liability values have grown faster as yields have fallen. Hence, the overall funding levels have fallen.

In advance of the 2017 actuarial valuation, the view of the Fund's Actuary on the suitability of the Contribution Stability Mechanism used for long-term secure employers in Lothian Pension Fund has been sought.

An update on the funding positions for Lothian Buses Pension Fund and Scottish Homes Pension Fund is also provided.

Greater oversight and scrutiny of pension funding plans by Scottish Ministers is expected as a result of changes in the Public Sector Pensions Act 2013. This may influence the approach to the 2017 actuarial valuation.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

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Report

Funding Update and Preparation for 2017 Actuarial Valuation

Recommendations

Committee is requested to:

1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider;

1.2 Approve the continued use of the Contribution Stability Mechanism (CSM) for long-term secure employers within Lothian Pension Fund for the 2017 actuarial valuation;

1.3 Note the advice from the Actuary to review the Contribution Stability Mechanism at the 2020 actuarial valuation;

1.4 Note the updated funding positions for the Lothian Buses Pension Fund and the Scottish Homes Pension Fund;

1.5 Note that greater oversight and scrutiny of pension funding plans by Scottish Ministers is expected and this may influence the approach to the 2017 actuarial valuation.

Background

2.1 The Funding Strategy Statement of Lothian Pension Fund states “The policy of the Fund is to operate a contribution stability mechanism on an ongoing basis subject to regular reviews”.

2.2 At its meeting on 18 December 2013, Pensions Committee approved the Contribution Stability Mechanism which used at the 2014 actuarial valuation. A copy is attached at Appendix 1.

2.3 In developing the Contribution Stability Mechanism, the Actuary undertook, detailed financial modelling of liability and asset cashflows under a range of employer contribution scenarios. Forecasts were made over the long term horizon relevant to the Local Government Pension Scheme.

2.4 Key financial assumptions reflected a prudent approach to funding obligations. The assumed replacement ratio of new entrants reflected an anticipated long term reduction in the public sector workforce. Expected investment returns and the future level of gilt yields were critical elements of the modelling.

2.5 The modelling work enabled quantification of the likelihood that a given contribution strategy would lead to the Fund being fully funded in the long term.

2.6 At the 2014 actuarial valuation, the funding level of Lothian Pension Fund was 91.3%. The 2014 actuarial valuation set employer contribution rates for 2015/16 to 2017/18 and the under the Contribution Stability Mechanism, indicative rates were provided for 2018/19 to 2020/21. For the employers included in the Contribution Stability Mechanism, contribution rates for 2015/16 to 2017/18 were generally unchanged from 2014/15 and indicative rates for 2018/19 to 2020/21 increased by 0.5% p.a., with scope for reduction of 0.5%p.a. should market conditions improve.

2.7 Lothian Pension Fund retained the right to review or withdraw the Contribution Stability Mechanism as protection against extreme adverse financial experience.

2.8 For Lothian Buses Pension Fund, the funding level at 31 March 2014 was 116.7% on an ongoing basis and 88.2% on a more prudent gilts basis.

2.9 For Scottish Homes Pension Fund, the Target Funding Level (TFL), as set out in the Scottish Government 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. The results of the review of the Scottish Homes Pension Fund investment strategy were previously reported to Committee. Work is underway on updating the funding agreement with Scottish Government.

Main report

3.1 In preparation for the 2017 actuarial valuation, the Actuary's advice on the sustainability of the Contribution Stability Mechanism has been sought. This is provided in Appendix 2. The Actuary will attend the Committee meeting to present the report.

3.2 The conclusions of the Actuary's report are as follows:-

- The funding level of Lothian Pension Fund is estimated to be 85% as at 31 August 2016 compared to 91% at 31 March 2014;
- Changes to market conditions and the outlook for investment returns will have reduced the certainty that, with the continued use of Contribution Stability Mechanism, the Fund will achieve 100% funding over the longer term. The likelihood of achieving full funding over the longer term should still be above a 2 in 3 chance;
- Therefore, at present the Contribution Stability Mechanism remains appropriate for long-term secure employers at the 2017 actuarial valuation;
- At the 2017 actuarial valuation, the Fund should set contributions for the following three years (i.e. 2018/19, 2019/20 and 2020/21) but provide only indicative contributions for the following three years;

- A full review of the Contribution Stability Mechanism, with updated asset liability modelling, should be undertaken as part of the 2020 actuarial valuation.

3.3 Committee should note that contributions for the employers who are not included in the Contribution Stability Mechanism will be considered as part of the review of the results of 2017 actuarial valuation in the normal manner.

Lothian Buses Pension Fund

3.4 The funding level of the Lothian Buses Pension Fund is estimated to be 104% on an ongoing basis and 76% on a more prudent gilts basis as at 31 August 2016 (reduced from 117% and 88% respectively at 31 March 2014). Contributions will be considered as part of the review of the results of 2017 actuarial valuation in the normal manner.

Scottish Homes Pension Fund

3.5 The funding level of Scottish Homes Pension Fund 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

3.6 The target funding level for March 2017 is 93.0% and at the time of writing, the estimated funding level is in excess of that level.

3.7 Discussions regarding potential changes to the funding agreement have been held with the Scottish Government. Options to change the funding approach, including an option where contributions would be determined by fund cash flows rather than funding level are being considered. Work is currently ongoing with the Actuary and investment advisers and progress is expected to be reported to Pensions Committee in December.

Review of Scottish LGPS Actuarial Valuations

3.8 Section 13 of the Public Service Pensions Act 2013 introduced a new requirement for a report on local fund actuarial valuations to be undertaken. This introduces greater oversight and scrutiny of funding plans for all LGPS funds.

3.9 The aims are to assess:

> compliance: whether the fund's valuation is in accordance with the scheme regulations;

> consistency: whether the fund's valuation has been carried out in a way which is not inconsistent with the other fund valuations within the LGPS;

> solvency: whether the rate of employer contributions is set at an appropriate level to ensure the solvency of the pension fund; and

> long term cost efficiency: whether the rate of employer contributions is set at an appropriate level to ensure the long-term cost efficiency of the scheme, so far as relating to the pension fund.

3.10 The Government Actuary's Department, on behalf of the Department of Communities and Local Government, have carried out a 'dry-run' section 13 analysis on the English & Welsh funds' 2013 valuations. An equivalent report on the Scottish LGPS funds' 2014 valuations in expected later in 2016 for the Scottish Public Pensions Agency on behalf of Scottish Ministers.

3.11 Committee should note that this greater oversight and scrutiny of funding plans for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund. The analysis may influence the approach to the 2017 actuarial valuation and updates will be provided to Committee over the coming months.

Measures of success

4.1 The principal objective of the Fund is to ensure its long-term solvency. The Fund therefore targets full funding on an ongoing basis over the long-term. Employer contribution stability is also a policy commitment of the Fund.

Financial impact

5.1 The Contribution Stability Mechanism provides certainty of pension contributions to certain Fund employers for future years, together with appropriate assurance of funding level to the Fund.

Risk, policy, compliance and governance impact

6.1 Detailed financial modelling of liability and asset cashflows informed the decision to adopt the Contribution Stability Mechanism in 2013.

Equalities impact

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

Sustainability impact

8.1 There are no adverse sustainability impacts from this report.

Consultation and engagement

9.1 Consultation on the contribution stability mechanism was undertaken with the Fund employers in 2013. The Pension Board, comprising of employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

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 objectives
Single Outcome Agreement	
Appendices	Appendix 1 – Contribution Stability Mechanism 2013 Appendix 2 – Update from Actuary

Lothian PENSION FUND

Contribution Stability Mechanism 2013

November 2013

Background

The 2011 triennial actuarial valuation set employer contribution rates for the three years to 31 March 2015. Pension schemes, however, have a long-term time horizon. Lothian Pension Fund wishes both to avoid volatility in contribution rates based on fluctuations in short-term funding levels and also, where possible, to assist employers with their budgeting.

The funding objectives as stated in the Funding Strategy Statement include:

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

These objectives are desirable individually, but may be mutually conflicting.

The principal issues facing the solvency of the Fund include the ability to finance liabilities as and when they arise, the rate or volatility in the rate of contribution paid by the employers, the pace at which deficits are recovered (or surpluses used up) and the returns on the Fund's investments.

The Fund therefore targets full funding on an ongoing basis over the long term with an acceptable likelihood of success and attempts to keep risks within tolerable limits, whilst ensuring contributions are as affordable and stable as possible.

An explicit commitment has been made to operate a contribution stability mechanism on an ongoing basis subject to regular reviews.

Contribution Stability

The cost of the benefits is not known in advance. The approach to funding determines the pace at which employers pay for the benefits and the ways in which the Fund ensures that it will have enough money to pay the benefits due to its members.

Accordingly, the Fund has received detailed modelling of liability and asset cashflows under a range of employer contribution scenarios from the Fund's actuary. The scenarios included consideration of different levels and duration of contribution stability.

Financial assumptions were tailored to reflect specific factors. These included the anticipated long term level and volatility of gilt yields, equity and other investment returns plus inflation. A reduction in the public sector employer workforce was also reflected. The Fund has thereby taken appropriate steps to assess the implications of potential contribution strategies to ensure compliance with professional standards, the relevant actuarial principles being prudence, affordability, stability and stewardship. The Fund can provide any employer with more detail on the actuarial modelling if required.

Risks to the Fund & Employers

The risk to the Fund in providing contribution stability is that the likelihood of achieving full funding is reduced. This has been a key consideration and the actuarial modelling has provided sufficient comfort on this matter.

The risk to employers is that, if they pay less than the theoretical contribution rates now, they would face increased pensions costs in future years, (As a reminder, however, the contribution rates agreed at actuarial valuations represent minimum contributions. Employers retain the discretion to pay more.)

Conversely, a risk facing employers should the level of stabilised contributions prove to be overly prudent, is that outlays will have been greater than actually required. In this case, employers would benefit from any accrued surplus in future years by reduced contributions.

A further risk to the Fund is the potential inability of employer(s) to finance increased pension costs in the future and stabilising contributions may increase this risk. As a multi-employer scheme, this is, in effect, a risk to all the employers in the Fund. This proposal allows for the specific circumstances of employers in an attempt to manage this risk. (See below)

Allowance for Different Employers

In parallel with the actuarial modelling, ongoing work to assess the financial security offered to the Fund by its respective employers is being undertaken. This includes guarantor and admission agreement reviews, as well as analysis of financial covenant and membership profiles. The strength of the employer covenant influences the extent to which it would be appropriate for the Fund to accord contribution stability to individual or groups of employers.

Councils and other statutory bodies have tax-raising powers, a large membership and will be in existence for a long period of time. There is therefore a low risk that such authorities will fail to meet pension obligations. Other large employers may also offer good financial security to the Fund and some employers with the Fund are guaranteed by the Scottish Government.

Employers to whom the Fund will not accord Contribution Stability:

- Employers which have closed the Lothian Pension Fund to new entrants (or are deemed by the Fund to have closed based on experience).

  As the duration of Fund membership of these employers is finite, it is not considered prudent to offer the discretion of contribution stability to these employers.

- Transfer Admission Bodies (i.e. Public Service Contractors)

  Such employers again have a finite duration of membership of the Fund, i.e. limited to the contract period with the awarding authority. Contractors should continue to pay contributions that target full funding by the end of the participation period.

- Community Admission Bodies included with the smaller employer “pool”

  As part of a pool of employers with similar membership characteristics, a degree of inherent stabilisation of contributions and risk mitigation is already provided. The Fund also has to consider the potential volatility in the smaller employer pool should some employers cease membership and exit the Local Government Pension Scheme.

Contribution Stability Mechanism – Proposal

What level of contributions?

- **"Frozen contribution rate until 31 March 2018 then +0.5% / -0.5% p.a."**
  i.e. contributions frozen at the total 2014/15 combined rate (as determined by Actuarial Valuation as at 31 March 2011) until 31 March 2018. Thereafter, for the next actuarial valuation period of three years, rates could only vary from this rate by a maximum of 0.5% per annum (or minimum of -0.5% per annum).
- This total rate above would be inclusive of contributions to recover the deficit in the Fund i.e. Past Service Deficit. This Past Service Deficit, however, would continue to be based on fixed monetary sum at each Actuarial Valuation. Suitable actuarial adjustment therefore would be made to the Future Service Rate to achieve requisite parity with total payable 2014/15. This is to guard against significant falls in Fund membership between actuarial valuations.

To Whom ?

- "Open" employers with individual contribution rates as at 2011 actuarial valuation:
  - Subject to assessment by Lothian Pension Fund of employer covenant as satisfactory.
  - Subject to agreement by guarantor(s) to inclusion of employer in Contribution Stability Mechanism.
  - Subject to the impact of the new Local Government Pension Scheme in Scotland from 2015 leading to a materially higher cost of future service benefit accrual as assessed by Lothian Pension Fund.

Continuing inclusion in the Contribution Stability Mechanism between actuarial valuations is subject to ongoing review. Factors which would lead to review / removal of an employer from Contribution Stability Mechanism would be:

- Significant adverse change in financial status (covenant) as assessed by Lothian Pension Fund. This could include, e.g. threatened or actual loss in funding or banking facilities / terms.
- Significant change in active membership payroll from previous actuarial valuation, e.g. payroll falls by more than 20%.
- Employer becomes closed to new entrants (or is deemed closed).

On removal from Contribution Stability Mechanism, an employer would immediately revert to the relevant rate as determined by the most recent actuarial valuation.

Duration of the Contribution Stability Mechanism

- The Contribution Stability Mechanism should be designed to cover a reasonable period of time in order to demonstrate value to its employers and meet its objectives.
- The proposal is therefore that the duration of the Contribution Stability Mechanism should be two actuarial valuation periods, i.e. the remaining period of the Actuarial Valuation as at 31 March 2011 plus six years. The Actuarial Valuation as at 31 March 2011 encompasses the current year 2013-14 and also 2014/15.
- The Contribution Stability Mechanism would therefore apply for:
    - 2014/15, as previously determined by Actuarial Valuation 2011
    - 2015/16, Actuarial Valuation 2014 – year 1
    - 2016/17, Actuarial Valuation 2014 – year 2
    - 2017/18, Actuarial Valuation 2014 – year 3
    - 2018/19, Actuarial Valuation 2017 – year 1
    - 2019/20, Actuarial Valuation 2017 – year 2
    - 2020/21, Actuarial Valuation 2017 – year 3

- However Lothian Pension Fund retains the right to review or withdraw the Contribution Stability Mechanism as protection against extreme adverse financial experience. Lothian Pension Fund shall monitor the overall funding level and theoretical contribution rate on an annual basis to ensure these remain within the acceptable parameters.

Actuarial "sign off"

- Regulations and professional standards require that the Fund's Actuary be content with the minimum level of contributions levied by the Fund. Suitable assurance has been received from the proposed Contribution Stability Mechanism from the Fund's Actuary, Hymans Robertson LLP.

2017 valuation – Contribution Stability Mechanism

Addressee and purpose

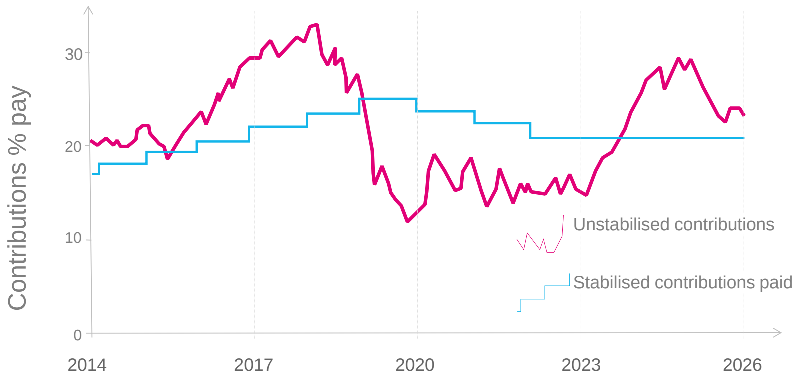
This paper has been commissioned by and is addressed to the City of Edinburgh Council in its role as the Administering Authority to the Lothian Pension Fund ("the Fund"). It has been prepared in our role as Fund Actuary in preparation for the 2017 actuarial valuation.

This paper provides justification for the continued use of the existing Contribution Stability Mechanism (CSM) when setting contribution rates for secure long-term employers at the 2017 valuation. The contributions in question cover the period from 1 April 2018 to 31 March 2021 only.

Purpose of the CSM

Variable market conditions and volatile deficits mean that contribution rates payable to Defined Benefit pension schemes can vary materially from time to time. The Contribution Stability Mechanism (CSM) is an approach adopted by the Fund to setting contribution rates for secure, long-term employers which achieves stability of contributions whilst ensuring that the long-term funding position remains secure. Employers appreciate the budgeting certainty that the CSM delivers.

The illustrative chart below shows how the CSM works in practice. Despite volatile movements in the non-stabilised contribution rates (i.e. those calculated using single valuation assumptions), the CSM ensures that employers pay a stable contribution rate.



The intention is for the CSM to apply over the longer term. Frequent revisions to CSM parameters should not be required unless warranted by a change in market conditions or some significant shift in the demographic or risk profile of the participating employers.

Current CSM

Asset Liability Modelling was carried out prior to the 2014 valuation to establish the CSM approach and to set the parameters by which contribution rates can change each year. At the 2014 valuation, the following CSM was set for secure, long-term employers;

- For the period 1 April 2015 to 31 March 2018 – Freeze in contribution rates.
- For the period from 1 April 2018 – change in rates limited to ±0.5% of pay each year.

The change in rates from year to year is determined by comparing the valuation rate (i.e. that assessed on the single set of valuation assumptions) against the rate in payment in the prior year. For example, if an employer is paying 20% of pay in year 1, and the valuation rate is assessed to be 25% of pay, contribution rates for years 2 to 4 will be set as 20.5%, 21.0% and 21.5% respectively.

Employers were advised of the contribution rates payable over the period from 1 April 2015 to 31 March 2021, i.e. for a period of 6 years following the commencement of the new Rates and Adjustments certificate. As is required by the LGPS Regulations, the R&A certificate only showed the contributions payable for the 3-year period to 31 March 2018. The Administering Authority retained the right to review the CSM at any time.

Asset Liability Modelling

Our report dated 25 October 2013 sets out the results (and associated assumptions and limitations) of the latest Asset Liability Modelling. This modelling showed that application of the CSM for secure, long-term employers led to;

- a very high likelihood of these employers achieving full funding in the long term,
- a relatively low downside funding risk, and
- stable and affordable future contributions.

As with all modelling, the results are dependent on the assumptions adopted for that exercise. One of the key assumptions made was in relation to the future projection of yields on long-dated Government bonds (which affect the value of the liabilities). The 25 October 2013 report explains this assumption in detail. In summary, a range of possible future yield projections were allowed for in the modelling, with the central projection (i.e. the median) of long-dated real (nominal) yields tending to 1.8% pa (5.0% pa) over the longer term. The real (nominal) long-dated bond yield at the time of the modelling was 0.0% pa (3.4% pa) (based on market conditions at 30 June 2013).

To understand the sensitivity of the modelling to possible future changes in projected yields, the model outcomes were also determined on a ‘stressed’ yield assumption. In particular, it was assumed that the central projection of future long-dated real yields would tend to 0.5% pa in the long term, i.e. that yields would be significantly lower in the future than that implied by the ‘standard’ assumption. This sensitivity modelling showed that the CSM remained sufficiently prudent even in the scenario where yields remain at a low level for a long period of time.

The table below shows a summary of the modelling results for the current CSM.

CONTRIBUTION STRATEGY	Prudence			Stewardship		Affordability
	LONG TERM LIKELIHOOD OF SUCCESS		AVERAGE OF THE WORST 5% OF FUNDING LEVELS IN 2035	MEDIAN FUNDING LEVEL IN 22 YEARS		HIGHEST MEDIAN CONTS DURING THE NEXT 22 YEARS
	FULL YIELD REVERSION	REAL YIELD OF 0.5% p.a.	FULL YIELD REVERSION	FULL YIELD REVERSION	REAL YIELD OF 0.5%	
3 year freeze then ±0.5 p.a.	78%	65%	45%	165%	135%	20.7%

Our modelling focused on results from 4 key areas: Prudence, Affordability, Stewardship and Stability (“PASS”). Different possible contribution scenarios were compared under measures from each of these areas and allocated a Green (acceptable), Amber (potentially acceptable) or Red (unacceptable) result.

The Red / Amber / Green ratings assigned to 2013 modelling outcomes were based on the following rules:

Likelihood of full funding (full yield reversion)	>67%	55% - 66%	<55%
Average worst 5% of funding levels	>50%	40% - 50%	<40%
Median funding level (full yield reversion)	>120%	100% – 120%	<100%
Highest median contribution rate	<23.0%	23.0% - 26.0%	>26.0%

Prudence

As actuaries we must satisfy professional requirements for funding valuations to be carried out on a prudent basis. To fund prudently is to adopt a strategy that has a greater likelihood of succeeding than it does of failing. The Asset Liability Modelling work enables us to quantify the likelihood that a given contribution strategy would lead to the Fund being fully funded in the long term.

In 2013 we assessed prudence by projecting potential funding levels in 22 years' time and determining the likelihood of being fully funded at that time as well as examining the average of the worst 5% of potential funding levels.

Affordability

The cost of pension benefits is a major expense for employers. Our affordability analysis shows the range of potential outcomes for the common employer contribution rate in the longer term and allows us to assess the likelihood that the rate exceeds a particular threshold.

In 2013 we assessed affordability by projecting potential contribution strategies over the next 22 years and determining the highest median contribution rate payable under each strategy.

Stewardship

Our stewardship analysis shows the expected funding level and the range of potential outcomes for the funding level in the longer term. This provides a measure of the overall financial health of the Fund and enables us to assess the likelihood that each scenario is consistent with the safe stewardship of the Fund.

In 2013 we assessed stewardship by projecting the median funding level in 22 years' time.

Stability

Our stability analysis illustrated the expected future variability in contributions from one valuation to the next. Unexpected significant rises in the contribution rates are highly undesirable for employers and it is a requirement of the LGPS Regulations that the funding approach should recognise the need for stability in contributions from year to year. A narrow distribution of outcomes centred on zero indicates good stability.

Experience since the 2014 valuation

The Administering Authority monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update was produced at 31 August 2016. It showed that the funding level (excluding the effect of any membership movements) was 85% (compared with 91% at 31 March 2014). The reasons for the change in funding level are:

- Since the 2014 valuation, yields on Government bonds have continued to fall. The yield on long-dated government bonds has fallen from 3.5% pa at 31 March 2014 to 1.2% pa at 31 August 2016. This places a higher value on the liabilities. The future RPI inflation assumption has also fallen (from 3.5% pa to 3.0% pa) which partially offsets the effect of this.

- Alongside this has been significant asset outperformance relative to the 2014 valuation discount rate. The Fund has achieved returns of around 42% since 31 March 2014 (to 31 August 2016) which is around 26% greater than that expected. The solid asset performance helps to offset some of the negative influence of falling bond yields.

The Fund's deficit has increased from £417m at the 2014 valuation to £1,118m at 31 August 2016. The expected cost of benefits (i.e. future service rate) has increased from 19.8% to 34.4%.

Expectations for the future

There is widespread belief that yields will remain low for a longer period of time than that previously expected (and assumed in the modelling carried out in 2013).

Our current expectation is that the central projection of real (nominal) yields on long-dated Government bonds will rise to 0.8% pa (4.0% pa) over the next 20 years (based on market conditions at 30 June 2016). Yields based on market conditions at 31 August 2016 were -1.8% pa (1.2% pa).

Actuarial assumptions at the 2017 valuation

The comments in the previous section make no allowance for any changes to actuarial assumptions, which will be reviewed as part of the valuation process next year.

Our experience so far of the 2016 English and Welsh LGPS valuations for the funds we advise has seen a focus on the following key assumptions:

- The discount rate – funds have either retained the same approach as applied at 2013, or increased by 0.1% or 0.2% pa.
- Salary growth – most funds have reduced this assumption significantly, to reflect continued public sector pay restraint and the expected steep run-off of benefits linked to final salary.
- Gap between RPI and CPI – this has generally been increased by 0.2% pa (from 0.8% pa to 1.0% pa) on the back of technical changes to the way the two indices are calculated.

In general, these changes to assumptions will reduce deficits and the expected cost of benefits.

Is the CSM still appropriate?

The CSM is designed to be robust for the long-term and the sensitivity modelling carried out prior to the 2014 valuation confirms this. Although market conditions have changed dramatically since the 2014 valuation, we believe that the existing CSM remains appropriate for setting contribution rates for long-term secure employers at the 2017 valuation without the requirement for further modelling to justify this at the 2017 valuation. The reasons for this are:

- The modelling results demonstrated that the CSM is likely to keep the Fund safe with a high degree of certainty. Changes to market conditions and investment return outlooks will have reduced that certainty, but to a level that should still be above a 2 in 3 chance of achieving full funding over the longer term.
- The Fund liabilities are valued using a prudent set of assumptions. Potential changes to the assumptions in 2017 could reduce liability values whilst maintaining prudence (for similar reasons to those changes that are being contemplated by funds in England and Wales). Any such changes would further improve the likelihood that the existing CSM remains fit for purpose.

Contribution rates from 2021 onwards

We suggest that the Fund does not provide any firm promises at the 2017 valuation in relation to contribution rates beyond 2020/21. In principle, whilst we believe the CSM remains appropriate in relation to short term rates for the 3 years following the 2017 valuation, we think it would be safer for the Fund to keep any projections of rates beyond that period as indicative meantime. The actual rates can be confirmed at the 2020 valuation, following updated Asset Liability Modelling at that point which will act as a full ‘healthcheck’ on the suitability of the existing CSM.

Reliances and Limitations

The advice in this paper is intended for City of Edinburgh Council to support discussions on the process of setting contribution rates at the 2017 actuarial valuation. This advice should not be passed on to any third party except as required by law or regulatory obligation without the prior written consent of Hymans Robertson LLP. If it is passed onto a third party, then it should be provided in full.

We accept no liability where the paper is used by or disclosed to a third party unless we have expressly accepted such liability in writing. Where disclosure is permitted, the paper may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.

The following Technical Actuarial Standards are applicable in relation to this paper:

- Pensions TAS;
- TAS R – Reporting;
- TAS M – Modelling; and
- TAS D – Data.

The advice and information given in this paper and our Asset Liability Modelling report dated 25 October 2013 (which together with any covering emails comprise the aggregate paper for this advice for the purpose of TAS R) comply with the above Standards.

Prepared by:-

Richard Warden	Steven Scott
Fund Actuary	Fund Actuary

14 September 2016

For and on behalf of Hymans Robertson LLP

Pensions Committee

2.00 p.m., Wednesday, 28 September 2016

Employers Participating in Lothian Pension Fund

Item number	5.9
Report number	
Executive/routine	
Wards	All

Executive summary

This report provides updates on:

- Employers who are currently looking to join the Fund;
- Employers leaving the Fund; and
- Other current matters affecting employers participating in the Fund.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

•EDINBVRGH•
THE CITY OF EDINBURGH COUNCIL

Report

Employers Participating in 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 Committee notes the changes to the employers participating in Lothian Pension Fund.

Background

2.1 Responsibilities of both the City of Edinburgh Council, as administering authority of the Fund, and the participating employers are set out in the Funding Strategy statement and the Pensions Administration Strategy.

2.2 The Funding Strategy Statement includes the ‘Admission Policy’ (for employers joining the Fund), the ‘Policy on Employers leaving the Fund’ (cessation policy) and the ‘Charging Policy’ outlining when charges will be levied by the Fund.

2.3 The Pensions Administration Strategy sets out standards for exchange of information, including the requirement for the employer to keep the Fund informed about planned changes to their pension provision, including bulk transfers of staff and any outsourcing.

Main report

Employers joining the Fund

3.1 As previously advised to Committee, the City of Edinburgh Council has entered into a contract with CGI IT UK Limited (CGI) for the provision of ICT services for the Council. This contract was previously with BT, who chose not join the Fund when staff transferred from the Council in 2001. Admission agreements have now been finalised with both CGI and their subcontractor Dacoll Limited. A total of 27 staff have joined the Fund – 22 with CGI and 5 with Dacoll.

3.2 Staff transferring from BT to CGI and Dacoll will have the option to transfer their previous pension rights accrued in the BT Pension Scheme. As required under the Scheme regulations, the transfers will be carried out on a bulk basis and the Fund’s actuary is working with the BT Pension Scheme actuary to agree transfer terms.

3.3 West Lothian Council entered into a contract with Dawn Construction to provide janitorial services for Schools in the West Lothian area. Dawn Construction were admitted to the Fund in 2009. Dawn sold their business to Bellrock Construction on

30 June 2016 and Bellrock applied for admission to the Fund for the remaining active members. An admission agreement with Bellrock Construction has now been finalised. As required by the Scheme Regulations, West Lothian Council will act as guarantor for Bellrock.

Employers leaving the Fund

3.4 As previously reported to Committee, cessation valuations have been carried out by the Fund's Actuary in respect of several employers who left the Fund last year. Full payment has been received from BAM Construction and from the Scottish Government in respect of the Forth Estuary Transport Authority.

3.5 Cessation valuations have now been carried out for both the National Mining Museum and the Broomhouse Centre who have now left the Fund following the retirement of their last active members. The Fund is currently in discussion with these employers regarding repayment of cessation debt in accordance with the principles established and agreed by Committee in November 2015 following the 2014 Actuarial Valuation process.

3.6 In recognition of affordability issues facing many employers, the Fund has, in consultation with external advisors, drawn up a funding agreement to address repayment of the cessation debt. As previously agreed by Committee, in order to avoid employer default or insolvency, the agreement will allow for repayment over longer terms, and if necessary for repayment of less than the cessation debt. In the latter scenario, an appropriate clause will be included which will allow the Fund to revisit the repayment of the remaining debt at a future date (i.e. the debt would be a contingent liability and hence not recognised on an employer's balance sheet). In addition, the agreement also contains an 'anti-embarrassment' provision to cover future increases in employer asset values.

3.7 The funding agreement will be tailored to each employer's circumstances, taking into consideration the employer's financial circumstances and also the ability to offer security over employer assets (where applicable).

3.8 Draft funding agreements have been issued to the National Mining Museum and the Broomhouse Centre, as well as Pilton Community Health Project, the latter organisation having ceased its membership last year. Details have also been communicated to the other employers who, as part of the Actuarial Valuation 2014 appeals process, indicated that they wished to leave the Fund.

3.9 As previously reported to Committee, a cessation valuation has also been carried out in respect of Age Scotland, a former Fund employer. Further information is included in item B1.2.

Other changes

3.10 Barony Housing Association has advised that it will enter into a partnership with Wheatley Housing Group. Barony will continue as a separate legal entity and will remain the employer of the staff who are currently members of Lothian Pension Fund. The Fund has carried out appropriate due diligence in consultation with legal advisers and has established that this change strengthens Barony's covenant and will thus provide greater protection for the Fund. As Barony was originally admitted to the Fund in 1980, a revised admission agreement has been prepared to ensure consistency with current legislation and documentation.

3.11 Edinburgh Cyrenians Trust changed from being governed by a Deed of Trust to a Scottish Charitable Incorporated Organisation from 1 April 2016. A new admission agreement has now been finalised to reflect this change in legal status, including commitment that the new entity has responsibility for previous pension liabilities.

3.12 West Lothian Leisure was admitted to the Fund in 1998. They have converted from an Industrial and Provident Society to a Company Limited by Guarantee with West Lothian Council as sole member of the company. A new admission agreement to reflect this change in status has been finalised and West Lothian Council have agreed to act as guarantor.

3.13 Canongate Youth Project and Citadel Youth Centre are both changing status to become Scottish Charitable Incorporated Organisations. New admission agreements have been prepared for both employers to reflect this change in legal status, including commitment that the new entity has responsibility for previous pension liabilities.

3.14 Into Work Ltd was admitted to the Fund in 1998. Into Work submitted a request that they be treated as Transferee Admission Body under Section 8.4 of the Fund's Funding Strategy Statement as staff were previously employed by the City of Edinburgh Council. As required, agreement to this change has been sought and obtained from the City of Edinburgh (as ceding employer). Any future cessation valuation for Into Work will now be carried out on the ongoing basis.

3.15 As previously reported to Committee, employees of the City of Edinburgh Council, East Lothian Council and West Lothian Council transferred to the Civil Service Pension Scheme in 2014. These transfers were part of a UK-wide exercise to introduce a Single Fraud Investigation Service. Since the last update to Committee, the Fund's Actuary has confirmed that bulk transfer terms have been agreed with the Government Actuary's Department and that members are currently being given the option to transfer their membership from the Local Government Pension Scheme to the Civil Service Pension Scheme.

Employer Covenant

3.16 Following the 2014 Actuarial Valuation appeals process, Fund officers have been in discussion with two employers regarding the potential to offer the Fund security over employer property and/or investment assets. This would strengthen the employer covenant (ie reduce the risk of default on pension liabilities) and potentially allow the employer to revert to the core investment strategy instead of being invested in lower-risk assets.

3.17 In preparation for the 2017 Actuarial Valuation, plans are in place to review the covenant of all employers participating in the Fund. This will involve gathering financial and other data from each employer and will be used to help set contribution rates and in the review of the Funding Strategy Statement.

3.18 The Fund is also reviewing admission agreements in order to ensure that these are all on standard terms. Priority will be given to those employers where this work could strengthen the employer's covenant.

Measures of success

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

Financial impact

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

Risk, policy, compliance and governance impact

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

Equalities impact

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

Sustainability impact

8.1 There is no sustainability impact 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.

9.2 The Fund engages with participating employers on a regular basis via monthly bulletins highlighting relevant issues and employer events held throughout the year. The Fund continues to remind employers of the importance of keeping the Fund informed of any changes that could have an impact on their pension arrangements.

9.3 Changes to relevant regulations and policies and the implications of these changes are communicated to employers, with consultation exercises carried out where appropriate.

Background reading/external references

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 objectives
Single Outcome Agreement	
Appendices	

Pensions Committee

2.00 p.m., Wednesday, 28 September 2016

2016 - 2018 Service Plan Update

Item number	5.10
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to provide an update on progress against the 2016 – 2018 Service Plan, performance indicators and the key actions to enable the Fund to meet its four key objectives:

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

Overall progress is being made against the service plan objectives.

Whilst three of our indicators are behind target, there are currently no reasons why performance targets should not be achieved by the end of the year.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

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Report

2016 - 2018 Service Plan Update

Recommendations

Committee is requested to:

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

1.2 Note the progress of the Fund against the 2016 – 2018 Service Plan.

Background

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

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

Main report

3.1 Progress is being made against the service plan and this report includes areas of particular note. The following areas are covered elsewhere on the agenda:

- LPFE Limited and LPFI Limited Annual Report
- Fiduciary Duty & Update on Governance
- Funding Update and Preparation for 2017 Actuarial Valuation
- Employers Participating in Lothian Pension Fund
- Collaboration Update.

3.2 At its recent meeting, the Pensions Audit Sub- Committee also considered Pensions Administration Data Quality and Fraud Prevention.

3.3 **Investments and Brexit:** The Investment Strategy Panel discussed the effect of Remain and Leave votes at its meeting in early June. Panel concluded that the markets appeared to be mispricing the risk of Brexit - the downside risk of Brexit was significantly bigger than the upside reward of Remain. For Scottish Homes Pension Fund, the planned reduction in equities by 5% and increase in bonds (consistent with the existing de-risking strategy) was implemented head of the vote. To protect the Lothian Pension Fund and the Lothian Buses Pension Fund, Panel agreed to increase exposure to German government bonds by approximately 2% and reduce investment exposure to European equities of approximately 2% of each Fund. Futures were used to implement these decisions and they were reversed on 28 June. Following the Brexit vote, sterling fell sharply against other currencies, stock markets were weak and bond markets were strong. The Funds' investments in overseas markets benefitted from the fall in sterling. These positions protected the Lothian Pension Fund and the Lothian Buses Pension Fund by approximately 0.17% (£m). Panel met in July for a special meeting where it was agreed that no further action was necessary.

3.4 **FCA registration:** On 24 June, LPFI, the Fund's regulated investment services vehicle, received authorisation from the Financial Conduct Authority (FCA). This authorisation allows the Fund to provide investment advisory and arranging services which will support the activities and development of the investment team in managing the portfolios of assets. It also will allow further collaboration with other pension funds and institutional investors. A update is provided elsewhere on the Committee's agenda.

3.5 **Potential merger of Lothian Buses Pension Fund and Lothian Pension Fund:** As agreed by Committee in March 2016, the option for Lothian Buses Pension Fund to be merged into Lothian Pension Fund is being explored. Work is being progressed and Investment Strategy Panel considered the issue in September concluding that from an investment and administration perspective, there are very clear benefits from a merger including improved diversification benefits and opportunities for Lothian Buses Pension Fund. Such a merger is made possible by the new unitisation system. Merger raises some important governance questions which need to be explored. These, together with consultation with stakeholders, will be taken forward over the coming months.

3.6 **Pension administration system:** The pension administration software system contract expires in October 2018. The Fund has begun the preparatory procurement stages of a tender as any change to provider will need long and careful planning. The tender stipulates the provision of an integrated administration service, including member benefit calculations and pensioner payroll, together with member self-service module and employer data portal.

3.7 **Pensions Administration Standards Association (PASA):** The Pensions Regulator and the Department of Work and Pensions have both identified that good administration can be demonstrated by independent accreditation. PASA Accreditation recognises pension organisations that have evidenced compliance with the standard. Given the existing accreditation with Customer Service Excellence, the Fund is well positioned relative to the 5 standards which are as follows:

1. Service Agreement
2. Measurement and Reporting
3. Operational Controls and Procedures
4. Data
5. People

However the Fund is using the framework to make further improvements, the main focus is currently on reviewing and updating procedure manuals. Other improvements include more extensive performance analysis. The Fund will consider applying for full accreditation later in the year. The accreditation involves an on-line application backed up with documentary evidence and a site visit by an Independent Assessor. PASA accreditation is valid for two years from the date it is awarded.

3.8 **Stewardship services:** As approved by Committee in March, the Hermes EOS contract has been extended until March 2017. The extension was agreed in order to allow the Fund to appoint a provider from the National LGPS Framework. Lothian Pension Fund staff, together with representatives from a range of funds, helped to set up the framework. Bids were submitted in July and the evaluated during August. It is anticipated that appointments to the framework will be finalised in September.

3.9 **Custodian services:** The contract with the Funds custodian, Northern Trust, was due to expire 28 February 2017. The Fund took up the option of extending its contract by 3 years (taking the contract up to 29 February 2020), after conducting a benchmarking exercise to ensure that value for money was being obtained by the Fund.

Performance Indicators

3.10 Performance Indicators for the first quarter are provided in the attached appendix.

3.11 **Annual benefit forecasts**: We issued 99.9% annual benefit statements to active and deferred members (where we held a valid address) within the Pension Regulator's statutory deadline of 31 August 2016. Work continues on statements for 159 members.

3.12 Three indicators are highlighted as 'amber':

- Customer satisfaction is below target (86.2% compared to 88%). Satisfaction of members with our email service is improving but remains below target. The annual survey to pensioner members has been issued and results will be reported to the Committee in December. Due to variations in the numbers of members responding to surveys and the impact on the overall satisfaction, the measure is now being calculated as the average of satisfaction of pensioners, employers (both measured by annual surveys) and members' satisfaction with specific transactions;
- The payment of employer contributions for the quarter (98.8%) is marginally behind target of 99%, primarily due to Scottish Police Services and Scottish Futures Trust paying contributions late. In total, there were 18 late payments in the first three months of the year;
- 62.5% of staff had completed their pro-rata training target up to 30 June 2016. The Fund is comfortable that this is a relatively short period over which training has been measured and the target should be achieved by the end of the year.

3.13 The Fund has won the Professional Pensions award for the best Communications in the Public Sector. The award submission covered general communications as well as those for the introduction of the new 2015 scheme.

3.14 At the 2016 LAPF Investment awards, Lothian Buses Pension Fund won the award for LGPS Fund of the Year of less than £1.5billion. Lothian Pension Fund won in the categories of Investment Strategy of the Year and Investment Performance of the Year. In two other categories, Lothian Pension Fund was 'Highly Commended' for the Infrastructure and Large LGPS Fund of the Year Awards.

Membership and Cashflow monitoring

3.15 Officers of the Fund continue to monitor movements in membership numbers in order to assess potential implications upon cashflow. Early retirement initiatives could trigger significant and immediate outflows due to the payment of tax free lump sums and pensions and reductions in contributions received. However payment of strain costs by the employer help to mitigate current cashflow pressures.

3.16 The below summary details the cash flows as at the end of July and projections for the financial year. This has been prepared on a cash flow basis (compared to the accruals basis of the year end financial statements and budget projections).

Lothian Pension Fund	**2016/17 YTD**	**2016/17 Projected**
Income	**£'000**	**£'000**
Contributions from Employers	50,086	145,000
Contributions from Employees	12,886	39,300
Transfers from Other Schemes	2,055	4,700
	65,027	**189,000**
Expenditure		
Pension Payments	(46,245)	(141,000)
Lump Sum Retirement Payments	(15,652)	(49,000)
Refunds to Members Leaving Service	(214)	(530)
Transfers to Other Schemes	(2,081)	(5,250)
Administrative expense	(589)	(1,865)
	(64,781)	**(197,645)**
Net Additions/(Deductions) From Dealings with Members	**246**	**(8,645)**

Lothian Buses Pension Fund	2016/17 YTD	2016/17 Projected
Income	**£'000**	**£'000**
Contributions from Employers	2,496	7,235
Contributions from Employees	690	1,975
Transfers from Other Schemes	10	30
	3,196	**9,240**
Expenditure		
Pension Payments	(2,771)	(8,450)
Lump Sum Retirement Payments	(1,310)	(3,000)
Refunds to Members Leaving Service	(7)	(25)
Transfers to Other Schemes	-	(72)
Administrative expense	(37)	(112)
	(4,125)	**(11,659)**
Net Additions/(Deductions) From Dealings with Members	**(929)**	**(2,419)**

Scottish Homes Pension Fund	2016/17 YTD	2016/17 Projected
Income	**£'000**	**£'000**
Contributions from Employers	**675**	**675**
Expenditure		
Pension Payments	(2,281)	(6,880)
Lump Sum Retirement Payments	(192)	(512)
Transfers to Other Schemes	(56)	(100)
Administrative expense	(19)	(55)
	(2,548)	**(7,547)**
Net Additions/(Deductions) From Dealings with Members	**(1,873)**	**(6,872)**

3.17 Due to the City of Edinburgh Council ongoing transformation project, there continues to be a significant number of leavers during 2016. It is expected that Lothian Pension Fund will have a negative cash flow position at the end of the year, whereby pension payments exceed total contributions received. Increased investment income has been targeted in recent years for this scenario. Investment income is expected to exceed net cashflow for the foreseeable future.

3.18 It is expected that the number of active members for Lothian and Lothian Buses Pension Funds will continue to decrease during the year, causing a fall in contributions and increase in pension and lump sum payments. Year to date the increase in pensioner payments for Lothian Pension Fund has been offset by one off employer contributions for strain costs.

3.19 In Lothian Buses and Scottish Homes Pension Funds, expenditure is anticipated to continue to exceed income.

Measures of success

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

Financial impact

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

Category	Approved Budget £'000	Projected Outturn £'000	Projected Variance £'000	Budget to date £'000	Actual to date £'000	Variance to date £'000
Employees	2,906	2,643	(263)	969	809	(160)
Transport & Premises	236	236	-	79	73	(6)
Supplies & Services	1,195	1,180	(15)	398	361	(37)
Investment Managers Fees	7,120	5,250	(1,870)	2,373	1,650	(723)
Other Third Party Payments	1,375	1,095	(280)	458	253	(205)
Central Support Costs	300	300	-	100	100	-
Depreciation	87	88	1	29	29	-
Direct Expenditure (Invoiced)	**13,219**	**10,792**	**(2,427)**	**4,406**	**3,275**	**(1,131)**
Income	(977)	(982)	(5)	(326)	(501)	(175)
Net Expenditure (Invoiced)	**12,242**	**9,810**	**(2,432)**	**4,080**	**2,774**	**(1,306)**
Indicative Expenditure (Uninvoiced)	**18,800**	**18,800**	**-**	**6,267**	**6,267**	**-**
Total Cost to the Funds	**31,042**	**28,610**	**(2,432)**	**10,347**	**9,041**	**(1,306)**

5.2 The financial outturn includes year to date budget, actual expenditure and variance as at the end of July 2015. Year to date actual expenditure includes provision for services incurred but for which no invoice has yet been received. Uninvoiced expenditure (i.e. investment management costs deducted from capital) is assumed to be in-line with the budget.

5.3 The projection shows an underspend of approximately £2,433k. The key variances against budget are:

- Employees **- £263k underspend**. This is mainly due to unfilled posts across the division during the period from April to July 2015. Various recruitment processes are underway.
- Investment management fees **- £1,870k underspend**. The budget for 2016/17 was set prior to the in-sourcing of a global equity portfolio in March 2016.
- Other Third Party Payments **- £280k underspend**. This is primarily due to delays in the splitting out research costs from broker's fees.

Risk, policy, compliance and governance impact

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

Equalities impact

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 objectives
Single Outcome Agreement	
Appendices	Appendix 1 – Performance Indicators

Appendix 1

Service Plan Performance Indicators – Targets & Actual Performance

	Q1 April to June	Q2 July to Sept	Q3 Oct to Dec	Target	Status
Customer First					
Maintain Customer Service Excellence Standard	Annual assessment will be carried out early in 2017			Retain CSE Award	Not yet known
Overall satisfaction of employers, active members and pensions measured by surveys	Rolling 12 month performance is 86.2%			88%	
Proportion of active members receiving a benefit statement and time of year statement is issued	99.9% issued by 31 August 2016			100%	
Forward Thinking					
Performance and Risk of Lothian Pension Fund	Actual 10.4%pa, Benchmark 8.4%pa. Exceeding benchmark. Risk/return measures will take some time to demonstrate the success or otherwise of the investment strategy.			Meet benchmark over rolling 5 year periods with lower risk with risk/return measures including performance in rising and falling markets.	
Proportion of critical pensions administration work completed within standards	92.4%			Greater than 90%	
Honest & Transparent					
Audit of annual report	Achieved			Unqualified opinion	
Percentage of employer contributions paid within 19 days of month end	98.8%			99%	
Data quality – compliance with best practice as defined by the Pensions Regulator	Assessment will be made at year-end			Fully compliant	Not yet known
Monthly Pension Payroll paid on time	Yes			Yes	
Working Together					
Level of sickness absence	0.72%			4%	
Annual staff survey question to determine satisfaction with present job	-			75%	Not yet known
Percentage of staff that have completed two days training per year.	62.5%			100%	

Pensions Committee

2.00 p.m., Wednesday, 28 September 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 Q2 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

Committee is requested to:

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

1.2 Recommend the 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 the Fund 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 16 August 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 objectives
Single Outcome Agreement	
Appendices	Appendix 1 – Quarterly Risk Summary, as at 16 August 2016

Appendix 1

Lothian
PENSION FUND

QUARTERLY RISK OVERVIEW

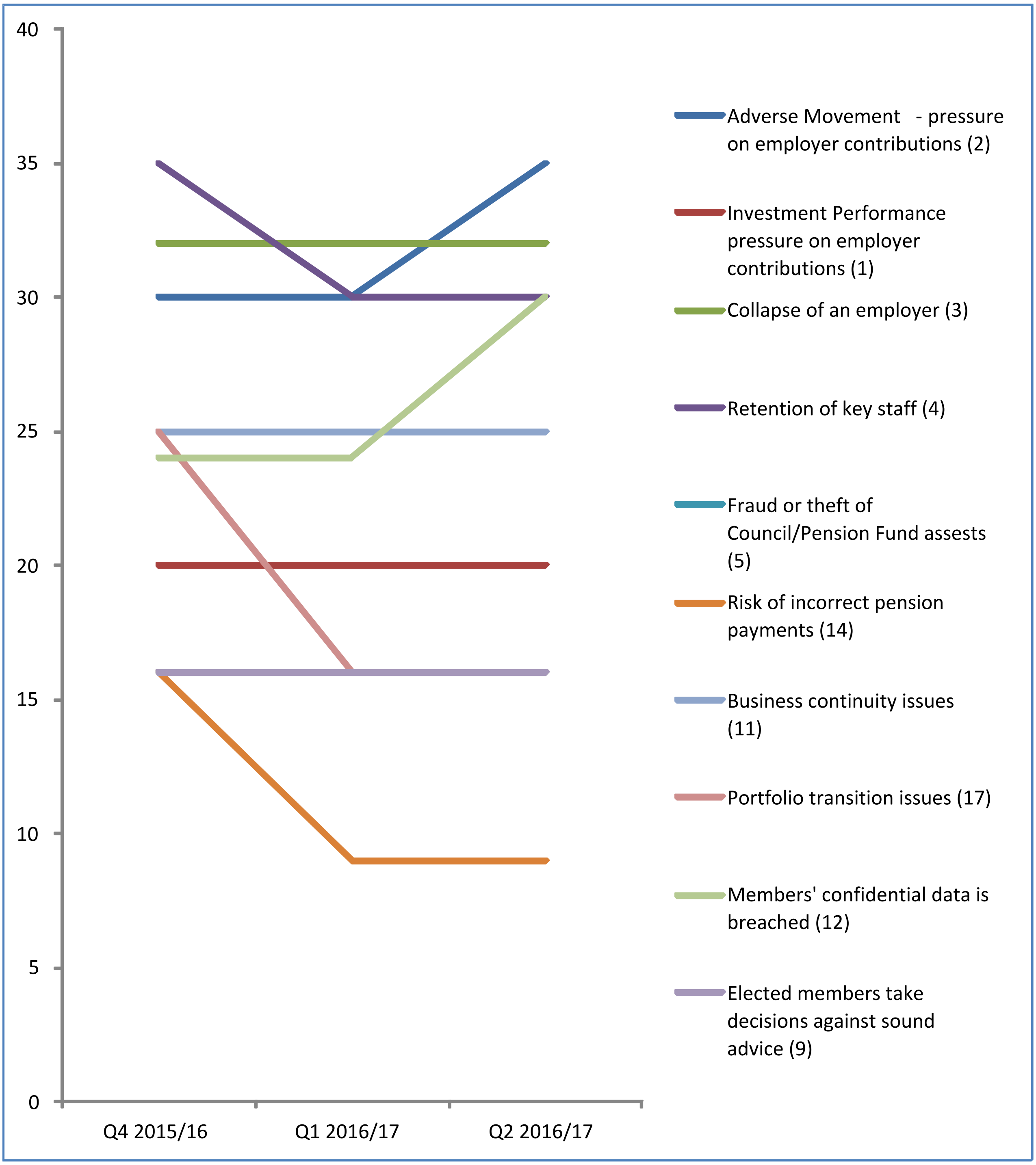
16 August 2016

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)	Added pressure on bond yields due to Brexit has resulted in this risk increasing in the short-medium term. Preparations are underway for the 2017 actuarial valuation including a review of the contribution stability mechnaism.	**Increase**
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)	LPF's management team continue to monitor the immediate impact of the revised HR policies and procedures for investment staff. The risk therefore remains on "warning" until such time as the new HR structure is finalised and bedded in. Also, the recent retirement of an investment analyst has reduced staff resources within the investment team. Recruitment of a replacement will commence soon.	**Static**

Risk & Reference Number	Update	Trend/ RAG
Failure of IT leading to poor ICT responsiveness, legal exposure and cost/risk implications (7)	The ongoing BT/CGI transition has resulted in issues with the pension administration scanner, resulting in a hold up to scanning mail onto the system. This resulted in a resource/cost risk to the Fund and was problematic for home working. In addition, computer and phone connection were lost on 22 August resulting in staff being relocated to Waverley Court for one working day. A meeting has been held with CGI to work through this, from a business continuity perspective, amongst other LPF specific items. The risk has been raised until the conclusion of this review process and the implementation of any required measures following discussions with CGI. The CEC accounts system is scheduled to be transferred to a new system later in 2016, which may cause transitional difficulties for the LPF finance team but with no major impact on LPF's systems.	**Increase** ⬆
Business continuity issues (11)	See above in relation to two specific incidents in relation to the Council's transfer of IT service provision to CGI. Otherwise this has had minimal impact, but we await details as to the service specification in order to assess the likely impact on the Fund's core systems. 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. Pre-tender meetings for pension administration software are now in progress. Potential business continuity issues being considered as part of this process.	**Static** ⬌
Members' confidential data is lost or made public. Breach of Data Protection Act (12)	A business process review is currently underway to strengthen the pensions administration printing and posting processes and in reaction to consistent, albeit minor, breaches in the process. Until changes are implimented this risk has beeen increased to reflect the fact that minor errors in this area can lead to meaningful reputational and other exposure.	**Increase** ⬆

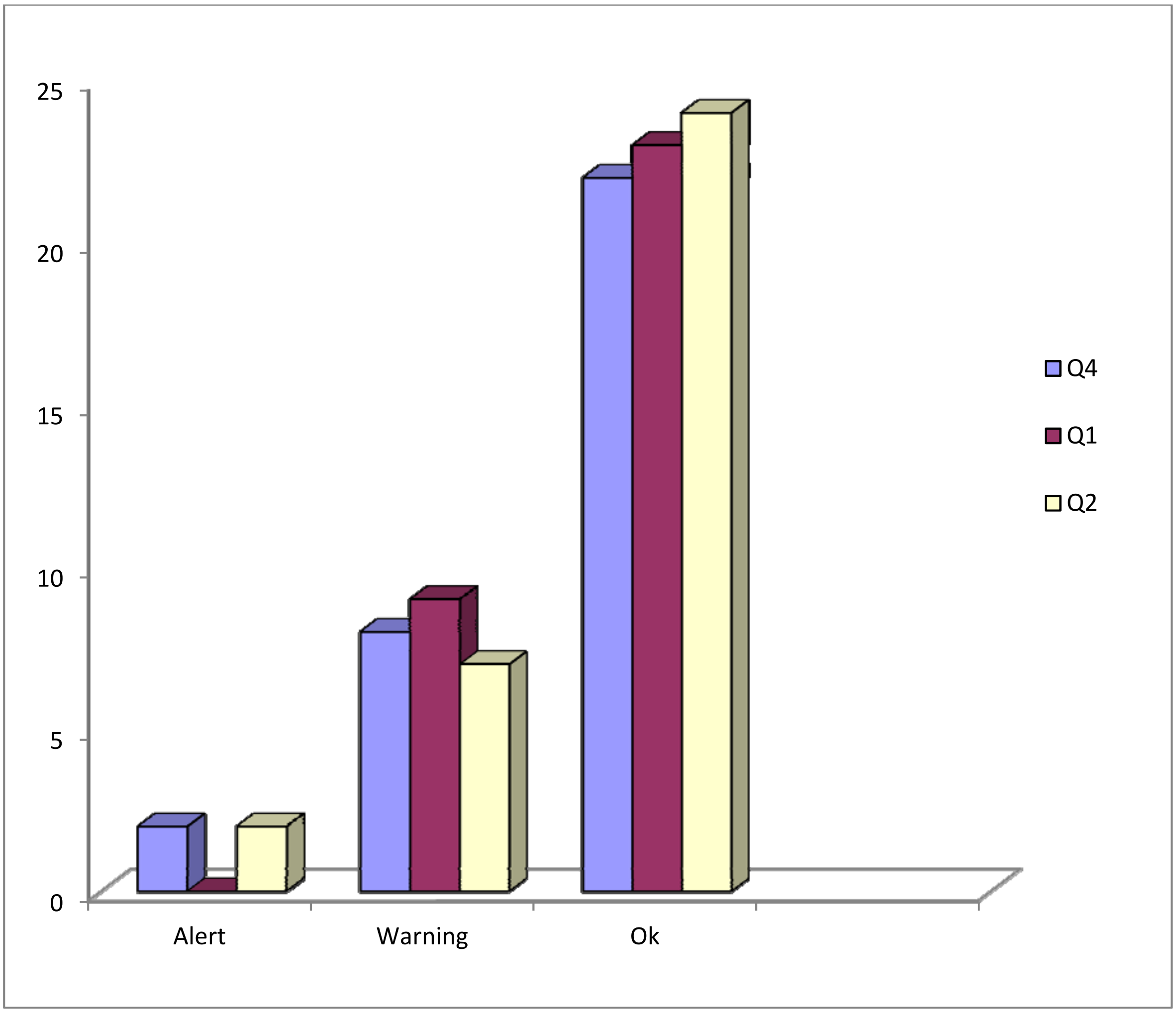
NOTABLE RISKS: PROGRESSION OF CURRENT RISK (ACCOUNTING FOR CONTROLS) IN LAST THREE QUARTERS



OTHER KEY POINTS

	Comments
New significant risks	None.
Other new risks	A new risk entitled '*Group Structure and Governance not fully compliant and up to date (including integration of subsidiaries, LPFI and LPFE)* (26) has been added to the risk register.
New controls	Moore Stephens engaged to provide FCA compliance filing support and annual training to staff and senior management.
Eliminated risks	None.
Notable initiatives / actions	Discussions with Falrkik Council are underway regarding a review of the current shared services structure, in light of developing business objectives of both LPF and Falkirk and LPF now have additional capability through its authorised investment vehcile, LPFI Limited. (27) Appointing a replacement HR director on the board of LPFE Limited, following the resignation of Martin Glover. (26) Reviewing potential conflict of interest arising in relation to Scott Moncieff becoming the external auditor of CEC and currently being the auditor of LPFE Limited and LPFI Limited. (20) The Fund has submitted it's Pension Regulator scheme returns for Scottish Homes and Lothian Pension Fund (which includes LBPF) in August within the set deadlines. In addition, training scheduled to take place after Financial Conduct Authority authorisation to ensure compliance required becomes well established within the Fund's compliance practices. (20) The Fund proactively supported employers to ensure prompt delivery of membership information at year-end and monthly contribution returns in order to improve data quality and ensure benefits statements were issued before the new regulatory deadline. (29) Aon has now designed a policy specifically to cover pension board members. The fund is presently liaising with Aon to ascertain the merits of benefiting from this policy and will report its findings to the Committee and Pensions Board. (10) Two members of the team are attending a Health and Safety workshop on 14 September 2016 to assist in ascertaining the health and safety risk profile for the Council. (33)
Material Litigation	None but there is a possibility of litigation to recover liabilities from employers in the coming months (dealt with elsewhere in the agenda).

All Risks: Status Overview



Q2 2016/17 All Risks: Impact and Likelihood Overview

Likelihood \ Impact	1	2	3	4	5	6	7	8	9	10
10										
9										
8				3						
7				31	2					
6					4					
5					11, 20	12	7			
4				5, 8, 9, 17, 28, 29, 33	1, 6, 18, 19, 22, 25, 26, 27, 32	23, 30				
3			14	10, 24	16					
2			13							
1					21				15	

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

Key: Risks by Number

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