

Notice of meeting and agenda

Pensions Committee

2.00pm, Monday 20 March 2017

Dunedin Room, City Chambers, High Street, Edinburgh

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

Contact

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1. Order of business

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

2. Declaration of interests

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

3. Deputations

- 3.1 None.

4. Minute

- 4.1 Minute of the Pensions Committee of 6 December 2017 – Submitted for approval as a correct record (circulated)

5. Reports

- 5.1 Considerations and matters to be raised by the Pension Board regarding any items on the agenda
- 5.2 Agenda Planning – report by the Acting Executive Director of Resources (circulated)
- 5.3 Internal Audit plan for 2017/18 – report by the Acting Executive Director of Resources (circulated)
- 5.4 External Audit – Annual Audit Plan 2016-17 – report by the Acting Executive Director of Resources (circulated)
- 5.5 Governance Update – report by the Acting Executive Director of Resources (circulated)
- 5.6 Lothian Pension Fund Staffing – report by the Acting Executive Director of Resources (circulated)
- 5.7 Investment Controls and Compliance – report by the Acting Executive Director of Resources (circulated)
- 5.8 Additional Voluntary Contributions (AVC) - administration service – 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 Budget for 2017/18 – report by the Acting Executive Director of Resources (circulated)
- 5.12 Risk Management Summary – report by the Acting Executive Director of Resources (circulated)

6. Motions

- 6.1 If any

Laurence Rockey

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 twelve 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, Tuesday 6 December 2016

Present:

Councillors Rankin (Convener), Child, Orr and Rose.

Pensions Board Members Present:

Darren May, Alan Williamson, Graeme Turnbull, Sharon Dalli, Catrina Warren, John Rodgers, Jim Anderson, Paul Ritchie, Richard Lamont.

1. Minutes

Decision

To approve the minute of the Pensions Committee of 28 September 2016 as a correct record, subject to including a further decision under item 3 to read 'To agree that a report on the Fund's engagement with companies on environmental, social and governance issues would be considered at a future meeting of the Pensions Committee'.

2. Referrals and Recommendations from Pensions Audit Sub Committee

Councillor Rose advised the Committee of the discussions and decisions taken at the Pensions Audit Sub-Committee on 5 December 2016.

Decision

To note the update.

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 March 2017 and June 2017.

Decision.

To note the agenda planning document.

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

5. Pension Fund Cost Benchmarking

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

Decision

- 1) To note the report by the Acting Executive Director of Resources
- 2) To note that the CEM Investment Benchmarking Analysis 2015 and the CIPFA Pensions Administration Benchmarking 2016 comparator reports had been provided, on a confidential basis, to the Convener of the Pensions Committee, Convener of the Pensions Audit Sub-Committee and the Independent Professional Observer.

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

6. Stewardship

An annual update on the Funds' class action activity was provided as well as an annual update on the activity of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund (the Funds) in relation to the stewardship of the assets of the Funds was provided.

Emma Hunt and Bruce Duguid, on behalf of Hermes, delivered a presentation regarding the engagement undertaken on behalf of the fund and the benefits of maintaining the current arrangements. From the beginning of the financial year 2016/17, Hermes had voted on behalf of Lothian Pension Fund at 367 meetings covering 5,292 resolutions.

Decision

- 1) To note the report by the Acting Executive Director of Resources.

- 2) To nominate Councillor Rankin to stand for election to the Local Authority Pension Fund Forum (LAPFF) Executive at the January 2017 AGM (the appointment being subject to approval by Council).

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

7. Service Plan Update

An update was provided on progress against the 2016-18 Service Plan, including performance indicators and the key actions of the Fund.

Decision

- 1) To note the progress of the Fund against the 2016-2018 Service Plan.
- 2) To note the responses on the issue of the full cost transparency of investment management fees from Chartered Institute of Public Finance and Accountancy and the Scheme Advisory Board.

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

8. Lothian Pension Fund Discretions Policy

Approval was sought to make minor amendments to The Lothian Pension Fund's (Discretions) Policy.

Decision

To approve the amended Lothian Pension Fund's Discretions Policy, as shown at Appendix 1 in the report by the Acting Executive Director of Resources.

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

9. Risk Management Summary

An overview of the pension fund's risk analysis as at 25 October 2016 was provided.

Decision

To note the Quarterly Risk Overview.

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

Pensions Committee

2.00 p.m., Monday, 20 March 2017

Agenda Planning

Item number	5.2
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

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; and
- 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.

June 2017

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

September 2017

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

Future Pensions Committee and Audit Sub Committee dates:

Pensions Committee	Pensions Audit Sub Committee
<ul style="list-style-type: none">• Wednesday 28 June 2017, 2pm Dunedin Room, City Chambers	<ul style="list-style-type: none">• Tuesday 27 June 2017, 2pm Dunedin Room, City Chambers

Measures of success

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

Financial impact

- 5.1 None.

Risk, policy, compliance and governance impact

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

Equalities impact

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

Sustainability impact

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

Consultation and engagement

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

Background reading/external references

None.

Hugh Dunn

Acting Executive Director of Resources

Contact: Struan Fairbairn, Chief Risk Officer

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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

Frequency	Pensions Committee	Audit Sub Committee	Month
Annually	Audit plans and reports (internal and external)	N/A - Draft audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee.	March
	Policies/Strategies/Training (including revised Pension Administration Strategy biennial from March 2016)	N/A	March
	Service Plan (every 2 years)	N/A	March
	Budget	N/A	March
	Governance Update	N/A	March
	Audit Sub-Committee Appointments	N/A	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	
N/A	Global Custody Services Performance	December	
	Risk Management In-depth review	December	

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

Pensions Committee

2.00 p.m., Monday, 20 March 2017

Internal Audit plan for 2017/18

Item number	5.3
Report number	
Executive/routine	
Wards	All

Executive summary

This document outlines the planned Internal Audit activities for the financial year 2017/18.

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

Links

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Internal Audit plan for 2017/18

Recommendations

- 1.1 Committee is requested to note the planned audit activity for the year 2017/18.

Background

- 2.1 The internal audit plan for the Fund is risk based and focuses on the governance, risk and controls within the Fund. In line with the requirements of the Public Sector Internal Audit Standards (PSIAS) which have been adopted by Internal Audit, the audit plan has been developed using a risk based methodology to ensure that assurance activity is focussed on the key areas of risk.
- 2.2 The methodology used to create the internal audit plan for the Fund is the same as was used for the City of Edinburgh Council's 2017/18 Internal Audit Plan, which was approved by the Governance, Risk and Best Value Committee on 9 March 2017.

Main report

Internal Audit Plan for the Lothian Pension Fund

- 3.1 The areas proposed for inclusion in the Pensions section of the Internal Audit plan were identified subsequent to consideration of the Fund's risk register, discussions with the Fund management team and discussions with the convenor of the Pensions Audit Sub-Committee to identify current areas of risk and to prioritise where obtaining assurance is appropriate.
- 3.2 The planned reviews for the year to 31 March 2018 are set out below:

	Audit remit	Planned days
1	<u>Business Continuity</u> Review the Fund's Business Continuity Plan. This will include IT disaster recovery for systems hosted by the Council and third party system providers.	20
2	<u>Information governance</u> Assess the processes and controls in place to ensure member data held by the Pension Fund is accurate, and is managed in compliance with Data Protection legislation.	20

3	<p><u>Lifetime and annual allowances</u></p> <p>Review the arrangements in place to ensure that pensions tax legislation is applied accurately, and that members are informed of its impact on their future pension provision.</p>	20
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- 3.3 It is proposed to conduct the Information Governance review in Q1 of the financial year with the other two reviews expected to be undertaken simultaneously in Q2, with the expectation that all reviews will be complete in advance of the December 2017 Pensions Committee meeting.
- 3.4 Planned days are indicative at this stage as the nature, timing and extent of the audit work is not confirmed until the detailed Terms of Reference have been finalised following the completion of the planning process with Fund management, for each review.
- 3.5 The Council's Internal Audit Plan also includes a review of the processes and controls in place around treasury management in Q1. Given that the Council's Treasury division provides a cash investment management service to the Fund, the Fund management team and elected members may be interested in the findings of this review.

Measures of success

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

Financial impact

- 5.1 A central support charge will be made to the Fund for the provision of Internal Audit services provided.

Risk, policy, compliance and governance impact

- 6.1 The Internal Audit plan sets out the areas of focus for Internal Audit activities for 2017/18. Internal Audit provides assurance over the governance and control environment operating in the Fund.

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 internal audit team consulted with Lothian Pension Fund management and the convenor of the Pensions Audit Sub- Committee in preparing the Internal Audit plan.

Background reading / external references

None.

Magnus Aitken, Chief Internal Auditor

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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., Monday, 20 March 2017

External Audit - Annual Audit Plan 2016-17

Item number	5.4
Report number	
Executive/routine	
Wards	All

Executive summary

Scott Moncrieff, the external auditor to the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2016/17. This is shown at Appendix 1 - "Scott Moncrieff Annual Audit Plan 2016-17".

Karen Jones, Director, Public Sector Audit, Scott Moncrieff, will present the Annual Audit Plan 2016-17 to Committee.

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

The proposed audit fee for 2016/17 is £44,350, which represents a reduction of 6.9% from 2015/16.

Links

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External Audit - Annual Audit Plan 2016-17

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 formal reliance placed on the work of Internal Audit;
- 1.3 Note that suitable provision has been made in the approved budget 2015-16 for the audit fee;
- 1.4 Note that there is sufficient separation between Scott Moncrieff's payroll, taxation advisory and audit services, and that it does not affect the firm's ability to provide an independent audit;
- 1.5 Approve the continuation of non-audit services of payroll and taxation advice provided by the company's external auditor to the LPF Group; and
- 1.6 Note that progress against the Annual Audit Plan 2016-17 will be reported to future meetings of the Pensions Audit Sub-Committee and the Pensions Committee.

Background

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

Main report

- 3.1 Scott Moncrieff, the external auditor to the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2015/16. This is shown at Appendix 1 - "Scott Moncrieff Annual Audit Plan 2016-16".

Measures of success

- 4.1 Progress against the Annual Audit Plan 2016-17 will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Pensions Committee. The prime objective is to ensure an unqualified audit opinion of the Annual Report 2016-17. This will be determined in due course.

Financial impact

- 5.1 The proposed audit fee for 2016/17 is £44,350, which represents a reduction of 6.9% from 2015/16. This fee of £44,350, however, has been increased by Scott Moncrieff from the expected fee of £40,800, “to take cognisance of the audit work we will carry out on the priorities and risks facing the Funds which are identified in this plan”. There is scope, within the terms of the contractual arrangement by which Scott Moncrieff has been awarded such audit work by Audit Scotland, for the proposed audit remuneration to exceed the expected fee by up to 10% where significant additional work is undertaken and with the agreement of the client.
- 5.2 The Fund has accepted the proposed audit fee of £44,350 for 2016/17 and suitable provision has been made in the 2016/17 budget.

Non-audit services

- 5.3 In November 2016, the Chief Internal Auditor provided an audit report on the “Governance of LPF Group”. This included the advisory finding that “Scott Moncrieff is the payroll provider for LPFE and also its external auditor. This arrangement is permitted for a non-regulated (unlisted) company such as LPFE, but we would recommend that management satisfy themselves that there is sufficient separation between Scott Moncrieff’s payroll and audit services, and that it does not affect the firm’s ability to provide an independent audit. We would also recommend that management consider obtaining audit committee approval for non-audit services provided by the company’s external auditor.”
- 5.4 Lothian Pension Fund has received the following requisite assurance from Scott Moncrieff:
- 5.5 “As a firm we have strict procedures in place to ensure the we comply with the Institute of Chartered Accountants of Scotland’s (ICAS) Code of Ethics and we are subject to an annual inspection by ICAS who review our compliance with these procedures as part of their inspection visit. Under these procedures, and in accordance with the ICAS Code of Ethics, we must determine whether providing a non-audit service to an audit client would create a threat to our independence before we accept the engagement. If the threat cannot be reduced to an acceptable level by the application of safeguards, the non-assurance service is not provided. We have evaluated the threat to our independence of providing payroll and other non-audit services to LPFE Ltd and LPFI Ltd, and are satisfied that the safeguards in place have reduced any threat to an acceptable level. For example, all non-audit services are performed by staff and partners who have no involvement in the audit of the financial statements. In the case of the payroll work in particular, this is undertaken by the payroll team which is based in our Glasgow office and is overseen by a partner based in Glasgow. Each year, at the planning stage of the audit, our procedures dictate that we must reassess whether the provision of non-audit services could threaten our independence and can only proceed with the audit if we are satisfied any threat has been reduced to an acceptable level. We

include a confirmation of our independence in the planning letter we issue in advance of the audit, as well as in the audit management report we issue at the conclusion of the audit.”

Risk, policy, compliance and governance impact

6.1 External audit is a critical part of the governance of 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

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

Hugh Dunn

Acting Executive Director of Resources

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Links

Coalition pledges

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

Single Outcome Agreement

Appendices Appendix 1 - Scott Moncrieff Annual Audit Plan 2016-17



Scott-Moncrieff
business advisers and accountants

Appendix 1

Lothian Pension Funds

External Audit Plan
2016/17

February 2017

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1

Introduction

Introduction

1. This document summarises the work plan for our 2016/17 external audit of Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund (collectively referred to as the “Funds”).
2. The core elements of our work include:
 - an audit of the 2016/17 annual accounts and related matters;
 - an interim audit, taking into consideration the work of internal audit, on accounting systems;
 - a review of arrangements for governance and transparency, financial management, financial sustainability and value for money; and
 - any other work requested by Audit Scotland, for example, local performance audit work.

Audit appointment

3. The Accounts Commission is an independent body appointed by Scottish Ministers responsible for securing the audit of local authorities and other local government bodies. The Commission’s work is governed mainly by the Local Government (Scotland) Act 1973.
4. Audit Scotland is an independent statutory body that provides the Accounts Commission with the services required to carry out their statutory functions, including monitoring the performance of auditors through a quality control process.
5. The Accounts Commission has appointed Scott-Moncrieff as external auditor of the Lothian Pension Funds for the five year period 2016/17 to 2020/21. This document comprises the audit plan for 2016/17 and summarises:
 - the responsibilities of Scott-Moncrieff as external auditors;
 - our audit strategy;
 - our planned audit work and how we will approach it;
 - our proposed audit outputs, timetable and fee; and
 - background to Scott-Moncrieff and the audit team.

Adding value through the audit

6. All of our clients quite rightly demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to the Funds through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way we aim to help the Funds promote improved standards of governance, better management and decision making and more effective use of resources.
7. Any comments you may have on the service we provide would be greatly appreciated at any time. Full contact details for your audit team can be found in Appendix 1.
8. While this plan is addressed to the Lothian Pension Funds, it will be published on Audit Scotland’s website www.audit-scotland.gov.uk.

2

Responsibilities of Scott-Moncrieff

Responsibilities of Scott-Moncrieff

Code of Audit Practice

9. The Code of Audit Practice (the Code) outlines the responsibilities of external auditors appointed by the Accounts Commission and it is a condition of our appointment that we follow it.
10. A new Code of Audit Practice was published in 2016 and applies to external audits for financial years starting on or after 1 April 2016. This Code replaces the previous one issued in 2011.

Auditor responsibilities

11. The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the annual accounts, but providing audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.
12. The Code sets out four audit dimensions that frame the wider scope audit work into identifiable audit areas. These are summarised in Exhibit 1.

Exhibit 1: Audit dimensions of wider scope public audit

Audit area	Scope
Financial sustainability	Financial sustainability looks forward to the medium (two to five years) and the longer term (over five years) to consider whether the body is planning effectively to allow it to continue to fulfil its functions in an affordable and sustainable manner.
Financial management	Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
Governance and transparency	Governance and transparency covers the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.
Value for money	Value for money is concerned with using resources effectively and continually improving services.

3

Audit strategy

Audit strategy

Risk-based audit approach

13. We follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the Funds. This

ensures that our audit focuses on the areas of highest risk. Our audit planning is based on:



14. Planning is a continuous process and our audit plans are therefore updated during the course of our audit to take account of developments as they arise.

Communications with those charged with governance

15. Auditing standards require us to make certain communications throughout the audit to those charged with governance. We have agreed with the Funds that these communications will be through both the Pensions Committee and Pensions Audit Sub-Committee.

Professional standards and guidance

16. We perform our audit of the annual accounts in accordance with International Standards on Auditing (UK and Ireland) (ISAs), the International Standard on Quality Control 1 (UK and Ireland), Ethical Standards, and applicable Practice Notes and other guidance issued by the Auditing Practices Board (APB).

Partnership working

17. We will coordinate our work with Audit Scotland, internal audit and other external auditors, recognising the increasing integration of service delivery and partnership working within the public sector.

Audit Scotland

18. Although we are independent of Audit Scotland and are responsible for forming our own views and opinions, we do work closely with Audit Scotland throughout the audit. This helps, for example, to identify common priorities and risks, treat consistently any issues arising that impact on a number of audited bodies, and further develop an efficient and effective approach to public audit. We will share information about identified risks, good practices and barriers to improvement so that lessons to be learnt and knowledge of what works can be disseminated to all relevant bodies.

19. Audit Scotland undertakes national performance audits on issues affecting the public sector. We will review the Funds' arrangements for taking action on any issues reported in the national performance reports which may have a local impact. We plan to assess the extent to which the Funds use the national performance reports as a means to help improve performance at the local level.

20. During the year we may also be required to provide information to Audit Scotland to support the national performance audits.

Internal audit

21. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the

Funds' total audit resource. The Funds' internal audit function is provided by the City of Edinburgh Council's internal audit team. We will consider the findings of the work of internal audit within our audit process and look to minimise duplication of effort, to ensure the total audit resource to the Funds are used efficiently and effectively.



Annual accounts

Annual accounts

Introduction

22. Audited bodies' annual accounts are an essential part of accounting for their stewardship of the resources made available to them and their financial performance in the use of those resources. This section sets out our approach to the audit of the Funds' annual accounts.

Approach to audit of annual accounts

23. Our opinion on the annual accounts will be based on:

Risk-based audit planning

24. We focus our work on the areas of highest risk. As part of our planning process we prepare a risk assessment highlighting the audit risk relating to each of the key systems on which the annual accounts will be based.

An audit of key systems and internal controls

25. We evaluate the key accounting systems and internal controls and determine whether they are adequate to prevent material misstatements in the annual accounts.
26. The systems we review and the nature of the work we perform will be based on the initial risk assessment. We will examine and test compliance with best practice and the Funds' own policies and procedures.
27. We will take cognisance of any relevant internal audit reviews of systems and controls.
28. We will update the risk assessment following our evaluation of systems and controls and this will ensure that we continue to focus attention on the areas of highest risk.

A final audit of the annual accounts

29. During our final audit we will test and review the material amounts and disclosures in the annual accounts. The extent of testing will be based on our risk assessment.
30. Our final audit will seek to provide reasonable assurance that the annual accounts are free from material misstatement and comply with the Code of Practice on Local Authority Accounting in the UK (the CIPFA Code).

Independent auditor's report

31. Our opinion on whether the annual accounts give a true and fair view of the financial position and its income and expenditure will be set out in our independent auditor's report which will be included in the annual accounts.

Materiality

32. Materiality is an expression of the relative significance of a matter in the context of the annual accounts as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement.
33. Our initial assessment of materiality for each Fund is set out in the table below. The Funds hold significant investment assets, which form the largest part of the net asset statements for each pension fund. We consider that the net asset statements are of primary interest to the reader of the annual accounts and therefore consider that these should be used in the calculation of overall materiality. While the net asset statements are of primary interest to the reader of the annual accounts we consider that a misstatement at the level of materiality or even much less than this figure would be highly material to the fund accounts and therefore of greater interest to the reader of the annual accounts. Therefore we will apply a materiality level to the fund account transactions at a lower level, to reduce the risk of material misstatement.

	Overall materiality £million	Fund account materiality £million
Lothian Pension Fund (group) ¹	81.5	8.8
Lothian Pension Fund (single entity)	81.5	8.8
Lothian Buses Pension Fund	5.9	0.4
Scottish Homes Pension Fund	2.3	0.2

34. We set a performance (testing) materiality for each area of work which is based on a risk assessment for the area. We perform audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we perform a greater level of testing on the areas deemed to be of significant risk of material misstatement.

	Area risk assessment £million		
	High (45%)	Medium (55%)	Low (70%)
Lothian Pension Fund (group)	36.7	44.8	57.1
Lothian Pension Fund (single entity)	36.7	44.8	57.1
Lothian Buses Pension Fund	2.7	3.2	4.1
Scottish Homes Pension Fund	1.0	1.2	1.6

¹ Lothian Pension Fund group comprises Lothian Pension Fund, LPFE and LPFI

35. Where transactions, or groups of transactions, and balances impact on the fund account, performance materiality will be set at the lower fund account materiality figures as disclosed above.

36. We will report any misstatements identified through our audit that fall into one of the following categories:

- All material corrected misstatements;
- Uncorrected misstatements with a value in excess of £250,000, less than 1% of the overall materiality figure; and
- Other misstatements below the 1% threshold that we believe warrant reporting on qualitative grounds.

Key audit risks in the annual accounts

37. Auditing standards require that we inform the Pensions Committee of our assessment of the risk of material misstatement in the annual accounts. We have set out our initial assessment below, including how the scope of our audit responds to those risks. We will provide an update to the Pensions Committee if our assessment changes significantly during the audit.

Exhibit 2 – Key audit risks in the annual accounts

1. Revenue recognition

Under ISA 240- *The auditor's responsibilities relating to fraud in an audit of financial statements* there is a presumed risk of fraud in relation to revenue recognition. The presumption is that the Funds could adopt accounting policies or recognise revenue transactions in such a way as to lead to a material misstatement in the reported financial position.



38. Our work on income will include an evaluation of each type of revenue transaction and a review of the controls in place over revenue accounting. We will consider the Funds' key revenue transactions and streams and carry out testing to confirm that the Funds' revenue recognition policy is appropriate and has been applied consistently throughout the year.

2. Management override

In any organisation, there exists a risk that management have the ability to process transactions or make adjustments to the financial records outside the normal financial control processes. Such issues could lead to a material misstatement in the annual accounts. This is treated as a presumed risk area in accordance with ISA 240 - *The auditor's responsibilities relating to fraud in an audit of financial statements*.



39. In response to this risk we will review the Funds' accounting records and obtain evidence to ensure that any significant transactions outside the normal course of business were valid and accounted for correctly.

3. Valuation of investments

The Funds held investments of £5.399 billion as at 31 March 2016, of which 25% (£1.350 billion) were classified as level 2 or level 3 financial instruments, meaning the valuation was not based on unadjusted quoted prices in active markets. Investments of this nature are complex, difficult to value and include a significant degree of judgement from the investment manager. The material nature of this balance means that any error in judgement could result in a material valuation error.



40. In response to this risk we will review the design and implementation of controls present at the scheme for ensuring the accurate valuation of investments. We will review the qualifications of the fund managers as experts to value the investments and gain an understanding of how the valuations have been reached. For a sample of investments we will confirm the prices quoted to fund manager reports and independent pricing sources. Where such prices are not available we will perform alternative procedures such as reviewing transactions around the year end.

4. Pension liability assumptions

An actuarial estimate of the pension fund liability is calculated on an annual basis under IAS 19 and on a triennial funding basis by independent firm of actuaries with specialist knowledge and experience. The estimates are based on the most up to date membership date held by the pension fund and have regard to local factors such as mortality rates and expected pay rises with other assumptions around inflation when calculating the liabilities. There is a risk that the assumptions used are not appropriate.



41. We will review the controls in place to ensure that the data provided from the fund to the actuary is complete and accurate. We will review the reasonableness of the assumptions used in the calculation against other local government pension fund actuaries and other observable data. We will agree the disclosures in the financial statements to information provided by the actuary.

Other risk factors

42. Further to the identification of significant audit risks, we have also identified risk factors which could potentially result in material misstatements. We do not propose, at this

stage to undertake specific audit procedures in response to these perceived risks. We will continue to monitor these areas during the year and adapt our audit approach as necessary.

Exhibit 3 – Other risk factors

1. Group accounts

The Pensions Committee for the Funds approved the creation of two special purpose vehicles, LPFE Ltd and LPFI Ltd which are wholly owned and controlled by the City of Edinburgh Council. Group accounts were prepared for the Funds for the first time in 2015-16 incorporating LPFE Ltd. LPFI Ltd only became operational after the funds received Financial Conduct Authority authorisation. It is anticipated that LPFI Ltd will be incorporated into the group accounts in 2016/17.



43. We will review the consolidation working papers to ensure the group accounts accurately reflect the activities of the parent and both subsidiaries. We will review the financial statements to ensure the disclosure requirements of the CIPFA Code are met.

2. Changes to the CIPFA Code

The main change for the 2016/17 pension fund accounts is the extension of the fair value disclosures required under the CIPFA Code. Other changes made to the pension fund accounts include the following:

- An analysis of investment management expenses in line with CIPFA's *Accounting for local government pension scheme management expenses* (2016).
- The net assets statement, along with certain notes have been amended to align with new investment classifications of the CIPFA Code.
- The classification of investment assets and liabilities into fair value hierarchies (levels 1 to 3) has been amended.
- An additional disclosure note covering remuneration of key management personnel has been included in related party transactions.



44. Our work will include discussions with the finance team to establish compliance with the CIPFA Code. We will review the disclosure checklist completed by the Funds' finance team. Where there are recommended disclosures we will discuss in advance the Funds planned approach to reporting.

5

Wider scope audit

Wider scope audit

Introduction

- 45. The Code frames a significant part of our wider scope responsibilities in terms of four audit dimensions. As part of our annual audit we will consider and report against these four dimensions; financial sustainability, financial management, governance and transparency and value for money. At the outset we will consider the Funds self-evaluation arrangements as they relate to these four dimensions.
- 46. At this stage of our audit planning process, we have identified one significant risk to the wider scope of our audit in relation to financial sustainability. We have not, at this stage, identified any significant risks in relation to the other three dimensions; financial management, governance and transparency or value for money. Audit planning however is a continuous process and we will report any identified significant risks, as they relate to the four dimensions, in our annual audit report.

Exhibit 3 - Wider scope audit

Financial sustainability: Financial sustainability looks forward to the medium and longer term to consider whether the Funds are planning effectively to continue to fulfill its functions in an affordable and sustainable manner.

Funds responsibilities	Our audit approach
<p>It is the Funds responsibility to put in place proper arrangements to ensure the financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> • Such financial monitoring and reporting arrangements as may be specified; • Compliance with any statutory financial requirements and achievement of financial targets; • Balances and reserves, including strategies about levels and their future use; • How the Funds plan to deal with uncertainty in the medium and long term; and • The impact of planned future policies and foreseeable developments on the financial position. 	<p>During our 2016/17 audit we will consider the Funds financial standing. This will involve a review of the arrangements in place for short, medium and long term financial planning, budgetary control and financial reporting. It is important that such arrangements are adequate in order to properly control the Funds’ operations and use of resources.</p> <p>Key audit risk</p> <p>The Funds produce an annual service plan and budget which covers a two year period of activity. In addition to this the Funds prepare a Funding Strategy Statement and receive a triennial actuarial valuation which builds up a picture of the longer term financial pressures. The service plan focuses on the running costs of the scheme whereas the Funding Strategy and triennial valuation focuses on meeting the demands of pension liabilities. There is a risk that pressures on the running costs of the Funds will increase going forward, resulting in service levels diminishing.</p> <p>During our audit we will consider whether the Funds have adequate arrangements in place for managing its financial position and its use of resources. Our conclusion will be based on a review of the Funds’ financial performance, underlying financial position, financial plans and financial reporting.</p>

Exhibit 3 - Wider scope audit

Financial management: Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

Funds responsibilities	Our audit approach
<p>It is the Funds' responsibility to ensure that its financial affairs are conducted in a proper manner. Management are responsible, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance.</p> <p>The Funds are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at its disposal.</p> <p>It is the Funds' responsibility to establish arrangements to prevent and detect fraud, error and irregularities, bribery and corruption and also to ensure that its affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.</p>	<p>During our 2016/17 audit we will review, conclude and report on the following:</p> <ul style="list-style-type: none"> • Whether the Funds have arrangements in place to ensure systems of internal control are operating effectively; • Whether the Funds can demonstrate the effectiveness of its budgetary control system in communicating accurate and timely performance; • How the Funds have assured itself that its financial capacity and skills are appropriate; and • Whether the Funds have established appropriate and effective arrangements for the prevention and detection of fraud and corruption.

Governance and transparency: Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

Funds responsibilities	Our audit approach
<p>It is the responsibility of the Funds to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The Funds should involve those charged with governance in monitoring these arrangements.</p> <p>In May 2017 local government elections will take place. It is the Funds' responsibility to manage any impact this may have on the governance of the organisation and reflect this appropriately in the Annual Governance Statement.</p> <p>The Funds are also responsible for establishing effective and appropriate internal audit and risk management functions.</p>	<p>We will review the effectiveness of the Funds governance framework and the extent to which board and committee roles, membership and terms of reference comply with current guidance.</p> <p>We will consider the appropriateness of the disclosures in the Annual Governance Statement.</p> <p>We will consider whether the information provided to the board and committees is sufficient for members to assess the impact of decisions on resources and performance.</p> <p>Our work will include consideration of how risk management has been addressed within the Funds. We will also consider the Funds' internal audit arrangements to determine their role in examining the control systems established by management.</p>

Exhibit 3 - Wider scope audit

Value for money: Value for money is concerned with the appropriate use of resources and ensuring continual improvement of services delivered.

Funds responsibilities	Our audit approach
<p>Accountable officers have a specific responsibility to ensure that arrangements have been made to secure best value. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.</p>	<p>We will work with the Funds to identify and review evidence which demonstrates the achievement of value for money in the use of its resources.</p> <p>We will seek evidence from the Funds that outcomes are improving and there is sufficient focus on improvement and the pace of it.</p> <p>Audit Scotland carries out a national performance audit programme on behalf of the Auditor General for Scotland and the Accounts Commission. We will work with Audit Scotland during the year to understand the outputs from this work and identify any particular reports that the Funds may have a direct interest in.</p>

5

Audit outputs, timetable and fees

Audit outputs, timetable and fees

Audit output	Format	Description	Target month
External audit plan	Report	This report sets out the scope of our audit for 2016/17.	February 2017
Independent Auditor's Report	Report	This report will contain our opinions on the truth and fairness of the annual accounts	September 2017
Annual Report to the Funds and the Controller of Audit	Report	At the conclusion of each year's audit we will issue an annual report setting out the nature and extent of our audit work for the year and summarising our opinions, conclusions and the significant issues arising from the work. This report will pull together all of our work under the Code of Audit Practice.	September 2017

Audit outputs

47. Prior to submitting our outputs, we will discuss all issues with management to confirm factual accuracy and agree a draft action plan where appropriate.
48. The action plans within the reports will include prioritised recommendations, responsible officers and implementation dates. We will review progress against the action plans on a regular basis.

Audit fee

49. Audit Scotland has completed a review of funding and fee setting arrangements and as a result revised its fee strategy. It now sets an expected fee for each audit carried out under appointment that assumes the body has sound governance arrangements in place, has been operating effectively throughout the year, prepares comprehensive and accurate draft accounts and meets the agreed timetable for audit. The expected fee will be reviewed by Audit Scotland each year and adjusted if necessary based on auditors' experience, new requirements, or significant changes to the audited body.
50. As auditors we negotiate a fee with the audited body during the planning process. The fee may be varied above the expected fee level to reflect the circumstances and local risks within the body.

51. For 2016/17 the expected fee for the Funds is £40,800. We propose setting the fee above this level at £44,350; to take cognisance of the audit work we will carry out on the priorities and risks facing the Funds which are identified in this plan.
52. The total proposed fee for the Funds for 2016/17 is as follows:

	2016/17
Auditor remuneration	£39,130
Pooled costs	£3,100
Performance audit and Best Value	-
Audit support costs	£2,120
Total expected fee	£44,350²

53. We will take account of the risk exposure of the Funds and the management assurances in place. We assume receipt of the draft working papers at the outset of our on-site final audit

² The audit fee in 2015/16 was £47,660.

visit. If the draft accounts and papers are late, or agreed management assurances are unavailable, we reserve the right to charge an additional fee for additional audit work. An additional fee will be required in relation to any other significant exercises not within our planned audit activity.

Audit timetable

54. The dates for our interim and final audits have been discussed with the Chief Financial Officer and the finance team. A summary timetable, including audit outputs, is set out as follows:



6

Appendices

Appendix 1: Your audit management team

Scott-Moncrieff is one of the largest independent accountancy firms in Scotland. We have 18 partners and over 200 staff operating from Edinburgh, Glasgow and Inverness. We are also part of the global Moore Stephens network.

We have been external auditors within the public sector for at least fifty years. We provide a comprehensive range of services to clients across the public sector, including NHS bodies, local authorities, central government bodies and FE colleges. We also provide services to charities, schools, as well as private and public limited companies.

Edinburgh	Glasgow	Inverness
Exchange Place 3 Seiple Street Edinburgh EH3 8BL	25 Bothwell Street Glasgow G2 6NL	10 Ardross Street Inverness IV3 5NS
(0131) 473 3500	(0141) 567 4500	(01463) 701 940

Your audit management team

Nick Bennett
Audit Partner

nick.bennett@scott-moncrieff.com

Nick has over 25 years’ experience of public sector auditing and has been heavily involved in developing public sector accounting standards. Nick’s experience and expertise is acknowledged both by clients and by other professionals involved right across the public sector.

Karen Jones
Audit Director

karen.jones@scott-moncrieff.com

Karen is one of our directors responsible for the audit of our Audit Scotland external audit appointments. She has considerable experience in planning and delivering audits, producing management reports and liaising with senior officers.

Claire Gardiner
Audit Manager

claire.gardiner@scott-moncrieff.com

Claire has over 12 years’ public sector external audit experience. She has delivered external audit services to a range of public sector bodies, including pension funds, local authorities, health bodies and central government bodies. Claire will manage the onsite team and work alongside Karen and Nick to deliver the audit engagement.

Confirmation of independence

ISA 260 requires us to communicate on a timely basis all facts and matters that may have a bearing on our independence.

We confirm that we will comply with APB Ethical Standard 1 – Integrity, Objectivity and Independence. In our professional judgement, the audit process is independent and our objectivity has not been compromised in any way. In particular there are and have been no relationships between Scott-Moncrieff and the Funds, its Funds members and senior

management that may reasonably be thought to bear on our objectivity and independence.

Appendix 2: Statement of understanding

Introduction

The purpose of this Statement of understanding is to clarify the terms of our appointment and the key responsibilities of the Lothian Pension Funds (the "Funds") and Scott-Moncrieff.

Annual accounts

We will require the annual accounts and supporting working papers for audit by the agreed date specified in the audit timetable. It is assumed that the relevant Funds staff will have adequate time available to deal with audit queries and will be available up to the expected time of completion of the audit. We will issue a financial statements strategy which sets out roles, responsibilities and expectations in terms of audit deliverables. This document helps to ensure we can work together effectively to deliver an efficient and effective audit.

Scope of audit

As auditors we will take reasonable steps to plan and carry out the audit so as to meet the objectives and comply with the requirements of the Code of Audit Practice. Audit work will be planned and performed on the basis of our assessment of audit risks, so as to obtain such information and explanations as are considered necessary to provide sufficient evidence to meet the requirements of the Code of Audit Practice.

As auditors we do not act as a substitute for the Funds responsibility to establish proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for and used economically, efficiently and effectively.

As part of our normal audit procedures, we will ask you to provide written confirmation of certain oral representations which we have received from the Funds during the course of the audit on matters having a material effect on the annual accounts. This will take place by means of a letter of representation, which will require to be signed by the Chief Finance Officer.

Internal audit

It is the responsibility of the Funds to establish adequate internal audit arrangements. The audit fee is agreed on the basis that an effective internal audit function exists.

We will liaise with internal audit to ensure an efficient audit process.

Fraud and irregularity

In order to discharge our responsibilities regarding fraud and irregularity we require any fraud or irregularity issues to be reported to us as they arise. We also require a historic record of instances of fraud or irregularity to be maintained and a summary to be made available to us after each year end.

Ethics

We are bound by the ethical guidelines of our professional body, the Institute of Chartered Accountants of Scotland.

Fees

We base our agreed fee upon the assumption that all of the required information for the audit is available within the agreed timetable. If the information is not available within the timetable we reserve the right to charge a fee for the additional time spent by our staff. The fee will depend upon the level of skill and responsibility of the staff involved. The indicative financial statements strategy referred to above is a key means for us to clarify our expectations in terms of quality, quantity and extent of working papers and supporting documentation.

Service

If at any time you would like to discuss with us how our service to you could be improved or if you are dissatisfied with the service you are receiving please let us know by contacting Nick Bennett. If you are not satisfied, you should contact our Ethics Partner, Bernadette Higgins. In the event of your not being satisfied by our response, you may also wish to bring the matter to the attention of the Institute of Chartered Accountants of Scotland.

We undertake to look at any complaint carefully and promptly and to do all we can to explain the position to you.

Reports

During the course of the audit we will produce reports detailing the results and conclusions from our work.

Any recommendations arising from our audit work will be included in an action plan. Management are responsible for providing responses, including target dates for implementation and details of the responsible officer.

Agreement of terms

We shall be grateful if the Pensions Committee would consider and note this Statement of Understanding. If the contents are not in accordance with your understanding of our terms of appointment, please let us know.



Scott-Moncrieff
business advisers and accountants

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Pensions Committee

2.00 p.m., Monday, 20 March 2017

Governance Update

Item number	5.5
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to update the Committee on the rotation of the Pension Board chair, training activities over 2016/17 and various other governance matters.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Governance Update

Recommendations

Committee is requested to:

- 1.1 Invite the Pension Board to raise any relevant matters or concerns which the Pensions Committee should consider;
- 1.2 Note the verbal update from the Pension Board regarding the newly appointed chair of the Pension Board effective from 1 April 2017 to 31 March 2018;
- 1.3 Thank Jim Anderson's for his significant contribution during his tenure as the Chair of the Pension Board;
- 1.4 Note the nominations for the non-elected members of the Committee;
- 1.5 Note the update regarding the Pension Board Insurance liability;
- 1.6 Note the update on the recent petition;
- 1.7 Note the recent release of the report on the Scottish Government's governance review and that a report on its recommendations and impact on the Fund will be considered by the Committee later in 2017; and
- 1.8 Note the Accounts Commission's Local Government Pensions supplement overview prepared by Audit Scotland.

Background

- 2.1 The Fund reports annually to Committee on governance matters including its compliance with the Appointments and Nominations Policy and its Training and Attendance Policy, and any other related matters that arise.

Main report

Rotation of the Pension Board Chair & Membership of the Pension Board

- 3.1 The Fund's constitution states that '*the chairman of the Pension Board will be rotated on an annual basis*'. In the Pension Board's second year the chair was drawn from the union membership of the Pension Board. The 2017/18 chair is required to be drawn from the employer membership of the Pension Board.
- 3.2 The Pension Board are meeting in advance of the Pensions Committee and are expected to provide a verbal update to the Committee regarding who they have appointed as chair.

- 3.3 Over the last year the Pension Board have received four resignations, Rucelle Soutar, Linda McDonald, Simon Belfer (all employer representatives) and Graeme Turnbull (member representative). Sharon Dalli, Paul Ritchie and Alan Williamson (all employer representatives) have joined the Board. At the time of writing, the Fund is in the process of appointing a new member representative and a verbal update will be reported to Committee.

Non-Elected Members of the Pensions Committee

- 3.4 Non-elected members of the Pension Committee can serve a maximum of two consecutive years before either standing down or submitting themselves as a candidate for further election. The current non-elected Pension Committee members were appointed in February 2015 therefore the Fund advertised the seats in February 2017 via the Fund's website and employer bulletin.
- 3.5 The Fund subsequently received two applications for the posts, one application for the employer representative and one application for the member representative, from Richard Lamont and John Anzani respectively. They are the current incumbents for the respective roles. In accordance with the Lothian Pension Fund's Appointment and Nomination policy, the applications have been agreed by the review panel and formal approval of the appointments will be sought from Council in May 2017.

Training hours 2017/18 for the Pensions Committee and Pension Board

- 3.6 The Fund's training policy sets out that a minimum of three days (21 hours) training hours are expected of Pensions Committee and Pension Board members. The Pensions Regulator also requires those involved with the governance of local government pension schemes to develop and build sufficient knowledge to effectively carry out their role.
- 3.7 Appendix 1 of this paper provides a breakdown of training of the Pension Committee and Board.
- 3.8 Although one Pensions Committee member and five Pension Board members, as at 8 February 2017, do not meet the required training hours there are two further training opportunities in March and it is expected that all Committee and Board members will fully achieve the minimum training requirement by the end of March.
- 3.9 The Fund aims to continue to provide quarterly reminders of training hours and details of future training opportunities to ensure the Pensions Committee and Pension Board members continue to achieve the training requirements.

Pension Board insurance liability

- 3.10 Over the last two quarters the Fund has reported on Pension Board liability insurance. The Fund initially sought advice from the City of Edinburgh Councils insurance team who confirmed that the Pension Board would not be covered under the Councils existing liability provision. The Fund then approached three insurance providers, AON, Zurich and the Occupational Pensions Defence Union (OPDU). AON provided an initial quote which was high and may not have

provided the necessary insurance required, OPDU were not able to provide insurance for Pension Boards at this time and Zurich were still researching the issue.

- 3.11 As set out in the Service Plan update in December 2016, the Fund identified two insurance groups that are considering insurance liability for Pension Board Members, AON and Zurich. As reported to the Committee in December, the view from Zurich's insurer is that although the legal relationships are now understood the risk exposure seems very limited. Since the last report in December they have developed a solution for indemnifying Local Pension Board Members under their Official's Indemnity policy which is an addition to the existing policy for Councils It is not available as a stand-alone policy. AON also concede that the risk is viewed as remote however Pension Boards are new therefore their underwriters have taken a cautious approach. The City of Edinburgh Council's Insurance Manager has confirmed that, to date, AON have not made an addition to include the Pension Board on the existing policy for City of Edinburgh Council. A further update will be provided to Committee when the Fund hears any more information regarding this matter.

Petition from Campaign Against Arms Trade and Edinburgh Peace and Justice Centre

- 3.12 A petition was raised by the Campaign Against Arms Trade and Edinburgh Peace and Justice Centre in February 2017 calling on 'the City of Edinburgh Council to do everything within its powers and remit to require that Lothian Pensions Trust divest from all investments concerning arms manufacture'. The petition was raised on 7 February 2017 and will close on 23 March 2017.
- 3.13 Before a petition can be considered by the Petitions Committee it must receive at least 200 signatures from people living in the City of Edinburgh Council Area, or from 20 businesses that are on the Valuation Roll. The Convener of the Petitions Committee has the power to declare a petition signed by more than 50 people valid, if it relates to a local issue or a community of interest. At the time of writing this paper the petition had 385 signatories. The Petitions Committee is due to meet on 30th March. The Fund will ensure the Pensions Committee and Pension Board are kept informed of the outcome.

Scottish Public Service Pensions Agency Governance Review

- 3.14 In September 2016 the Scottish Public Pension Agency commissioned KPMG to undertake a Pensions Governance Review to assess the new governance arrangements introduced in April 2015 for public sector pension schemes, including the Scheme Advisory Board and Pension Boards. The Fund has been involved in the review process, providing comments on the initial remit and taking part in the review itself. In particular, two members of the Pension Board, the Convenor of the Pensions Committee and the Chief Executive of the Fund have been interviewed. A questionnaire was also circulated to members of the Pension Board.

- 3.15 The report on the review was received on 28 February and it has been circulated via email to members of the Pensions Committee and the Pension Board. Comments on the report were sought by the Scottish Government by 20 March. It is anticipated that the report will be considered by Scottish Government ministers in the coming months. A report on the outcome of the review and the potential implications for Lothian Pension Fund will be submitted to the Pensions Committee later in 2017.

Accounts Commission Overview of the LGPS

- 3.16 The Accounts Commission, the public spending watchdog for the Local Government, publish a financial overview of accounts and audit each financial year. The financial overview for 15/16 from the Accounts Commission is now available and a link to the report is available later in this report. This year, the Accounts Commission have also provided a supplementary report on the Local Government Pension Scheme which is set out in Appendix 2 of this report. It sets out various comparisons of the Pension Funds in Scotland.

Measures of success

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

Financial impact

- 5.1 None.

Risk, policy, compliance and governance impact

- 6.1 The Pensions Committee must undertake training in line with the Training and Attendance policy. Training and attendance must be monitored and reviewed.
- 6.2 The Pension Board has the knowledge and understanding to enable its members to properly exercise their functions. All training and attendance is monitored and is compliant with the Pension Regulator Code.
- 6.3 Two external Pensions Committee members, one employer representative and one member representative with full voting rights are elected to the Committee in accordance with the terms of reference and elected as set out in the nomination and appointments policy.

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

[Local Government in Scotland Financial Overview 2015/16, Accounts Commission, prepared by Audit Scotland, November 2016.](#)

Hugh Dunn

Acting Executive Director of Resources

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Links

Coalition pledges

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

Single Outcome Agreement

Appendices

Appendix 1 – Committee and Pension Board Members' Training Record from 1 April 2016 to 31 March 2017

Appendix 2 – Local Government Pension Scheme Supplement 2015/16, Accounts Commission, prepared by Audit Scotland.

Event:	TPR online training	PLSA Investment Conference	Internal Training Investments	Sarah Smart Session	Audit Sub Committee Preparation	Pension Committee Preparation	Internal Training Session	LGC Investment Seminar	Sarah Smart Session	Audit Sub Committee Preparation	Pension Committee Preparation	LGPS investment training seminar	PLSA Annual Conference	Internal training session	Sarah Smart Session	Audit Sub Committee Preparation	Pension Committee Preparation	LAPFF Conference (Bournemouth)	LGPS (Scotland) Seminar	Internal Training Session	Pensions & Lifetime Savings Conference.	Sarah Smart Session	Pension Committee Preparation	Additional training/reading	Total		
Date		16-18/05/15	7/6/16	27/6/16	22/6/16	27/6/16	7/9/16	8-9/9/16	28/9/16	27/9/16	28/9/16	5-6/10/16	19-21/10/16	15/11/16	6/12/16	5/12/16	6/12/16	7-9/12/16	12/12/16	1/3/17	8-10/03/17	20/3/17	20/3/17				
Pensions Committee																											
Maureen Child			3	0	1	2.5		0	0	1.5	3		0	0	0	1	0	0								12	
Bill Cook		11	3	0	0.5	1	2		0	0.5	1.5	5		3		0	0	0	0							27.5	
Jim Orr			3	1.75	0.5	1	3		0	0.5	1.5	8		3	0.58	0.5	1	0	5.5							29.83	
Alasdair Rankin (Convener)		10	3	0		1	3		0	0	1.5	8		3		0	1	11.25	5.5							47.25	
Cameron Rose			3	0	0.5	1	3		0	0.5	1.5	0		0		0.5	1	11.25	0						10	32.25	
John Anzani			3	0		1	3		0	0	1.5	5		3		0	0	11.25	5.5							4	37.25
Richard Lamont			0	0		1	3		0	0	1.5	8		3		0	1	0	0							24	41.5
																									227.58		
Lothian Pension Funds' Pension Board																											
Employer Representatives																											
Eric Adair (EDI Group)			3	0	0	3			0	1.5				0		0	0	0	0							4.5	12
Linda McDonald (Handicabs)			0	1.25		1	resigned from board																				N/A
Darren May (Scottish Water)			3	0.75		1	3			0.5	1			3	0.83	0	1	0	5.5							5.5	25.08
Rucelle Soutar (the Edinburgh Military Tattoo)			0	0		1	resigned from board																				N/A
Sharon Dalli (joined September 2016)	7					0	0		0.92	0	1.5			0	0.83	0	1	0	5.5							22	38.75
Alan Williamson (joined September 2016)	7					0	3			0	1.5			3		0.5	1	0	5.5							2	23.5
Paul Ritchie (joined September 2016)	7		0	0		0	3			0	1.5			3	0.25	0	1	0	0							2	17.75
Member Representatives																											
Graeme Turnbull (UCATT)			0	0.75		1	0			0	0			3		0	1	0	0							Resigned 25/01/17	5.75
John Rodgers (UNITE)			3	0.5		1	3		0.75	0	1.5			3	1.16	0	1	0	0							1.5	16.41
Jim Anderson (UNISON)			3	1.25	0.5	1	3		1.25	0.5	1.5			3	1.16	0	1	11.25	5.5								33.91
Catrina Warren (UNISON)			0	0		0	3			0	0			3		0.5	1	0	5.5								13
Thomas Carr Pollock (GMB)			0	0		1	3			0	1.5			0		0	1	0	5.5								12
Total																									198.15		

*Please note 1/2 an hour preparation is given to all those that attend the audit sub committee. 1 hour is given to those who attend the Pensions Committee.

Clr Rose on LAPFF behalf attended the SSE AGM 21 July (2 hours) and the National Grid AGM 25 July (2 hours)
Clr Rose - LAPFF meeting 5 October (3 hours), LAPFF meeting 18 October (3 hours)

Alan Williamson and Paul Ritchie Induction training Tuesday 6 September 2016 (2 hours). Sharon Dalli is credited for 1 hour for induction training.
September Pension Committee attendees credited with additional 1/2 hour for actuary training during committee.

John Anzani 15/06/2016 PLSA Scotland event - (2 hours) and 02/08/16 PLSA Scotland event - (2 hours)

Eric Adair LGC Seminar 27 October 2016 - (4.5 hours)

Darren May additional reading e.g. Professional Pensions - (5.5 hours over 6 months)

Richard Lamont - additional training, 2/8/16 Shepherd and Wedderburn LLP - (2 hours), 29/11/16 - Trustee training for British tourist board Pension Fund - (4 hours), Trustee Meetings British Tourist Board 26/5, 30/11, 23/8 - (18 hours)

John Rodgers - additional training at Atria 27/01/17 - (1.5 hours)

Sharon Dalli - 21 hours for her work on the auto enrolment group and SAB work.

Local Government Pension Scheme 2015/16



ACCOUNTS COMMISSION 

1. This supplement accompanies our Financial Overview of Local Government in Scotland 2015/16.
2. There are 11 council administered Local Government Pension Scheme (LGPS) pension funds in Scotland. They range from one of the biggest pension funds in the UK (Strathclyde) to one of the smallest (Orkney). Key LGPS facts are shown in [Exhibit 1](#).

Exhibit 1

Scottish Local Government Pension Scheme—key numbers

Membership



Active **226,000**
Deferred¹ **126,000**
Pensioner **169,000**

Assets and liabilities



Position
£34.5 billion assets
£41.8 billion liabilities
(estimate)

Transactions



£1.1 billion benefits paid
£0.94 billion employer contributions
£0.27 billion employee contributions
£0.68 billion return on investments

Note: 1 Deferred pensioners are members who have left the scheme but will be eligible for benefits upon reaching retirement age

3. It has been a challenging year for the LGPS in Scotland with the introduction of the new career average revalued earnings (CARE) scheme from 1 April 2015, new governance arrangements at UK, Scotland and local levels and uncertainty in investment markets affecting invest returns.

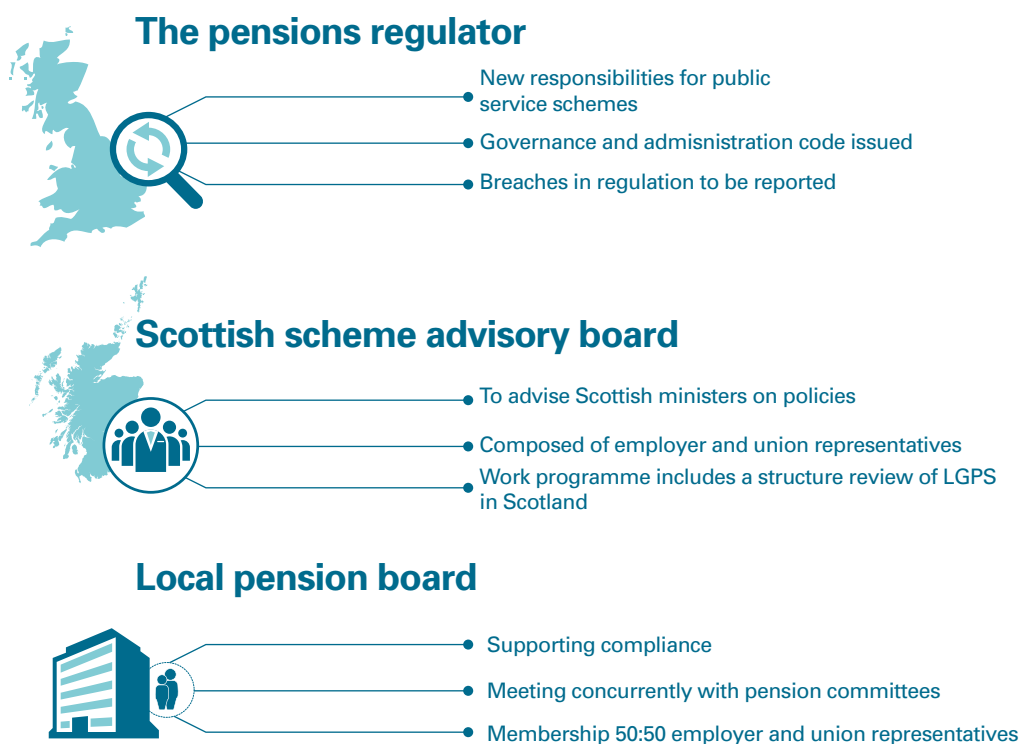
4. Pension funds are required by regulation to produce an annual report and accounts and these are audited separately from the accounts of the administering council. Auditors' deemed the 2015/16 annual accounts of all 11 pensions funds to be true and fair.

Governance arrangements

5. The Public Service Pensions Act 2013 introduced significant changes to the governance framework for public service pension schemes and for the LGPS in Scotland. [Exhibit 2](#) sets out the key changes to governance in 2015.

Exhibit 2

New LGPS governance arrangements in Scotland 2015



6. The Pensions Regulator has issued a code of practice for public sector schemes and pension funds in Scotland continue to monitor compliance with the new code assisted by local pension boards. Fund managers and advisors have a statutory responsibility to report significant breaches to the Pensions Regulator. We have not been made aware of any reports in respect of breaches in 2015/16.

7. The Scheme Advisory Board has a comprehensive programme of work and is planning to review of the LGPS structure in Scotland during 2016-17. Its review will include consideration of collective investment vehicles and the asset pooling model adopted in England and Wales.

8. At a local level all funds introduced pension boards. The role of pension boards is to support pension committees on compliance with regulations and codes. The role pension boards can play is developing, but it is clear they can also provide a useful scrutiny function. Auditors will be expected to monitor the operation of pension boards.

The new Career Average Revalued Earnings LGPS 2015

9. A new Scottish Local Government Pension Scheme was introduced on 1 April 2015. The key changes include:

- a move to benefits being worked out using career average (CARE) rather than final salary
- pension is built up at a rate of 1/49th of annual pensionable pay
- member's normal retirement age being linked to their own State Pension Age.
- A cost-control mechanism will be implemented to make sure the Scheme remains affordable and sustainable in the future.

10. Pension funds have coped well with the introduction of the new CARE LGPS with only minor teething issues reported by auditors. However, there are ongoing challenges in relation to the new scheme as record keeping is more complex than for final salary schemes and there is greater dependency on employers for complete and accurate information. Pension calculations for existing older members will be complex as many will have benefits accrued under the new 2015 scheme (based on CARE and 1/49ths) the previous 2009 scheme (based on final salary and 1/60ths) and the 1998 scheme (based on final salary and 1/80ths).

Cost control under the LGPS 2015

11. The new LGPS 2015 includes a cost control mechanism designed to ensure that the LGPS remains affordable for employers. Under this arrangement, the Government's Actuary Department (GAD) has established a Scottish LGPS cost cap of 15.5 per cent for employers (on a whole scheme basis). If the cost in relation to future service increases by more than two per cent above the employer cost cap, then employee contributions and/or benefits will be reviewed. We understand that employer cost cap costs will next be appraised by GAD following the 2017 triennial valuation and that the earliest cost sharing could start would be 2019.

Investment returns and expenses 2015/16

12. A number of LGPS funds saw negative investment returns on their assets in 2015/16, as shown in [Exhibit 3 \(page 4\)](#). This was influenced by increased uncertainty in global investment markets, low inflation and low growth. The outlook for investment management remains challenging with ongoing volatility and uncertainty in global markets following important events such as Brexit and the US presidential election.

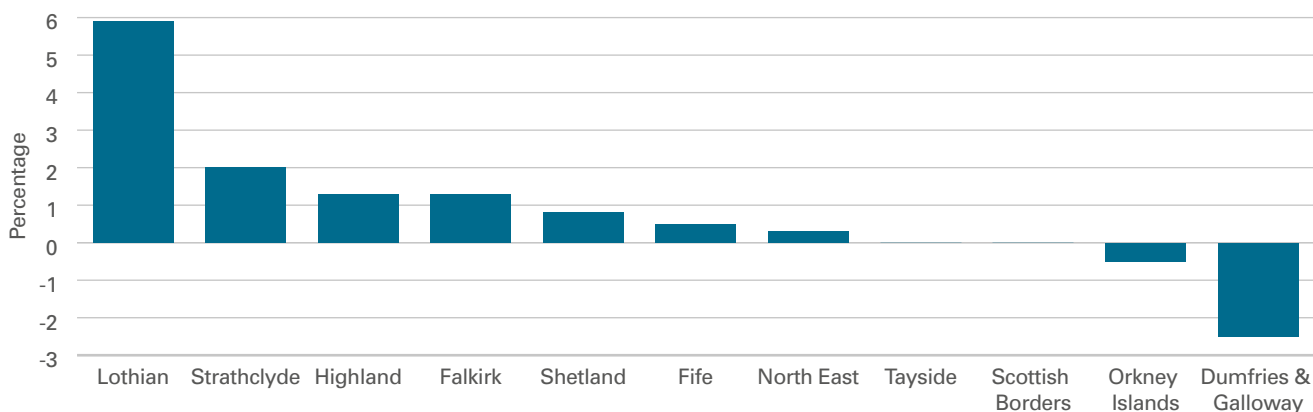
13. Although pension funds manage their investments in line with the same regulatory and governance regimes they have differing strategies and arrangements. Investment management is a complex area and funds make use of external advisers and managers. The full costs of investment management are not always fully transparent and there has been increased scrutiny and changes to guidance around accounting for these costs in recent years.

14. In 2015/16 we saw a divergence in approach by pension funds to the inclusion of investment management expenses in their annual accounts. Revised accounting guidance for 2016/17 emphasises that pension funds' financial statements should only include costs for which they are directly liable, or are within their control. The Accounts Commission is encouraged by the commitment of Scottish funds to full transparency around investment management costs charged and supports indirect expenses being reported in the wider annual report.

Exhibit 3

LGPS pension funds – Net return on investment 2015/16

In 2015/16, four funds saw negative returns on investments.



Source: Pension Fund accounts 2015/16

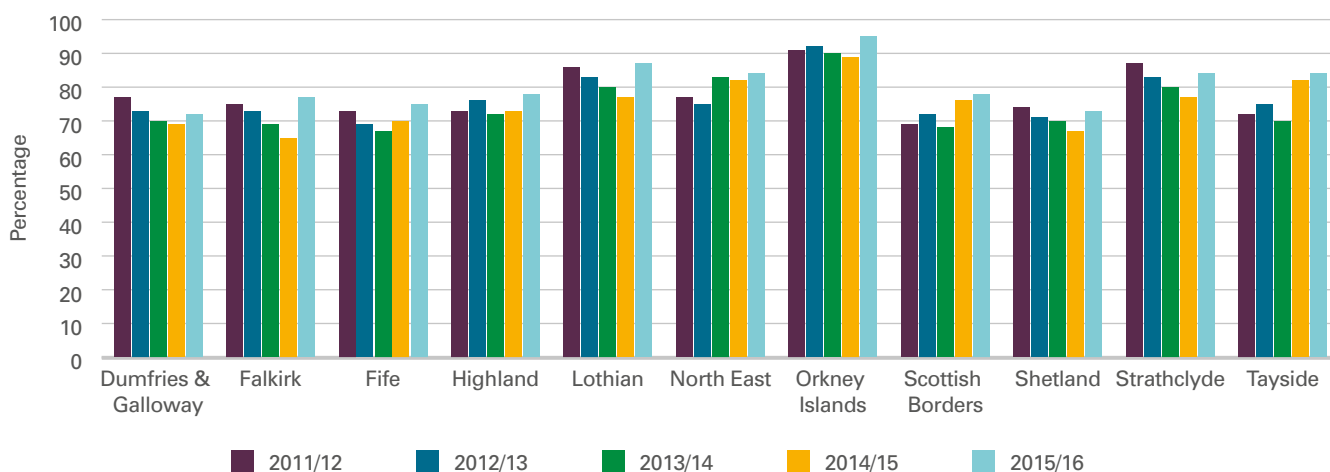
Present value of promised retirement benefits

15. Pension fund accounts include a disclosure of the present value of promised retirement benefits. This value of this liability is an estimate made by actuaries based on a number of assumptions about the future and the figure is quite sensitive to changes to those assumptions. The Liability can be compared with the assets of the pension fund at a point in time and [Exhibit 4](#) shows the valuation of pension fund assets as a proportion of liabilities for each of the last five years.

Exhibit 4

Pension fund assets as a proportion of the present value of promised retirement benefits

The position of all funds improved in 2015/16.



Note: The Scottish weighted average is close to that for Strathclyde which is by far the biggest pension fund in Scotland and one of the biggest in the UK.

Source: Pension Fund accounts 2011/12–2015/16

16. The percentages shown in [Exhibit 4](#) will typically be lower than those calculated by actuaries for the triennial funding valuations which are then used to set employer contributions. This is because the assumptions that can be used for accounting purposes are more tightly prescribed.

17. The overall Scottish LGPS net pension deficit at 31 March 2016 was £7.3 billion. Pension fund deficits are included in employers' accounts. Pension funds have arrangements to recover deficits over periods of up to 20 years in some cases, depending on the risk status associated with individual employers.

18. Pension deficits and employer contributions are complex areas and it can be difficult to establish differences between pension funds from their annual reports. Greater transparency and consistency of reporting in this an area would be beneficial to an understanding of the LGPS in Scotland.

Outlook

19. At a time when councils are under increasing financial pressure, administrative workloads will remain high as councils: continue to reduce their workforces and deal with auto enrolment; refine how they administer the new LGPS; embrace new online technologies to improve information flows with employers and members; deal with recent changes to pension scheme governance; and changes to the UK state pension arrangements.

20. The low inflation and low growth economic outlook together with uncertainty on the financial markets means that investment management will remain challenging at a time when investment performance is key.

21. The new cost control mechanism should help ensure that the LGPS remains affordable for employers in respect of active members although it does nothing to reduce the costs of pensions in payment and the associated deficits.

22. The Scottish Scheme Advisory Board is currently undertaking a structural review of the LGPS in Scotland. The outcome of this review is clearly of pivotal importance to the shape of the scheme and to administration costs going forward.



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Pensions Committee

2.00 p.m., Monday, 20 March 2017

Lothian Pension Fund Staffing

Item number	5.6
Report number	
Executive/routine	
Wards	All

Executive summary

In 2015, key investment staff were transferred to LPFE Limited, a new vehicle owned by the Lothian Pension Fund. Additional consideration was to be given to the transfer of other pension fund staff in due course.

While morale in the pension fund team is generally good, there is evidence of an element of dissatisfaction as a result of the different employment arrangements between the two groups of staff, particularly for those with aspirations to develop into role(s) within LPFE Limited. Inevitably, an increasing number of issues are expected to arise over time as the employment practices of LPFE Limited and the City of Edinburgh Council diverge.

Further, with increasing collaboration with other pension funds, the legal structuring of such arrangements and accounting procedures would be more straightforward if all pension fund staff were employed by the same legal entity.

Committee is asked to agree that the remaining pension fund staff are transferred to LPFE Limited subject to the appropriate consultation with staff and trades unions and any legal and risk analysis being concluded to the Executive Director of Resources' satisfaction.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Lothian Pension Fund Staffing

Recommendations

Committee is requested to:

- 1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider; and
- 1.2 Agree that the remaining pension fund staff should be transferred to LPFE Limited subject to the appropriate consultation with staff and trades unions and any legal and risk analysis being concluded to the Executive Director of Resources' satisfaction.

Background

- 2.1 Lothian Pension Fund has, for many years, in-sourced investment management for part of the Fund. Aside from lower cost, the advantages of internal investment management include the fact that investment staff are more clearly aligned to the Fund and they are not distracted by non-investment issues (such as marketing, advertising, client service and business development). Independent analysis of local government pension schemes shows that funds which have in-house management capability outperform in the long term.
- 2.2 Over recent years, the internal team has been expanded, which has facilitated further in-sourcing of investment functions, as well as the development of innovative and low cost investment strategies to meet the significant funding challenges faced by the Fund.
- 2.3 A review of investment governance arrangements of the Fund in December 2013, by an external consultant, highlighted a key risk associated with staff remuneration and retention, which had also been identified as a risk internally. The review identified that the Fund does not externally benchmark salaries and that the notice period provisions in staff contracts were very short compared with market practice for the equivalent roles. The consultant also noted that the Fund adheres to wider Council Human Resource (HR) policies and procedures but ideally special arrangements should be made for key staff to mitigate risk.
- 2.4 The Pensions Committee recognised that the stability of investment employees is key to the success of the Fund's investments and that significant staff losses would prompt the implementation of an expensive contingency plan.

- 2.5 In September 2014, the Committee agreed that staff directly involved in the internal investment management function should be transferred to a special purpose vehicle, subject to approval by Council for the establishment of the vehicle and the necessary consultation with staff and trades unions. The Committee also agreed that additional consideration should be given to the transfer of other pension fund staff in due course, cognisant of the issues which may arise as a result of operating a dual employer structure within the pension fund team.
- 2.6 In May 2015, 6 posts (at the time, 11 staff members) were transferred to LPFE Limited, a new vehicle wholly owned and controlled by the City of Edinburgh Council (acting in its capacity as administering authority of the Lothian Pension Funds). The board of LPFE Limited is made up of the Executive Director of Resources (chair), the Convener of the Pensions Committee, the City of Edinburgh Council's Head of Finance (not currently a director due to the ongoing HR/recruitment position), Head of Human Resources and the Chief Executive of LPFE Limited / Lothian Pension Fund.
- 2.7 As previously reported to Committee, LPFE Limited, in reviewing remuneration, has externally benchmarked salaries against comparable positions in the investment industry and put in place new terms and conditions including longer notice periods to mitigate the risks associated with an internal investment team.
- 2.8 It is felt that the employment of key investment staff via LPFE Limited has reduced the risks facing the pension fund group. Staff turnover in the investment team has been low over recent years, albeit the situation is still in its infancy.
- 2.9 The Fund has been developing its efforts to collaborate with other funds in order to deliver greater efficiencies and improved services. Currently some members of the Fund's team (both LPFE Limited and City of Edinburgh Council) are seconded to Falkirk Council to provide advice in relation to investments including infrastructure investment.

Main report

- 3.1 The Lothian Pension Fund staff currently comprises 56 individuals that are managed as one team. The 12 key investment staff are employed by LPFE Limited and the remaining staff are employed by the City of Edinburgh Council.
- 3.2 Pensions Committee were concerned about the potential impact on staff morale, both for those directly affected and others in the Fund not transferring to the special purpose vehicle. Results of the recent staff survey (provided in the report on service plan progress elsewhere on the agenda) show that staff satisfaction and morale generally continue to be positive.
- 3.3 However, there is evidence of some dissatisfaction within the investment and accounting teams employed by the City of Edinburgh Council, and particularly for those with ambitions to develop into role(s) within LPFE Limited.

- 3.4 Further difficulties will inevitably arise as changes of management practice within the Council occur and LPFE Limited elects not to follow suite. Hence management practice will diverge with a risk of increasing dissatisfaction over time.
- 3.5 The Fund is continuing to develop its efforts to collaborate with other funds in order to deliver greater efficiencies and improved services. This is reported on elsewhere on the agenda. The new collaborative efforts are expected to cover all aspects of the Fund's services impacting on all staff, both in LPFE Limited and the Council.
- 3.6 The transfer of the remaining pension fund staff to LPFE Limited would facilitate the collaborative efforts with other local government pension funds, in that it would mean the arrangements would be more streamlined as an organisation and so better placed to provide shared services across the board, rather than simply on the investment side. Having all staff on consistent terms, with the potential to increase notice periods, would place it on a better footing to lead on these collaborative initiatives, both from the Fund's perspective and likely that of any collaborative partners. Also, having all staff employed within LPFE Limited allows for a cleaner legal structuring, and likely more operational efficiencies, in providing shared services to other LGPS funds in the manner contemplated.
- 3.7 The streamlining of staff within LPFE Limited would also assist in the Fund's external communications and recruitment, in that it could manage this directly and without thought to the dual employer situation and potentially complex issues, or constraints, surrounding long term career development of staff in terms of any transition from the City of Edinburgh Council's employment to that of LPFE Limited – which is clearly not practical on an *ad hoc* basis.
- 3.8 The recent staff survey included questions regarding collaboration with other pension funds. 86% said they understood the reasons for collaboration and 66% felt that Lothian Pension Fund should look to collaborate with other funds. Of the staff comments in this section, 21 were positive and 4 negative.
- 3.9 Detailed external legal advice and analysis on the risks associated with the transfer of staff to LPFE Limited from the City of Edinburgh Council was sought at the time of the original transfer and a re-fresh of that advice in relation to the remaining pension fund staff at this time has been instructed. A verbal update will be provided to Committee.
- 3.10 Committee is asked to agree that the remaining pension fund staff should be transferred to LPFE Limited subject to the legal and risk analysis being concluded to the Executive Director of Resources' satisfaction and the appropriate consultation with staff and trades unions.

Measures of success

- 4.1 The success of the staffing arrangements is reflected in the general performance of the pension funds. Staff satisfaction is a key performance indicator for the Funds.

Financial impact

- 5.1 Due diligence costs relating to external legal advice and analysis on the risks associated with the transfer of staff to LPFE Limited from the City of Edinburgh Council are being incurred but are contained within the 2016/17 budget.
- 5.2 With a larger number of staff, additional human resource support will be required for LPFE Limited including extended remuneration benchmarking. This is included in the business case for collaboration to be considered by Committee elsewhere on the agenda.

Risk, policy, compliance and governance impact

- 6.1 Governance arrangements are in place for LPFE Limited. See 2.6 above.
- 6.2 Detailed external legal advice and analysis on the risks associated with the transfer of staff to LPFE Limited from the City of Edinburgh Council is being sought and a verbal update will be provided to Committee.
- 6.3 The decision whether to transfer the remaining pension fund staff to LPFE Limited could impact on staff morale, whether the transfer goes ahead or not. This risk will need to be managed accordingly. Communication will be particularly important.

Equalities impact

- 7.1 See 6.2 above.

Sustainability impact

- 8.1 The transfer of the remaining pension fund staff to LPFE Limited is expected to enhance the sustainability of the current pension fund team. Further it would facilitate collaboration with other funds to further enhance sustainability.

Consultation and engagement

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

9.2 Consultation and engagement with associated staff will be important as the options for change are developed.

Background reading/external references

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 None

Pensions Committee

2.00 p.m., Monday, 20 March 2017

Investment Controls and Compliance

Item number	5.7
Report number	
Executive/routine	
Wards	All

Executive summary

This report summarises the key matters in relation to investment controls and the development of the in-house investment operations. These are:

- **Investment controls:** the Fund has now finalised its process of reviewing and implementing the appropriate recommendations of the external consultant following a review of the in-house investment operations in December 2013. However, it is looking to re-appraise its position in light of the potential implementation of certain collaborative initiatives
- **Financial Conduct Authority (FCA) compliance:** LPFI Limited (LPFI) has now obtained its FCA authorisation and has continued to comply with its ongoing regulatory capital and filing requirements since. LPFI began to trade in December 2016 and that has placed an increased focus on ongoing FCA compliance.
- **Wider financial services regulation:** draft European-driven regulation within the UK may have a substantial impact on LGPS funds' ability to operate in particular investment markets. The Fund's current strategy to operate and develop an in-house investment team continues to make it well placed to work within these regulations. However, the Fund must also review and monitor the ongoing regulatory status of any other LGPS funds with which it collaborates.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Investment Controls and Compliance

Recommendations

Committee is requested to:

- 1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider; and
- 1.2 Note the update on ongoing compliance, monitoring and other initiatives in relation to potentially enhancing investment controls in relation to the current activity of the LPF group and also with future collaboration in mind.

Background

- 2.1 The Fund instructed a review of its in-house investment operations by a consultant in December 2013 in order to ensure that its systems and controls were fit for purpose and also to benchmark them against those needed for full FCA compliance (albeit not currently a requirement for the Fund).
- 2.2 The consultant's report concluded that the Fund's systems were fit for its current purpose, but that certain improvements could be made and would be required in anticipation of it operating an FCA authorised vehicle. The Fund has since been phasing in appropriate operational and compliance improvements generally and in advance of LPFI receiving FCA authorisation. The Committee last received an update on the Fund's progress in this regard in [March 2016] and, since then, LPFI has received its FCA authorisation and has begun to trade.
- 2.3 This report should also be read in conjunction with the report for Pensions Committee on Budget for 2017-18 as regards the costs associated with the ongoing initiatives, and the Risk Management Overview for a more detailed update on the associated risk analysis.

Main report

Investment controls

- 3.1 *Human capital:* The Fund has recruited further resource within the investment team to cover high level strategic initiatives across its portfolios as well as to provide cover for the equity and bond portfolio managers. However, the Fund has subsequently received notice from its Bond Portfolio Manager and so is now actively recruiting for this role. Separately, the Fund has for some time identified the need to enhance its legal and compliance function to keep pace with the increased compliance and legal work. The Fund expects to complete the

recruitment process for a junior lawyer in March 2017. The Fund has also secured a legal trainee on a full time basis.

- 3.2 *Back-office resource:* The Fund continues to monitor the resource and systems within the finance and back-office function to ensure that these are appropriate for current levels of increased regulatory, accounting and other activity arising from the ongoing development of the in-house function.
- 3.3 *Internal service level agreements:* The Fund continues to be in the process of updating its existing internal service level agreements with the City of Edinburgh Council's (CEC) in order to ensure that it has certainty around the costs and service levels/deliverability of the key services on which it relies (such as IT, payroll, information compliance etc.). The Fund also continues to compare these internal services with the comparable external service providers, to assess if the internally resourced solution remains the best one – particularly as the Fund continues to develop more complex systems, controls and external relationships, resulting in a need for increasingly robust and reliable service provision and resources.
- 3.4 *Other Ongoing Initiatives:* Other control and compliance resource and initiatives will be considered as the Fund's work and collaborative initiatives develop. Specifically, the need for an automated Front Office System is under review.

LPI and FCA compliance

- 3.5 *Regulatory capital and filings:* Since receiving FCA authorisation the Fund has submitted all its quarterly filings correctly and timeously. However, due to the unprecedented post-Brexit fall in the value of Sterling and the fact that the Fund is required to maintain the sterling equivalent of €50,000 regulatory capital within LPI, the Board of LPI was required to approve the issue of a small amount of further share capital to its parent, CEC, in order to ensure that any further adverse fluctuations in the Sterling-to-Euro exchange rate would not cause it to be in breach of its regulatory capital requirements. LPI has therefore issued a further 9,999 ordinary shares of £1 each to CEC, taking its total issued share capital to £50,000.
- 3.6 *Non-executive director:* The board of LPI has now approved the appointment of Leslie Robb as a non-executive director effective from 7 February 2017, subject to Leslie receiving the requisite approvals from the FCA. Leslie is a former Partner of Baillie Gifford and Co, has held senior roles in the asset management industry, including Chief Investment Officer and Managing Director, and has significant experience as an investment advisor to both LGPS funds and the wider UK institutional investment sector. He currently acts as an independent investment advisor to certain LGPS funds in England and Wales.
- 3.7 *LPI club-deals:* LPI began trading in December of 2016 and completed its first collaborative club-deal in the infrastructure sector in January 2017. With further club-deals expected to follow in the first quarter of 2017, the Chief Risk Officer is carrying out a review of the process undertaken on the first club deal (in terms of pre-vetting LPI's clients, dealing with those clients and treating them fairly,

processes for information sharing and execution of deals etc.) to ensure that we are adopting best practice across the full process from deal sourcing to completion. The board of LPFI has no reason to expect that this is not the case, given work done in anticipation of this core aspect of LPFI's business plan, but believes it is prudent to continually assess our processes particularly at this early stage in trading.

- 3.8 *Regulatory compliance support:* The LPFI board has instructed Moore Stephens on an annual retainer to provide ongoing support services in relation to quarterly FCA filings, quarterly on-site audits of LPFI's processes and compliance with the FCA procedures/ guidance, and training.

Wider financial services regulation

- 3.9 The Fund continues to monitor the progress of the implementation of the Markets in Financial Instruments Directive (2014/65/EU) (**MiFID II**) and, in particular, its intention that local government pension scheme administering authorities will default to being classified as 'Retail Clients' rather than 'Professional Clients', resulting in their being regulated within the more onerous and restrictive retail regulatory regime. This classification would be based on such local authorities not having sufficient investment knowledge and expertise to properly assess and make their own investments in particular sectors. It would effectively exclude such funds from the more sophisticated private markets (e.g. private equity/infrastructure/timberland/debt funds, co-investments, single asset opportunities etc.) and therefore meaningfully reduce their investment universe and ability to diversify their investment strategies and potentially increase fees. Whilst the detail is yet to be determined and finalised, the Fund is currently of the view that it would be able to 'opt-up' and continue to benefit from classification as a 'Professional Client', given the nature of its current authorised structure and the current, and historic, activity and expertise of its in-house investment team.
- 3.10 The Fund is therefore taking the view that its current strategy of retaining an in-house investment function, and further developing this capability through its new structure, will make it well placed to deal with this (and any other) regulatory change. This will allow the Fund to mitigate the potentially significant costs and constraints that such regulation could potentially impose.
- 3.11 However, given the Fund's efforts to collaborative with other LGPS funds, it must also now monitor the position with regards to the ongoing regulatory status of those funds.
- 3.12 The Chief Risk Officer is a member of a UK wide group liaising with the FCA on behalf of UK local government pension schemes and so the Fund expects that it will remain fully apprised of the FCA's position and the timing for implementation through participation in this group.

Measures of success

- 4.1 That the Fund continues to develop efficiencies for the benefit of its members, and employer bodies, while mitigating any risk associated with the necessary arrangements.
- 4.2 That the Fund seeks to improve its service provision and adapts its operations to the wider structural and regulatory changes facing public sector funds and to changes arising from its own internal developments.
- 4.3 That the Fund's investment controls, resource and systems keep pace with the implementation of its business strategy.

Financial impact

- 5.1 There is no direct financial impact associated with the update of progress in relation to the matters set out in this report.
- 5.2 The improvements in day-to-day investment controls have been met from within existing budgets.
- 5.3 There continue to be very significant cost implications in not ensuring that the Fund's internal investment operation is best placed to adapt to the market and regulatory changes currently affecting the sector.

Risk, policy, compliance and governance impact

- 6.1 The Fund needs to continue to ensure that its governance processes and procedures (including FCA regulatory compliance, corporate governance, delegations etc.) adapt to any organisational changes within the Council and are sufficient to allow it to continue to carry out its business effectively and to exercise its functions with sufficient fiduciary independence.
- 6.2 There are significant risk and compliance considerations for the Fund to consider around any implementation of MIFID II within the United Kingdom in the manner currently proposed.

Equalities impact

- 7.1 None.

Sustainability impact

- 8.1 The review of investment operations and the implementation of actions resulting from that review are intended to secure the long-term sustainability of the internal investment operations for the benefit of the pension funds.

Consultation and engagement

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

Background reading/external references

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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 None

Pensions Committee

2.00 p.m., Monday, 20 March 2017

Additional Voluntary Contributions (AVC) – administration service

Item number	5.8
Report number	
Executive/routine	
Wards	All

Executive summary

Significant concerns have arisen regarding the administrative performance of both AVC providers to the Fund, Standard Life and Prudential. These have been raised with the companies and both have stated their commitment to progress solutions. Delivery of requisite service enhancements will be reviewed by the Fund and a further update provided to Committee in September 2017.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Additional Voluntary Contributions (AVC) – administration service

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 administrative concerns in respect of the AVC service provision and that these have been raised by the Fund directly with the Standard Life and Prudential;
- 1.3 Note that Standard Life has committed “to work with” the Fund “to resolve the issues” and that, similarly, Prudential has stated its attention to expedite solutions;
- 1.4 Note that, at present, in light of the recent assurances received, the Fund does not intend to raise the issue of contribution monitoring with the Pensions Regulator; and
- 1.5 Note that such delivery of AVC contribution monitoring and UFPLS service provision will be reviewed by the Fund and a further update provided to Committee in September 2017.

Background

- 2.1 The administering authority of the Local Government Pension Scheme (LGPS) has a duty to ensure that the companies providing AVC services continue to offer financial security as well as competitive investment and administrative performance.
- 2.2 In accordance with previous determination of the Pensions Committee and in light of the importance of investment performance and fund security, an annual report on the performance of Lothian Pension Fund’s and Lothian Buses Pension Fund’s two Additional Voluntary Contributions providers, Standard Life and Prudential, is submitted to the Investment Strategy Panel (ISP), in its advisory role to the Executive Director of Resources.
- 2.3 On 2 December 2016, ISP considered the latest AVC annual reports, that is to 31 March 2016. “Executive Summary” is shown below:

- “Prudential and Standard Life are both regarded as financially secure organisations with investment grade ratings and low implied risk of default.
- Prudential continues to be more proactive than Standard Life in the promotion of AVCs to members of the Fund.
- Performance of the Funds continues to be variable as is typical across such a range of funds. Both providers are well-resourced organisations competing in and committed to the investment management business.
- Administration service from Standard Life and responsiveness to queries is a frustration and a concern.
- There are two key issues/concerns that are being escalated with the providers and within the industry:
 - the Fund is unable to monitor the payment of contributions by the employers to the AVC providers and this may need to be reported to the Pensions Regulator;
 - new freedom for members to take AVC benefits from age 55 before their main scheme benefits could be a significant administration burden on the Fund if the providers fail to provide a satisfactory solution. The Fund is liaising with the providers on this matter.
- Lack of satisfactory resolution of these issues could mean that the Fund has to amend its AVC offerings to members.
- Further member communication is required regarding the need for members to ensure that their AVC fund choice remains appropriate.”

Main report

AVC Administration

- 3.1 There are a number of concerns regarding AVC administration which are outlined below:

Monitoring the receipt of contributions from employers

- 3.2 All public sector schemes were brought within the remit of The Pensions Regulator from April 2015. In July 2016, the Pensions Regulator published its “Code of practice no:13 Governance and administration of occupational trust-based schemes providing money purchase benefits”. The Fund is aware of a number of instances of late payment by employers and has been attempting (unsuccessfully) to gain the necessary information from the providers to be able to monitor payments on an ongoing basis. Whilst Prudential appear to be making efforts in this regard, Standard Life has stated that it does not intend to provide this information. The Fund is attempting to escalate the issue with Standard Life and to raise awareness of the broader issue in the industry. The Fund also intends to disclose this breach to the regulator in the very near future.

“Freedom and Choice”- Uncrystallised funds pension lump sum (UFPLS) - Communication and Payment

- 3.3 With effect from 6 April 2015, the Taxation of Pension Act 2014 granted the opportunity to access such funds to any member aged 55 or over. Any such withdrawal would be termed an “uncrystallised funds pension lump sum (UFPLS)” payment, with 25% being paid free of income tax. This greater flexibility for members to access defined contribution pension savings introduced under ‘Freedom and Choice’ conflicts with current LGPS in Scotland regulations with regards to AVCs. As a result, the Scottish Government wrote to Funds in July 2016 providing guidance to exercise the permissive scheme rules override to allow UFPLS payments to be made until such time as the legislative changes could be made. UFPLS flexibilities render the administrative process very complicated, given the potential for drawdown of AVC funds by a member over a prolonged period and also taxation implications, including the money purchase annual allowance (MPAA) and Lifetime Allowance (LTA).
- 3.4 Standard Life has agreed to offer a payment facility to facilitate such full withdrawal, although the company has determined that this does not constitute UFPLS within its definition. However, at present, Prudential has declined to do so, although it has stated its intention to provide such in the long-term (unspecified timeframe). Neither provider is currently willing to address the administration requirements of a scenario where a member may seek phased UFPLS withdrawal(s), although Prudential has stated this to be its future aim. At the time of writing, LPF has only two cases where active members, post age 55, have requested UFPLS. Both of these relate to Standard Life funds and the requests are for the full AVC value and not partial withdrawal. Accordingly, these funds have been released.
- 3.5 In summary, the Fund, along with other LGPS administering authorities, is not actively publicising this UFPLS entitlement to members, pending confirmation of the administrative position on a Scotland-wide basis.

General administration service standards

- 3.6 Delays in providing member AVC fund values to the Fund are causing delays in retirement processing. Liaison is ongoing with both providers to provide requisite assurance and address current deficiencies. In that context, it is acknowledged that performance by Prudential over the recent period has indeed improved and reverted to target levels.

AVC Member Communications

- 3.7 In November 2015, LPF wrote to all members holding an AVC to remind them that they need to regularly review their fund choice(s). LPF has asked both Prudential and Standard Life to ensure that their AVC statements include explicit information for members to review their investments to ensure the Fund choice is right for them. Following clarification of the position on monitoring of receipt of

contributions and UFPLS, the Fund intends to write to all members again regarding their AVCs.

Responses from the providers - update

- 3.8 Further dialogue was undertaken with both Standard Life and Prudential in February 2017.
- 3.9 Standard Life has stated that it is “committed to work with you (LPF) to resolve the issues that you have raised around servicing, the Pensions Regulator Contribution Monitoring, websites and communications, and UFPLS / pension freedoms.”
- 3.10 Prudential has commented “Please be assured we are fully committed to finding a solution that will provide you with the data you require to fully meet your contribution monitoring requirements on a month by month basis, down to member level”. Timescale for provision of such, however, remains uncertain. As regards UFPLS, Prudential has stated that it has now received requisite clarity from the Scottish LGPS administering authorities on the expected service demands, sufficient for the company to develop an UFPLS proposition.

Measures of success

- 4.1 Service performance expectations of the Funds in respect of its AVC providers are:
- a. Compliance with the Pensions Regulator’s “Code of practice no:13 Governance and administration of occupational trust-based schemes providing money purchase benefits”;
 - b. Administrative provision of the Uncrystallised funds pension lump sum (UFPLS)” in accordance with the statutory entitlement of members;
 - c. General administration service standards to align with industry best practice.

Financial impact

- 5.1 Additional work by the Funds’ administrative and accounting staff resources is required in order to address poor service performance by the providers.

Risk, policy, compliance and governance impact

- 6.1 The availability of AVC services is a discretionary, rather than mandatory, supply by LGPS Funds. It is important that the Funds exercise due diligence in ensuring, as far as is possible, that AVC providers meet service performance expectations in order to mitigate potential reputational damage. Communications with members should be clear that AVC choice is not the Funds’ responsibility, given the potential for adverse investment outcomes.

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

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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., Monday, 20 March 2017

Employers Participating in Lothian Pension Fund

Item number	5.9
Report number	
Executive/routine	
Wards	All

Executive summary

This report provides updates on:

- Employers leaving the Fund; and
- Other current matters affecting employers participating in the Fund.

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Employers Participating in Lothian Pension Fund

Recommendations

Committee is requested to:

- 1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider; and
- 1.2 Note 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 leaving the Fund

- 3.1 Following the retirement of the last active member in August 2016, a cessation valuation has been carried out in respect of Edinburgh Rape Crisis Centre. The Fund is currently in discussion with the employer regarding repayment of cessation debt in accordance with the principles established and agreed by Committee in November 2015 following the 2014 Actuarial Valuation process. Further information is included in item B1.3.
- 3.2 As previously reported to Committee, cessation valuations have been carried out for the National Mining Museum, the Broomhouse Centre and Pilton Community Health Project. Further information is included in item B1.3.
- 3.3 As reported to Committee in September 2016, the Fund has continued discussions with Age Scotland, a former Fund employer in respect of the cessation valuation. Further information is included in item B1.3.

Other changes

- 3.4 Citadel Youth Centre has advised that it is changing status to become a Scottish Charitable Incorporated Organisation from 1 April 2017. A new admission agreement has been prepared to reflect this change in legal status, including commitment that the new entity has responsibility for previous pension liabilities.
- 3.5 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, payment of £173,335 in respect of staff transferred from West Lothian Council has been made to the Department and Work and Pensions. The Fund is awaiting further information in respect of the other two transfers.
- 3.6 The City of Edinburgh Council has recently announced a change to current arrangements for city development which will impact on its arms-length companies currently delivering these services. These include EDI Group which is an admitted body to the Fund. Fund officers are in discussion with EDI Group and the City of Edinburgh Council on the treatment of pension liabilities for EDI Group and a verbal update will be provided to Committee.
- 3.7 Two admitted bodies have approached the Fund to advise that they wish to merge. Further information is included in item B1.3.

Transferee Admission Body status

- 3.8 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. A revised admission agreement to reflect this arrangement has been prepared and will be finalised shortly.
- 3.9 ELCAP was admitted to the Fund in 1991 following the transfer of several hostels from East Lothian District Council (as was) into ownership of ELCAP. Staff employed in these hostels also transferred to ELCAP and ELCAP has now requested that it be treated as a Transferee Admission Body. Fund officers have attended meetings with representatives of both East Lothian Council (as ceding authority) and ELCAP in order to provide information on the implications of such a change. The Fund is awaiting an update on the outcome of further discussions between the two organisations.
- 3.10 Youthlink Scotland was admitted to the Fund in 2002 following the dissolution of Community Learning Scotland (at that time an admitted body to the Fund) by the then Scottish Executive. Half of the Community Learning Scotland staff transferred to the Scottish Executive, becoming members of the Civil Service Pension Scheme, with the remaining staff transferred to Youthlink Scotland who had no previous interest in the Fund. No other employees of Youthlink Scotland

have joined the Local Government Pension Scheme. Youthlink Scotland now only has one active member remaining and has made representation to the Fund that it should be treated as a Transferee Admission Body on the grounds that:

- Community Learning Scotland was a non-departmental public body for which the Scottish Ministers were ultimately responsible,
- it was the Scottish Executive which forced through the closure of Community Learning Scotland and subsequent transfer of staff to Youthlink Scotland; and
- Youthlink Scotland agreed to join the Fund in good faith to maintain terms and conditions for the relevant staff.

Fund officers passed the request to the Scottish Government and at their request met with policy officers from the Scottish Public Pensions Agency. However, the employer has now been advised by the Scottish Government that it will not act as guarantor for Youthlink Scotland nor agree to the change in funding and cessation basis.

Employer Covenant

- 3.11 As previously reported to Committee, work has begun on a review of all employers participating in the Fund. A survey was sent to all employers within the Fund in November 2016 to request financial and other data. This will be used as part of the 2017 Actuarial Valuation to help set employer contribution rates and in the review of the Funding Strategy Statement. At time of writing, responses have been received from 63 of 96 employers and work is ongoing to obtain outstanding information.

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	None

Pensions Committee

2.00 p.m., Monday, 20 March 2017

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.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

2016-2018 Service Plan and Budget

Recommendations

Committee is requested to:

- 1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider; and
- 1.2 Note the progress being made against the Service Plan 2016-2018.

Background

- 2.1 The Lothian Pension Fund's two-year Service Plan for 2016-2018 was approved by the Pensions Committee in March 2016. An update on progress is shown below.

Main report

- 3.1 Progress is being made against the service plan. The following areas are covered elsewhere on the agenda for Committee:
 - Collaboration with other pension funds;
 - Ensuring effective Governance;
 - Investment Controls and Compliance;
 - Consider potential for further transfer of pension fund staff.

Other progress of particular note is shown below.

Pension Administration Standards Association (PASA) accreditation

- 3.2 The Fund has applied for Pension Administration Standards Association (PASA) accreditation which promotes a standard for administration services for UK pension schemes. The accreditation covers service commitments, performance measurement and reporting, operational procedures and controls, data security and staffing, with the focus being on providing the optimal service to customers. The assessment involves an online application with documentary evidence and site visit by an Independent Assessor in March. An oral update on the progress will be provided to Committee.

Scottish Homes Pension Fund (SHPF)

- 3.3 Progress is being made in reviewing the SHPF funding agreement with Scottish Government. Analysis of potential investment portfolios to deliver cashflows which are projected to meet the liability requirements is being undertaken with the Actuary and the Investment Strategy Panel. Further engagement with the Scottish Government (and in consultation with the Convener of the Pensions Committee) is planned for the coming months in order to conclude the funding agreement for the 2017 actuarial valuation. Progress will be reported to Pensions Committee in due course.

Monthly Contribution Return (MCR) position

- 3.4 At present, 93 of the 96 Fund employers are submitting monthly contribution returns with 91.7% in target for the first 9 months of 2016/17. December 2016 saw further improvements with 93.7% being provided on time. Two employers, Enjoy East Lothian and Police Scotland, have temporarily had new submissions suspended as we found incorrect data previously submitted. Enjoy East Lothian has now provided revised data and Police Scotland expects to provide its revised data by no later than the end of the financial year. The Fund is carrying out an exercise with larger employers to tackle a backlog of outstanding information regarding early leavers. The City of Edinburgh Council in particular has done considerable work to reduce the backlog over the last 3 months.

Three employers have not yet started submitting monthly contribution returns. They have been informed that the Fund will levy an annual charge to recover administrative costs arising from this failure to meet the PAS requirements. These employers are:

- a. Scottish Police Authority, in respect of the former Scottish Police Services Authority;
- b. Scottish Fire and Rescue Service;
- c. South East of Scotland Transport Partnership (SEStran).

Committee will also recall that the Fund introduced similar cost recovery charges to be applied if an employer failed to provide their year-end information within timescale with a revised Pension Administration Strategy (PAS) in March 2016. Committee decided to extend the timescale from 19th April to 30th April in the first year. In 2016, 69 employers provided their return by 19th April with a further 25 making a submission before 30th April. Two employers provided returns later than this date and charges were levied. For 2017, it is the intention to set the deadline as 19th April.

City of Edinburgh Council – pension record identifier

- 3.5 The Fund is also addressing data issues caused by the inherent but undesired variability in the City of Edinburgh Council's payroll "position identifier" also being the identifier for pension records. This has caused significant issues as the Council is currently undergoing a review of their services and staff are being given a new identifier as part of this process.

Guaranteed Minimum Pension (GMP) reconciliation

3.6 Details of the GMP reconciliation to HMRC records were provided to the Pensions Audit Sub-Committee on 27 September 2016. Work is ongoing to achieve full reconciliation of by the target date of December 2018, with the current position being that 55% of relevant records align. Nationally, given the volume of data queries, concerns have been expressed at HMRC's ability to respond within a reasonable timescale. In November 2016, Hymans Robertson LLP reported a backlog of eight months to process GMP data by HMRC. Lothian Pension Fund will monitor reconciliation progress closely over the coming months and ascertain any resource implications in order to achieve the target.

HM Treasury "Consultation on indexation and equalisation of GMP in public service pension schemes"

3.7 In November 2016, HM Treasury issued a "Consultation on indexation and equalisation of GMP in public service pension schemes". This aimed to answer two issues within a single policy solution:

- "How best to avoid the introduction of unequal payments to men and women in the public service schemes that will result from the abolition of the additional state pension (AP)."
- "Whether, following the introduction of the new state pension, the public service pension schemes should pay full indexation on GMP earned while a member of a public service pension scheme, for someone who reaches state pension age after 5 December 2018."

The Scheme Advisory Board (SAB) for the LGPS in Scotland has submitted a response to the consultation. To minimise administrative workload and reduce complexity, the preferred option is that of "GMP conversion". Under this option, for those members attaining state pension age after 5 December 2018, "the GMP element of the pension would be converted into scheme benefit on a 1:1 basis. GMP records would no longer be required following conversion, with indexation being applied to the full pension. This approach prevents inequalities being introduced between men and women by the abolition of the additional state pension and ensures no individual is worse off.

This will require public services to meet the cost of indexing the GMP. The additional cost implications (0.5% of liabilities), on LGPS employers already facing a difficult and constrained financial environment should be recognised. We (SAB) would expect the government to provide additional funding or some level of compensation, given cuts to local authority budgets. " Importantly, SAB has also requested "clarification as to whether full GMP reconciliation would still be required".

Freedom of Information (FOI) requests

- 3.8 The Fund receives regular FOI requests and in 2016 responded to 22 that covered topics such as private market investments, shareholdings, climate change, travel and proxy voting. We also received one request for personal information held on our record under the Data Protection Act. These requests are resource intensive and where possible we refer queries to the website for publicly available information.

Cohabiting partners' pensions

- 3.9 A recent decision by the Supreme Court saw a survivor's pension granted to a Northern Ireland LGPS member's surviving partner where the member did not meet the Regulations and nominate the partner for a pension. The rules of the Local Government Pension Scheme (LGPS) in Scotland did not recognise widowers until April 1988 or unmarried partners, until April 2009. In the event of death before this date, a pension was payable only to a legal widow.

However, in Scotland, unmarried persons were able to obtain a "Declarator of Marriage" from a Sheriff Court. Where a member left prior to April 2009, the Fund considered evidence to establish that the deceased and surviving partner had a valid marriage as under Scots Law it is possible to constitute a valid marriage by 'habit and repute'.

Subsequent amendments to the LGPS in April 2009 now recognise surviving spouses, civil partners or co-habiting partners. Although a form nominating a co-habiting partner was required for members who were subject to the 2008 Scheme regulations, where no form has been submitted, Lothian Pension Fund's practice is to consider evidence under Scots Law. Since April 2015, no co-cohabiting partner form is required. However, the criteria stipulated in the Regulations must be met.

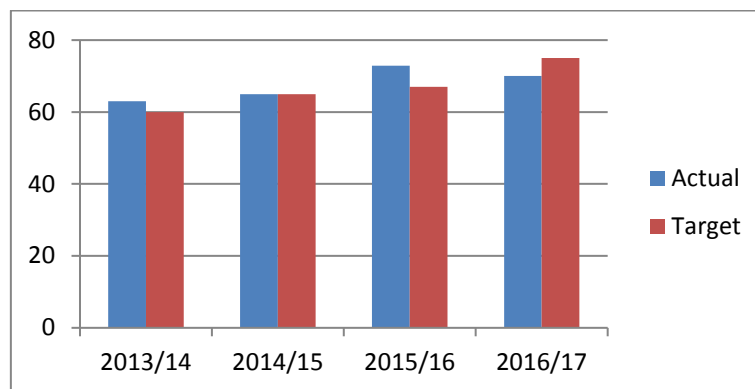
Performance Indicators

- 3.10 Performance Indicators for the first three quarters of the financial year are provided in the attached appendix.

Two indicators are highlighted as 'amber':

The staff training indicator shows that 81% of staff had completed their pro-rata training target up to 31 December 2016. The Fund is comfortable that the target should be achieved by the end of the year.

The 2016 staff survey has been undertaken and 52 members of staff completed the survey (representing 96% of the Lothian Pension Fund team), although not all questions were answered by everyone who responded. Overall satisfaction decreased marginally to 70% which is lower than the target of 75%. The graph below shows these figures for previous years.



The following table provides the responses to a selection of other questions.

Staff Survey - % who agree or strongly agree	2014 %	2015 %	2016 %
My manager listens to and is open to suggestions	70	77	78
My manager motivates me to achieve my full potential	59	69	76
My line manager delegates responsibility effectively	54	75	76
The reasons for change are well communicated	57	73	68
Have a say on changes that affect me before they are made	46	51	56
Feel that change affecting our service area is well managed	49	65	62
Have confidence in the decision made by the senior management team	62	77	72

This year's survey also included questions regarding views on collaboration with other pension funds. 86% said they understood the reasons for collaboration and 66% felt that Lothian Pension Fund should look to collaborate with other funds. Of the comments in this section, 21 were positive and 4 negative. An action plan is being developed with a focus on improving the way change is managed, staff development and celebrating success.

Pension Administration Strategy (PAS) performance 2016/17 to date

3.11 Overall employer performance for the first three quarters of 2016/17 is shown below, with 2015/16 shown for comparison purposes.

Employer performance		April to Dec 2016			2015/16		
Case type	Target (working days)	Number received	Number within target	% within target	Number received	Number within target	% within target
New Starts	20	3666	3098	85%	4653	4074	88%
Leavers	20	2518	1112	44%	2377	1207	51%
Retirements	20	965	340	35%	1156	398	34%
Death in Service	10	20	14	70%	40	11	28%

Overall, this shows a continuation of poor employer performance for the first three quarters of this year particularly for retirements and leavers.

The receipt of new start information through the secure data transmission portal is generally good, although the small drop in performance is disappointing. This can be attributed to poor performance by a single employer. Missing records were identified via the monthly contribution return process and details requested. Performance for all other employers, excluding this specific employer, was 88% over the same period.

The deterioration in the performance for leavers in the first three quarters of 2016/17 is primarily due to the significant voluntary staff release programme of the City of Edinburgh Council (CEC). In 2016/17, excluding CEC there have been:

- 1624 leavers, 58% of which were received within target;
- 443 retirements, of which 57% were received within target.

Customer Service Excellence

- 3.12 This Fund's annual Customer Service Excellence (CSE) assessment was held in January and covered key customer service provisions such as complaints, listening to customers and taking action on feedback provided. The assessor provided excellent feedback and confirmed that the award had been retained for another year along with a sixth Compliance Plus for excellence.

Customer Satisfaction

- 3.13 The Fund recently conducted the annual employer survey and received helpful feedback on our performance. Key Results were as follows:
- 96% of respondents were satisfied with the overall service provided by the fund (up from 85% in 2015);
 - the monthly employer bulletin continues to be well received with 97% satisfaction;
 - 89% agreed the website was easy to use;
 - satisfaction of pensionsWEB went up from 79% to 87%.

The positive results from the employer survey, together with improving customer satisfaction from email services, overall satisfaction is 90% ahead of target 88%.

Membership and cashflow monitoring

- 3.14 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 helps to mitigate current cashflow pressures.
- 3.15 The summary below details the cash flows as at the end of December 2016 and projections for the financial year. This has been prepared on a cashflow basis

(compared to the accruals basis of the year end financial statements and budget projections).

Lothian Pension Fund	2016/17 YTD	2016/17 Projected
<u>Income</u>	£'000	£'000
Contributions from Employers	105,830	146,250
Contributions from Employees	30,705	41,200
Transfers from Other Schemes	4,170	5,200
	140,705	192,650
<u>Expenditure</u>		
Pension Payments	(105,705)	(141,800)
Lump Sum Retirement Payments	(47,535)	(59,500)
Refunds to Members Leaving Service	(665)	(850)
Transfers to Other Schemes	(7,080)	(10,300)
Administrative expense	(1,395)	(1,865)
	(162,380)	(214,315)
Net Additions/(Deductions) From Dealings with Members	(21,675)	(21,665)

Lothian Buses Pension Fund	2016/17 YTD	2016/17 Projected
<u>Income</u>	£'000	£'000
Contributions from Employers	5,625	7,475
Contributions from Employees	1,555	2,080
Transfers from Other Schemes	10	10
	7,190	9,565
<u>Expenditure</u>		
Pension Payments	(6,300)	(8,420)
Lump Sum Retirement Payments	(2,790)	(3,835)
Refunds to Members Leaving Service	(10)	(10)
Transfers to Other Schemes	(120)	(180)
Administrative expense	(84)	(112)
	(9,304)	(12,557)
Net Additions/(Deductions) From Dealings with Members	(2,114)	(2,992)

Scottish Homes Pension Fund	2016/17 YTD	2016/17 Projected
<u>Income</u>	£'000	£'000
Contributions from Employers	675	675
<u>Expenditure</u>		
Pension Payments	(5,115)	(6,810)
Lump Sum Retirement Payments	(448)	(600)
Transfers to Other Schemes	(120)	(170)
Administrative expense	(41)	(55)
	(5,724)	(7,635)
Net Additions/(Deductions) From Dealings with Members	(5,049)	(6,960)

- 3.16 Owing to the City of Edinburgh Council's ongoing transformation project, there has been a significant number of leavers. As a result, 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. The Fund has targeted increased investment income in recent years which is expected to exceed net cashflow for the foreseeable future. It is therefore not anticipated that the sale of assets will be required to meet this funding requirement.
- 3.17 In Lothian Buses and Scottish Homes Pension Funds, expenditure is anticipated to continue to exceed income. A combination of investment income and asset sales are used to fund this shortfall.

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 2016/17 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	2,500	(406)	2,180	1,802	(378)
Transport & Premises	236	251	15	177	169	(8)
Supplies & Services	1,195	1,137	(58)	896	796	(100)
Investment Managers Fees	7,120	5,100	(2,020)	5,340	3,745	(1,595)
Other Third Party Payments	1,375	875	(500)	1,031	500	(531)
Central Support Costs	300	300	-	225	225	-
Depreciation	87	88	1	65	65	-
Direct Expenditure (Invoiced)	13,219	10,251	(2,968)	9,914	7,302	(2,612)
Income	(977)	(825)	152	(733)	(620)	113
Net Expenditure (Invoiced)	12,242	9,426	(2,816)	9,181	6,682	(2,499)
Indicative Expenditure (Uninvoiced)	18,800	19,300	500	9,400	9,775	375
Total Cost to the Funds	31,042	28,726	(2,316)	18,581	16,457	(2,124)

5.2 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 generally assumed to be in-line with the budget. With delays experienced in separating research costs from brokers fees (see below) a £500k overspend in uninvoiced fees has been forecast.

5.3 The key variances for each category in the budget are:

- Investment Managers Fees - **£2,020k underspend**. The budget for external fund management costs was set prior to the in-sourcing of a global equity portfolio in March 2016.
- Employees - **£406k underspend**. This is mainly due to unfilled posts across the division during the period from April to December 2016. Recruitment processes are progressing with many of the posts expected to be filled by the financial year end.
- Other Third Party Payments - **£500k underspend**. Underspend due to delays in the separating research costs from brokers' fees. As mentioned above these costs have been offset in the Uninvoiced expenditure.
- Transport & Premises - **£15k overspend**. A historical business rates charge relating to 2013/14 was recently invoiced resulting in the overspend.
- Income - **£189k below budget**. This relates to stock lending commission. The budget was modelled on the original projections by the global custodian. The custodian has highlighted that potentially securities lending will become less profitable with tighter regulation.

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

[LPF Service Plan 2016-2018](#)

HM Treasury consultation: <https://www.gov.uk/government/consultations/indexation-and-equalisation-of-gmp-in-public-service-pension-schemes/consultation-on-indexation-and-equalisation-of-gmp-in-public-service-pension-schemes>

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 – Performance Indicators

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	Retained			Retain CSE Award	
Overall satisfaction of employers, active members and pensions measured by surveys	Rolling 12-month performance is 90.3%			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%	90.3%	93.5%	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%	99.2%	99.6%	99%	
Data quality – compliance with best practice as defined by the Pensions Regulator	Assessment will be made at year-end			Fully compliant	Not yet known
Monthly Pension Payroll paid on time	Yes	Yes	Yes	Yes	
Working Together					
Level of sickness absence	0.72%	1.27%	0.55%	4%	
Annual staff survey question to determine satisfaction with present job	70%			75%	
Percentage of staff that have completed two days training per year.	62.5%	75.3%	81.2%	100%	

Pensions Committee

2.00 p.m., Monday, 20 March 2017

Budget for 2017/18

Item number	5.11
Report number	
Executive/routine	
Wards	All

Executive summary

The budget for 2017/18 sets out the Pension Fund's expected expenditure for 2017/18 and also an indicative budget for 2018/19 is provided. Please note that the budget reflects the totality of the three funds, Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

Links

Coalition pledges	
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Budget for 2017/18

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 budget 2017/2018; and
- 1.3 Note the indicative budget 2018/2019.

Background

- 2.1 For many years, Lothian Pension Fund has prepared its budget separately to the City of Edinburgh Council. The Fund's 2016/17 budget was prepared in conjunction with its Service Plan. The Council's policy on Service Plans has changed from these being prepared annually to biennially. Accordingly, this is the first occasion where the Pension Fund's budget has been reported for approval separately from its Service Plan.
- 2.2 The budget 2017/18 has been prepared after reviewing the 2016/17 budget and adjusting for changes in the Funds expenditure and income.

Main report

- 3.1 The proposed budget 2017/18 and indicative budget 2018/19 are included in Appendix 1. The main points to note are summarised below at "Financial Impact".
- 3.2 The budget does not include costs considered in the staffing and collaboration business cases, which are reported separately on this agenda.

Measures of success

- 4.1 The Fund's key measure of success is to control and monitor costs to ensure expenditure remains within the confines of the budget approved by Committee.

Financial impact

- 5.1 The budget proposed for net invoiced expenditures for 2017-2018 totals £10.7m, with an indicative net invoiced outlay for 2018-2019 of £11.5m. A breakdown is provided in Appendix 1.
- 5.2 The proposed budget for invoiced costs represents a £1.5m saving to the comparable 2016/17 budget. The key changes comprise the following:

	Increase/ (Decrease) £'000
<u>Investment Management fees</u> – Reduction in external fund management fees owing to increased internal management of funds (LPFE staff).	(1,900)
<u>Securities Lending</u> – Reduction in income due to increasing regulatory constraints in European markets impacting the scale of lending activity.	250
<u>Employee Costs</u> – Increase in costs reflecting salary increments.	103
<u>Actuarial Fees</u> – Increase in costs due to triennial Actuarial Valuation as at 31 March 2017	40

Please note that Central Support Costs for services provided to the Fund by the City of Edinburgh Council are provisional estimates. The Fund is seeking to establish Service Level Agreements with the Council for specified services.

- 5.3 The indicative 2018/19 budget estimates a £621k increase in costs from that anticipated for 2017/19. Primarily, these relate to investment manager fees, reflecting increased market values, but also include the impact of salary increments and minor strengthening of pension administration staff resources.
- 5.4 **Uninvoiced Expenditure** – Provision has also been made for indicative costs of uninvoiced investment fees which are deducted from capital asset valuations.

Uninvoiced costs are forecasted to be in the region of £17.1million for both 2017/18 and 2018/19. The key changes from 2016/17 are summarised as follows:

	Increase/ (Decrease) £'000
<u>Investment Management Fees deducted from Capital</u> – An increase in such fees is expected owing to increased strategic exposure to infrastructure and private debt markets, offset by reducing private equity investments.	2,000
<u>Transactions costs</u> – Reduction in costs owing to re-aligning portfolios to internal management with inherent lower frequency trading	(100)

Please note that in this budget 2017/18 and 2018/19, intentionally, the Fund has not included investment performance fees. Performance fees are driven by fluctuations in market values and the timing of assets being sold which are very difficult to anticipate. This coupled by inconsistencies in the level accounting treatment by investment managers (some reporting performance on an accruals basis, others on a cash basis) make it extremely difficult to accurately forecast costs.

2015/16's accounts highlight the issues faced. The total value of uninvoiced costs was £26m, £12.1m of this in relation to performance fees. A majority of these performance fees were in relation to the Funds private equity investments which are now in the realisation stage of their life cycle. The value of performance element was also inflated by a change in accounting treatment by a manager to change performance being recognised on a cash basis to an accruals basis.

- 5.5 The budget continues to include £10 million contingency to be utilised in the specific event of significant departures from the internal investment team compelling the outsourcing of the investment management function.
- 5.6 There is no capital expenditure budgeted for 2017-2019. Please note that depending upon competitive tenders to be received, there may be capital expenditure in 2018/19 in relation to a new pension administration system. At this time, prior to the start of the tender, it is not considered appropriate to make specific anticipatory provision. Implications of the contract award will be reported to Committee in due course.

Risk, policy, compliance and governance impact

- 6.1 The budget contains contingencies to manage the key risks faced by the Pension Fund.

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

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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 – Lothian Pension Fund Budget 2017-2019

Appendix 1 Lothian Pension Fund Budget

The budget for 2017-18 and indicative figures for 2018-2019 are as follows:

	Projected 2016/17 £000	Budget 2016/17 £000	Movement £000	Budget 2017/18 £000	Movement £000	Indicative Budget 2018/19 £000
Employees	2,500	2,906	103	3,009	206	3,215
Property Costs	212	195	6	201	1	202
Plant and Transport	39	41	0	41	0	41
Supplies and Services	1,137	1,195	37	1,232	-12	1,220
Third Party Payments	875	1,375	17	1,392	-34	1,358
Investment Managers Fees	5,100	7,120	-1,920	5,200	450	5,650
Support Costs	300	300	-14	286	0	286
Capital Funding	88	87	-5	82	15	97
Gross Expenditure (Invoiced)	10,251	13,219	-1,776	11,443	626	12,069
Receipts	-166	-177	0	-177	-5	-182
Income - Other	-660	-800	250	-550	0	-550
Total Income	-826	-977	250	-727	-5	-732
Net Expenditure (Invoiced)	9,425	12,242	-1,526	10,716	621	11,337
Property Operational Costs	1,000	1,000	0	1,000	0	1,000
Investment fees deducted from Capital*	13,000	13,000	2,000	15,000	0	15,000
Transaction Costs	1,700	1,200	-100	1,100	0	1,100
Indicative Net Expenditure (Uninvoiced)	15,700	15,200	1,900	17,100	0	17,100
*Note 2016/17 figures have been adjusted to remove performance element						
Total Indicative Expenditure	25,125	27,442	374	27,816	621	28,437
Pension Administration	1,980	2,061	160	2,221	39	2,260
Investment Management	23,145	25,381	214	25,595	582	26,177
Investment Managers Fee Contingency	0	10,000	0	10,000	0	10,000

Lothian Pension Fund Budget continued

The budget for 2017-18 and indicative figures for 2018-2019 are as follows:

Capital Expenditure

	Projected	Budget	Movement	Budget	Movement	Indicative
	2016/17	2016/17	2016/17	2017/18	2017/18	Budget
	£000	£000	£000	£000	£000	2018/19
						£000
Loan Facility - LPFI	16	75	-75	0	0	0
LPFI Share Capital	50	36	-36	0	0	0
Total Capital Expenditure	66	111	-111	0	0	0

Pensions Committee

2.00 p.m., Monday, 20 March 2017

Risk Management Summary

Item number	5.12
Report number	
Executive/routine	
Wards	All

Executive summary

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

Links

Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

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; and
- 1.2 Note the Quarterly Risk Overview.

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 is issued to the conveners of the Pensions Committee and the Pensions Audit-Sub Committee and the Independent Professional Observer on a quarterly basis.
- 3.2 The Quarterly Risk Overview, as at 7 February 2017, 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

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Appendices Appendix 1 – Quarterly Risk Summary, as at 7 February 2017










QUARTERLY RISK OVERVIEW


7 February 2017

UPDATE ON MOST NOTABLE RISKS

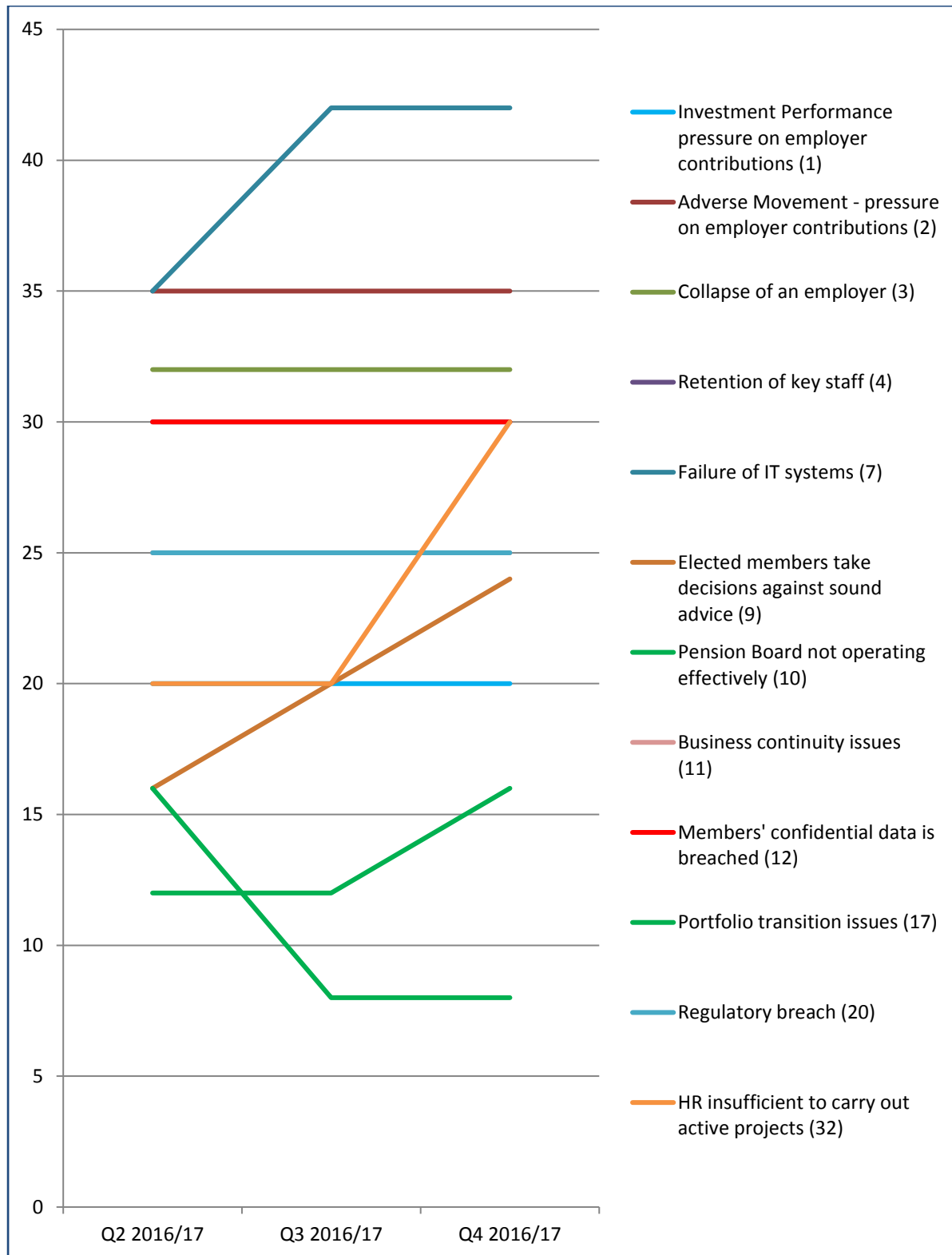
Risk & Reference Number	Update	Trend / RAG
Adverse Investment performance leading to pressure on employer contribution (1)	Implementation of the Lothian Buses Pension Fund strategy is being planned with the Investment Strategy Panel, together with the review of the merger of the Fund with Lothian Buses Pension Fund.	Static 
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions (2)	<p>Pressure on bond yields following Brexit has resulted in the adverse movement against non-investment funding assumptions and warrants keeping the risk at its current level.</p> <p>Preparations are underway for the 2017 actuarial valuation and the contribution stability position was agreed at the September 2016 Committee.</p>	Static 
Collapse/restructuring of an employer body leading to pressure on other employers (3)	<p>The revised funding approach for employers close to exiting the Fund reduces the overall risk to the Fund and the other employers.</p> <p>The Fund continues to engage with a group of smaller employers regarding the potentially adverse financial impact of the revised funding strategy and to implement the outcomes from the appeals process and the Pensions Committee decision in this regard. Where appropriate, the Fund will be pursuing guarantees and securities from the employers in order to further mitigate this risk.</p> <p>This risk will continue to be closely monitored over the coming months in the context of the overall Fund. In particular, the Fund will monitor and assess (i) the impact of the arrangements agreed with those employers participating in the appeals process, (ii) any guidance from the Scheme Advisory Board or Scottish Government.</p> <p>The employer's admission agreements continue to be updated on an ongoing basis.</p>	Static 

Risk & Reference Number	Update	Trend / RAG
Recruitment and retention of key staff (4)	<p>The Fund’s management team continue to monitor the immediate impact of the revised HR policies and procedures for investment staff who were transferred to LPFE Limited. The risk therefore remains on “warning” until such time as the new HR structure is bedded in. The potential for a ‘phase 2’ transfer of the remaining LPF staff into LPFE is being considered. A recommendation will be presented to the Pension Committee in March 2017.</p> <p>The post for a further solicitor has been re-advertised. The Fund is also assessing resourcing in light of future collaborative initiatives and the increasingly complex nature of the Fund’s business and in the shorter term the impact on senior management resource during the negotiation and implementation of any such collaboration.</p> <p>New portfolio manager joined the Fund in January but the Fund’s Bond Portfolio Manager recently resigned and currently working notice. A replacement sought as a matter of urgency.</p>	<p>Static</p> 
Failure of IT leading to poor ICT responsiveness, legal exposure and cost/risk implications (7)	<p>The Fund continues to closely monitor the outcome and process for CEC to embed the new global IT services provider, CGI, to ensure existing systems and IT will continue to be supported. The Fund is ensuring that all issues are reported to CGI and to the senior contract manager within CEC. Delays are still being experienced by the fund in the new system provider updating non CEC platforms and systems.</p> <p>The Fund is currently awaiting the necessary IT approval before the issues with the ‘Tell Us Once’ initiative is resolved. In the interim the workload of frontline staff is greater than it should be.</p> <p>The Fund is also progressing matters raised in the recent Internal Audit (reported in December 2016) as a priority. One of the three actions has been completed. At the time of writing, the other two actions are being progressed and a verbal update will be provided to Committee.</p> <p>The CEC accounts system is still scheduled to be transferred to a new system, which may cause transitional difficulties for the Fund’s finance team but with no major impact on the Fund’s systems. This project has currently been delayed; the date of transfer to the new system is to be confirmed.</p>	<p>Static</p> 
Elected member take decisions against sound advice (9)	<p>Arrangements are being put in place to ensure that induction training for any newly appointed members to the Pensions Committee is in place after the Council elections in May 2017 and before their first meeting.</p> <p>The Fund continues to receive an increasing number of queries or approaches regarding both its infrastructure and local investments and on other socio, economic and environmental matters, most recently including a petition to the wider Council.</p>	<p>Increase</p> 

Risk & Reference Number	Update	Trend / RAG
<p>Pension Board not operating effectively with a negative impact on the operation of the Fund (e.g. due to lack of attendance/participation or not maintaining sufficient levels of knowledge, skill and/or expertise.) (10)</p>	<p>Over the last year the Pension Board has received four resignations and three appointments. There is currently a member vacancy on the Pension Board due to the UCATT member representative's resignation. Due to UCATT's recent merge with Unite, the Fund and Pension Board are currently in consultation to agree if should be offered a second place on the Board. A replacement representative is currently being sought. The risk has been raised until a new representative is in place.</p>	<p>Increase</p> 
<p>Business continuity issues (11)</p>	<p>Review of business continuity plans are now drafted and currently being reviewed. The Fund is also ensuring that home-working and relevant health and safety procedures are adhered to across the board and, where necessary, continue to be enhanced in line with current practice.</p> <p>Internal Audit plans over the next year presented to the Pension Committee in March 2017 include a review of the business continuity plan.</p>	<p>Static</p> 
<p>Members' confidential data is lost or made public. Breach of Data Protection Act (12)</p>	<p>Business process reviews are now complete and an action plan is being developed to strengthen the pensions administration printing and posting processes and in reaction to consistent, albeit minor, breaches in the process. Until changes are implemented this risk remains at an increased level to reflect the fact that minor errors in this area can lead to meaningful reputational and other exposure. The Fund is also aware of the more onerous Data Protection legislation coming into force and the growing trend of class actions in this sector. Internal Audit plans over the next year presented to the Pension Committee in March 2017 include a review of Data Protection and Fraud.</p>	<p>Static</p> 
<p>Regulatory breach (20)</p>	<p>The Pensions and Lifetimes Savings Association (PLSA) has fed back that it continues to lobby the Financial Conduct Authority (FCA) regarding the implementation of MiFID II within the UK resulting in LGPS funds stepping down to Retail Investor status. The Fund has been tracking this for some time and believes it would be in a strong position to "opt-up" to Professional Investor status in light of it recently receiving and operating an FCA authorised structure (having been diligenced in the current FCA regime) and long history and track-record of its in-house investment team. Nevertheless, close scrutiny of this continues to be needed to ensure (i) awareness and input to the "opt-in" criteria, (ii) there are no regulatory constraints or issues associated with the new regulation, and (iii) there is no market practice or distinction around the treatment of opted-up Professional Investors (there should not be, as this is binary in nature) as has been loosely suggested by some in the market. It will also be important to keep track of this with regard to the Fund's collaborative initiatives and the impact of this on other LGPS funds. The Fund is also monitoring this as regards other LGPS funds in Scotland, with whom it may be looking to collaborate.</p> <p>The Fund is also closely monitoring the ongoing collaboration initiatives, to ensure regulatory compliance and appropriate systems and governance are in place prior to any subsequent material change in business scope.</p>	<p>Static</p> 

Risk & Reference Number	Update	Trend / RAG
<p>Human Resource within the Division not sufficient to carry out core tasks in conjunction with active or anticipated projects (32)</p>	<p>In light of the significant collaborative and other national initiatives that the Fund is currently involved in, we are closely monitoring the risk that senior management time is stretched to the point where this adversely impacts on the 'business as usual' processes within the Fund.</p> <p>Significant delays and use of fund's resources, including having to seek external legal advice, to deal with queries regarding procurement legislation and procedure for providers.</p>	<p>Increase</p> 

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

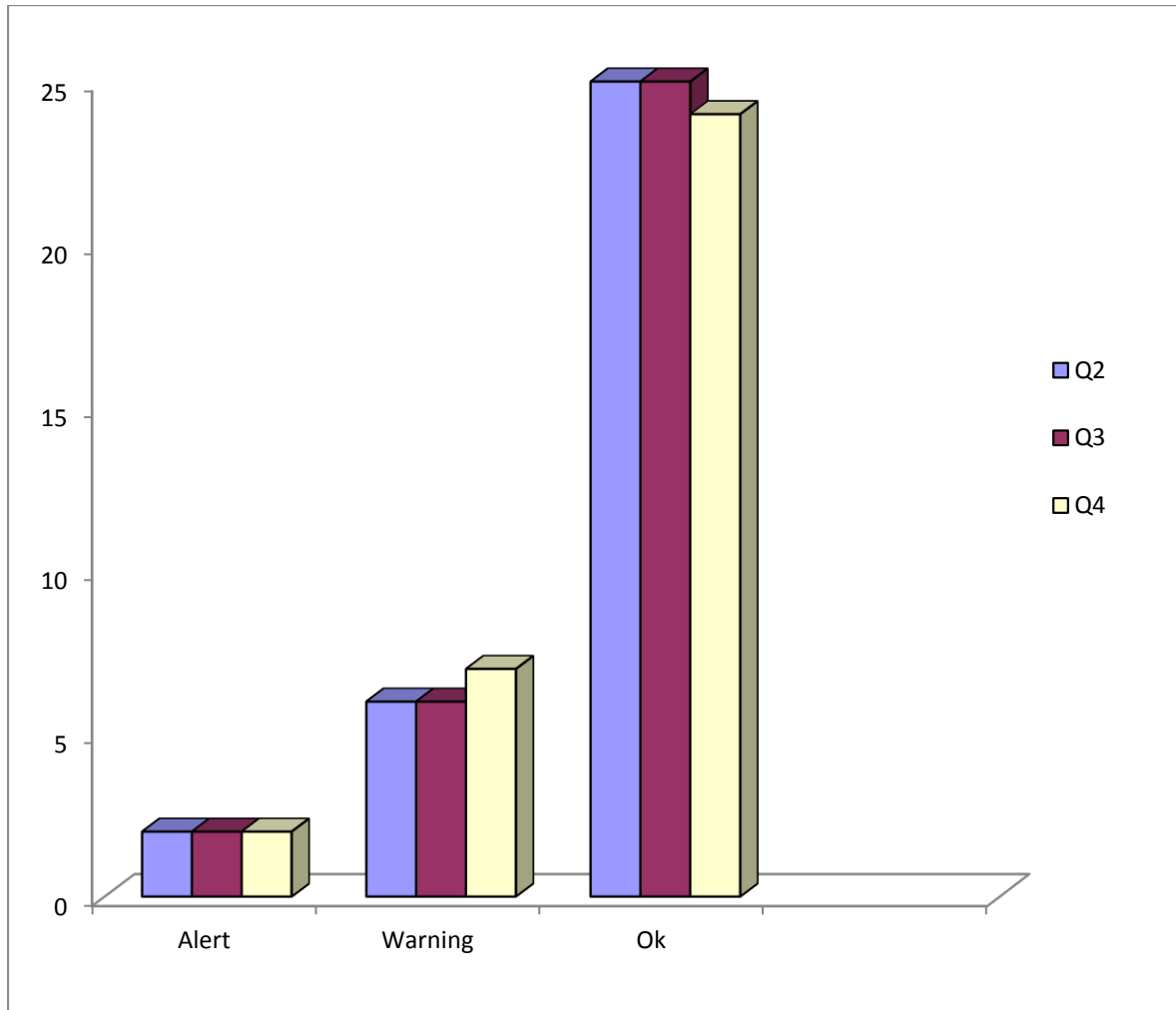


PLEASE NOTE, OVER THE LAST THREE QUARTERS RISK '11 – BUSINESS CONTINUITY' AND RISK '20 – REGULATORY BREACH' HAVE SHARED THE SAME RISK SCORE.

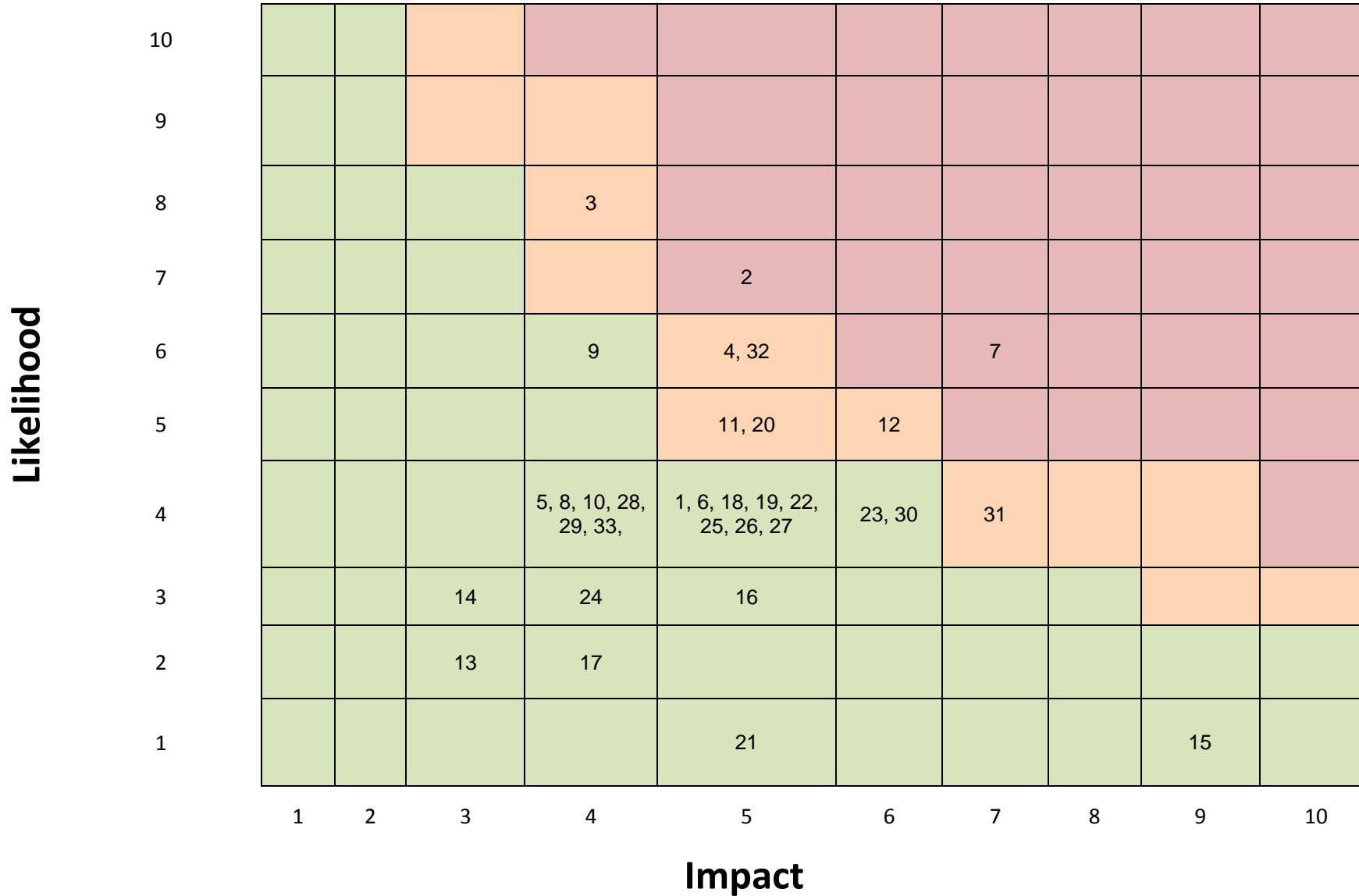
OTHER KEY POINTS

	Comments
New significant risks	None.
Other new risks	None.
New controls	<p>Quarterly compliance training and on-site audits are now provided by Moore Stephens in relation to the ongoing business of LPFI Limited. The first set of onsite sessions is being co-ordinated with the next LPFI Limited board meeting in March (6)</p> <p>A pensions administration 'procedure version control' spreadsheet has been put in place to control and authorise all amendments to the Altair system) (7)</p> <p>Leslie Robb has joined the LPFI Board as Non-Executive Director (6)</p>
Eliminated risks	None.
Notable initiatives / actions	<p>The Fund's connected persons register to be reviewed and updated to ensure all connected persons that may present a conflict of interest or risk are included. (16)</p> <p>The Fund is taking steps to ensure the remaining three employers that have not joined PensionsWeb do so (29)</p>
Material Litigation	None.

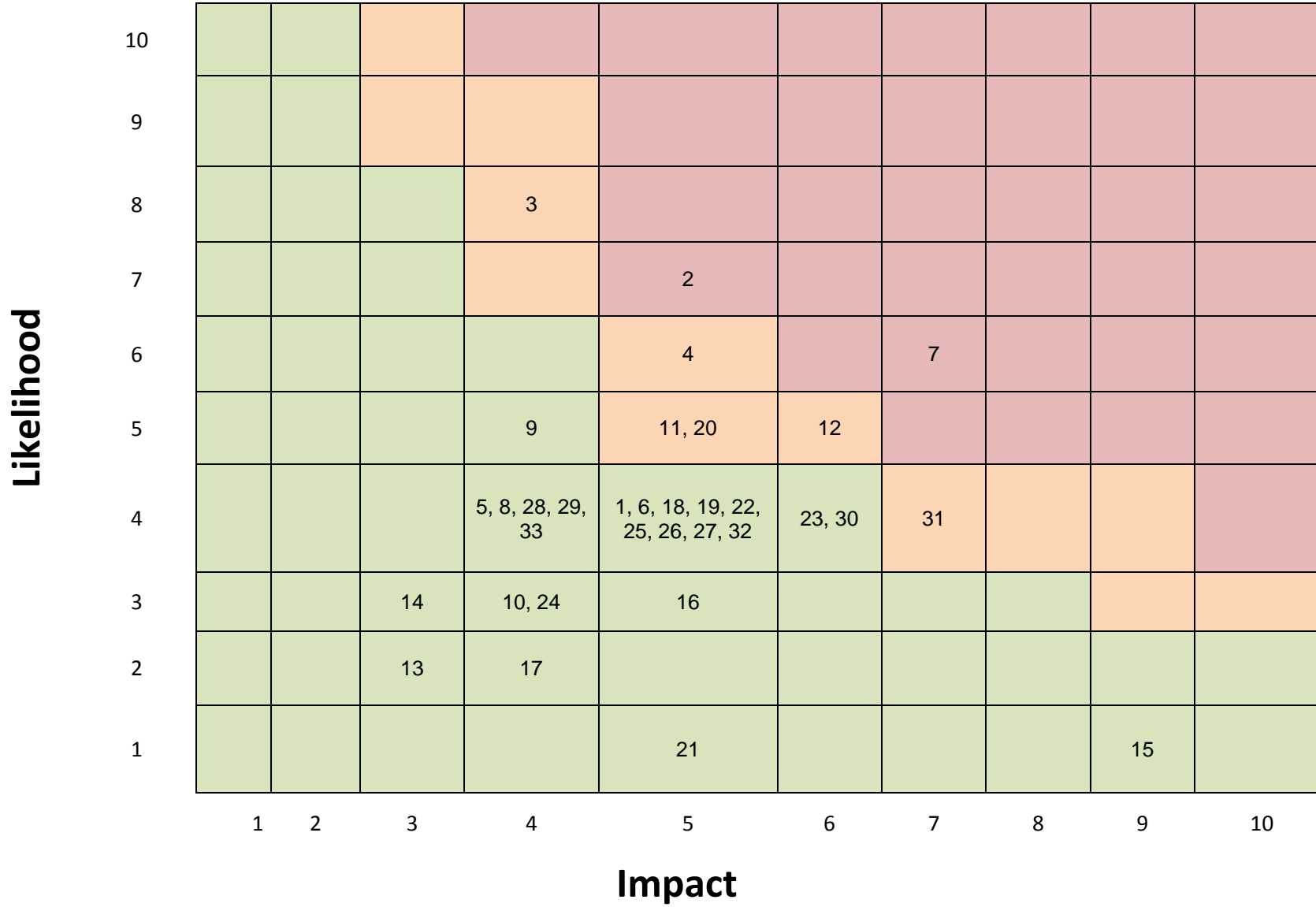
All Risks: Status Overview



Q4 2016/17 All Risks: Impact and Likelihood Overview



Q3 2016/17 All Risks: Impact and Likelihood Overview



Key: Risks by Number

- 1 Adverse Investment Performance - pressure on employer contributions
- 2 Adverse Movement of non-investment funding assumptions- pressure on employer contributions
- 3 Collapse of an employer
- 4 Recruitment and retention of key staff
- 5 Fraud or theft of Council/Pension Fund assets
- 6 Staff negligence
- 7 Failure of IT systems
- 8 Employers HR decisions without consideration of fund
- 9 Committee members take decisions against sound advice

- 10 Pension Board not operating effectively
- 11 Business continuity issues
- 12 Members' confidential data is breached
- 13 Loss due to stock lending default
- 14 Risk of incorrect pension payments
- 15 Late payment of pension
- 16 Market abuse by investment team or others
- 17 Portfolio transition issues

- 18 Disclosure of confidential information
- 19 Material breach of contract
- 20 Regulatory breach
- 21 FOI process not in accordance with law
- 22 Incorrect communication with members
- 23 Not acting in accordance with proper authority/delegations
- 24 Inappropriate use of pension fund monies
- 25 Procurement/framework breach
- 26 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