Notice of meeting and agenda

Pensions Committee

2:00pm, Monday 26 March 2018

Dunedin Room, City Chambers, High Street, Edinburgh

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

Contact:

Lesley Birrell, Committee Services
Tel: 0131 529 4240
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1. Order of business

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

2. Declaration of interests

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

3. Deputations

3.1 If any

4. Minute

4.1 Minute of the Pensions Committee of 12 December 2017 (circulated) - submitted for approval as a correct record

5. Reports

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

5.2 Lothian Pension Fund – Draft Internal Audit Plan for 2018/19 - report by the Chief Internal Auditor (circulated)

5.3 External Audit - Annual Audit Plan 2017-18 - report by the Executive Director of Resources (circulated)

5.4 Governance Update - report by the Executive Director of Resources (circulated)

5.5 2017 Actuarial Valuation for Lothian Pension Fund - report by the Executive Director of Resources (circulated)

5.6 2017 Actuarial Valuation for Lothian Buses Pension Fund – report by the Executive Director of Resources (circulated)

5.7 Merger of Lothian Buses Pension Fund and Lothian Pension Fund – report by the Executive Director of Resources (circulated)

5.8 2017 Actuarial Valuation for Scottish Homes Pension Fund – report by the Executive Director of Resources (circulated)

5.9 Funding Strategy Statement – report by the Executive Director of Resources (circulated)

5.10 Pension Fund Cost Benchmarking – report by the Executive Director of Resources (circulated)

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

5.12 2016-2018 Service Plan Update – report by the Executive Director of Resources (circulated)

5.13 2018-2020 Service Plan and Budget – report by the Executive Director of Resources (circulated)

5.14 Procurement Governance and Contract in respect of Integrated Pensions Administration and Payroll Software System (Ref: CT0400) – report by the Executive Director of Resources (circulated)

6. Motions

6.1 If any

Laurence Rockey

Head of Strategy and Insight

Committee Members

Councillors Rankin (Convener), Child, McVey, Miller and 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 Lesley Birrell, Committee Services, City of Edinburgh Council, Business Centre 2:1, Waverley Court, 4 East Market Street, Edinburgh EH8 8BG, Tel 0131 529 4240 email lesley.birrell@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/meetings .

For remaining items of business, likely to be considered in private, see separate agenda.

Minutes Item 4.1

Pensions Committee

2.00pm, Tuesday 12 December 2017

Present:

Councillors Rankin (Convener), Child, McVey, Miller and Rose; John Anzani and Richard Lamont.

Pension Board Members Present:

Eric Adair, Thomas Carr-Pollock, Sharon Dali, Diane Hogarth, Darren May and Brian Robertson.

1. Minutes

Decision

To approve the minutes of the Pensions Committee of 27 September 2017 as a correct record.

2. Referrals/recommendations from Pensions Audit Sub-Committee

Councillor Rose advised the Committee of the discussion and decisions taken at the Pensions Audit Sub-Committee on 11 December 2017.

Decision

To note the update and that Councillor Rose would raise any specific issues as each agenda item was considered.

(Minute of Pensions Audit Sub-Committee Committee 11 December 2017)

3. Agenda Planning

Details were provided of potential reports for future meetings of the Pensions Committee and Pensions Audit Sub-Committee, including meetings in March and June 2018.

Decision.

To note the agenda planning document.

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

4. Stewardship and Engagement

Details concerning 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, including the approach to environmental, social and governance (ESG) issues, were provided.

Decision

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

2) To nominate Councillor Rankin to the Local Authority Pension Fund Forum (LAPFF).

3) To continue to lobby for governance improvements at LAPFF.

(References – Pensions Committee 6 December 2016 (item 6); report by the Executive Director of Resources, submitted.)

5. 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 approve that consultation would be undertaken with employers on the “Voluntary Scheme Pays” taxation charge in respect of the “Annual Allowance”, including the stipulation that the Fund would only consent to apply such discretion with the prior agreement of the respective employer to accept all cost risks arising, e.g. member longevity.

3) To note that officers, in consultation with the Convener, would respond to the Scottish Government’s consultation on the scheme regulations.

(References – Pensions Committee 27 September 2017 (item 15); report by the Executive Director of Resources, submitted.)

6. Appointment of Providers

An update on the appointment of providers for services to the pension funds covering the period since the last report in March 2016 to date was provided.

Decision

1) To note the appointments of the providers for the pension funds as detailed in the report by the Executive Director of Resources.

2) To thank Sarah Smart, Independent Professional Observer, for her support to the Pensions Committee and the Pension Board.

(References – Pensions Committee 15 March 2016 (item 8); report by the Executive Director of Resources, submitted.)

7. Webcast Pensions Committee - Motion by Councillor Miller

Decision

To note that Councillor Miller had withdrawn the motion.

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

8. Resolution to consider in private

The Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the following items of business on the grounds that they involved the disclosure of exempt information as defined in Paragraphs 6 and 9 of Schedule 7(A) of the Act.

9. Risk Management Summary

An overview was provided of the Lothian Pension Fund's risk analysis and the material risks facing the Fund.

Councillor Rose reported that the Pensions Audit Sub-Committee had discussed a report providing an in depth review of risk management.

Decision

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

(References – Pensions Audit Committee 11 December 2017 (item 11); report by the Executive Director of Resources, submitted.)

10. Collaboration Update

An update on collaborative integration with other Pension Funds was provided.

Decision

1) To note the progress made by the Fund in relation to wider collaboration initiatives with Falkirk and Fife.

2) To note the progress to extend LPFI's Financial Conduct Authority (FCA) permissions to provide investment management to collaborative partners.

3) To note the progress made by LPFI regarding its business strategy to collaboratively invest with other Local Government Pension Scheme (LGPS) pension funds in the private markets (including infrastructure).

4) To agree that consultation takes places with members of the Committee regarding their involvement in the procurement of certain providers, such as the Actuary and investment advisers.

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

Pensions Committee

2.00pm, Monday, 26 March 2018

Agenda Planning

Item number	5.1
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

This document provides Committee with an overview of the proposed 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.

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Report

Agenda Planning

1. Recommendations

Committee is requested to:

1.1 Note the agenda planning document; and

1.2 Note that the Pension Board are invited to comment on agenda items during Committee meetings.

2. 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 and highlights any changes to the agenda over the last quarter.

3. 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 2018

Pensions Committee	**Audit Sub Committee**
• Referrals / recommendations from Pensions Audit-Sub Committee • 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	• LPF Annual Report & Accounts Unaudited • Risk Management summary

September 2018

Pensions Committee	Audit Sub Committee
• Referrals / recommendations from Pensions Audit-Sub Committee • LPFE Limited and LPFI Limited Annual Report • LPF Annual Report & Accounts Audited • ISA 260 Audit Report • Revised Pensions Administration Strategy (to be confirmed) • Annual Report by External Auditor • Employers participating in Lothian Pension Fund • Service Plan Update • Risk management summary	• LPFE Limited and LPFI Limited Annual Report • LPF Annual Report & Accounts Audited • ISA 260 Audit Report • Pensions Data Quality • Irrecoverable overpayment of pensions – decisions made under delegated authority • Fraud Prevention • Annual Report by External Auditor • Risk Management summary

Future Pensions Committee and Audit Sub Committee dates (dates from September 2018 onwards are expected to be approved by Council in March 2018):

Pensions Committee	Pensions Audit Sub Committee
• Wednesday 27 June 2018, 2pm, Dunedin Room, City Chambers • Wednesday 26 September 2018, 2pm, Dunedin Room, City Chambers • Wednesday, 12 December 2018, 2pm, Dunedin Room, City Chambers • Wednesday, 27 March 2019, 2pm, Dunedin Room, City Chambers • Wednesday, 26 June 2019, 2pm, Dunedin Room, City Chambers	• Tuesday 26 June 2018, 2pm, Dunedin Room, City Chambers • Tuesday, 25 September 2018, 2pm, Dunedin Room, City Chambers • Tuesday, 11 December 2018, 2pm, Dunedin Room, City Chambers • Tuesday, 25 June 2019, 2pm, Dunedin Room, City Chambers (Sept onwards to be approved by Committee in March)

4. Measures of success

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

5. Financial impact

5.1 None.

6. 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

7. Equalities impact

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

8. Sustainability impact

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

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1 None

Stephen S. Moir

Executive Director of Resources

Contact: Struan Fairbairn, Chief Risk Officer, Lothian Pension Fund

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11. Appendices

Appendix – Scheme of Committee Papers

Appendix 1

Frequency	Pensions Committee	Audit Sub Committee	Month
Annually	Audit plans and reports (internal and external)	N/A - Draft audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee.	March
	Policies/Strategies/Training (including revised Pension Administration Strategy biennial from March 2016)	N/A	March
	Service Plan (every 2 years)	N/A	March
	Budget	N/A	March
	Governance Update (including Pension 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
	LPFE limited and LPFI limited Annual Report	LPFE limited and LPFI limited Annual Report	September
	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	Irrecoverable overpayment of pensions – decisions made under delegated authority	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 and Engagement	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
Every 3 years	Actuarial Valuation: LPF/LBPF/SHPF Funding Strategy Statement		December or March
As required	Delegated authorities (provider appointments)	N/A	
	Discretions (death grants etc.)	N/A	
	N/A	Internal Audit Reports	
	Regulatory Update	N/A	
	Investment Strategy Reviews (at least every 3 years)	N/A	
	N/A	Risk management (in depth review)	

Pensions Committee

2.00pm, Monday, 26 March 2018

Lothian Pension Fund – Draft Internal Audit plan for 2018/19

Item number	5.2
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

The purpose of this paper is to present the Lothian Pension Fund draft Internal Audit plan (the plan) for the period 1 April 2018 to 31 March 2019 to the Committee for approval.

A total of three reviews are included in the draft plan which is in line with Internal Audit coverage in previous years.

The Internal Audit plan has been developed using a risk based methodology to ensure that Internal Audit assurance activity is focused on Lothian Pension Fund's key risks. It should also be noted that Internal Audit is not the sole source of assurance provision for Lothian Pension Fund.

The current Internal Audit co-source arrangement with PwC will continue be used in 2018/19 where the required skills sets are not available within the IA team.

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Report

Lothian Pension Fund – Draft Internal Audit plan for 2018/19

1. Recommendations

Committee is requested to:

1.1 The Committee is requested to review and approve the Lothian Pension Fund 2018/19 Internal Audit plan.

2. Background

2.1 The Lothian Pension Fund (the Fund) Internal Audit (IA) plan is driven by Public Sector Internal Audit Standards (PSIAS) requirements; the Fund's organisational objectives and priorities; and an assessment of the risks that could prevent the Fund from meeting those objectives and providing pension services to employers and members.

2.2 The methodology used to create the Fund's IA plan is the same as that applied when developing the City of Edinburgh Council's (the Council) 2018/19 IA annual plan, which was approved by the Governance, Risk, and Best Value Committee on 20 March 2018. The Council IA plan also included details of the proposed 2018/19 Fund reviews.

2.3 It should also be noted that IA is not the sole source of assurance provision for Lothian Pension Fund, as assurance on risks faced by the Fund is also provided by external specialists. The Fund is currently preparing an 'assurance map' at the request of the Pensions Audit Sub-Committee, that will illustrate how assurance is provided from all sources across the Fund's key risks.

3. Main report

3.1 The areas proposed for inclusion in the plan were identified by considering the key risks included in the Fund's risk register, and discussions with the Fund management team; the convenor of the Pensions Audit Sub-Committee; and the former Independent Observer to the Pensions Committee.

3.2 The scope of the three reviews planned for the year to 31 March 2019 are detailed below:

	Audit Scope	Planned days	Risk Ref
1	<u>Unlisted investment valuations and application of fund administration fees and charges</u> Review of the design adequacy and operational effectiveness of key controls supporting valuation of unlisted investment valuations. Review will focus on the consistency of the valuation process applied, ensuring that the valuation approach is aligned with applicable guidance, and also completeness and accuracy of the range of fund administration fees and charges applied by Lothian Pension Fund. This review will be performed by PwC specialists.	20	Risk 1 Risk 24
2	<u>Unitisation</u> Assessment of the design adequacy and operational effectiveness of the control framework supporting the unitisation process. The review will focus on ensuring appropriate segregation of assets; accurate allocation of cash flows; and accurate application of interest and charges. We will also consider completeness and accuracy of reporting to third parties.	20	Risk 2 Risk 3
3	<u>Stock Lending</u> Review of the design adequacy and operational effectiveness of key controls support stock lending. The review will focus on adequacy of collateral provided to mitigate counterparty risk; adequacy of transfer and title arrangements (in the event that LPF require return of the stock to address market risk or for early settlement); compliance with best execution requirements; controls to mitigate conflicts of interest; and completeness and accuracy of income received from the counterparty.	20	Risk 13

3.3 Information Governance and readiness for the new General Data Protection Requirements (GDPR) that come into force in May 2018 remain key risks for the Fund.

3.3.1 It has recently been confirmed that the Fund will be registered under the Council's Information Commissioner's Office registration for GDPR with the Council assuming data controller responsibilities for the Fund.

3.3.2 Consequently, the Fund will be included within the Council wide GDPR readiness review currently being performed by the Information Governance Unit. The objective of this review is to ensure that the Service Areas across the Council are fully aware of GDPR compliance requirements and have appropriate action plans in place to address gaps identified.

3.3.3 The Council's IGU GDPR readiness review is currently being audited as part of the 2017/18 IA plan, with additional assurance work included in the 2018/19 IA plan to confirm progress with implementation of GDPR action plans across the Council. The Fund is included in the scope of both reviews.

3.4 Given the significant value of assets managed internally (circa £4 billion at 31 March 2017), trading of investments remains a significant risk for the Fund. However, as a new front-office trading system will be implemented during 2018/19, a review of trading controls (including operation of the new trading system) will be included in the 2019/20 IA plan.

4. Measures of success

4.1 Delivery of a risk based IA plan that provided assurance on the key risks facing the Fund and supports the 2018/19 Internal Audit Annual Opinion.

5. Financial impact

5.1 No direct financial impact

6. Risk, policy, compliance and governance impact

6.1 The IA plan has been prepared in compliance with the annual planning requirements specified by the Public Sector Internal Audit standards.

7. Equalities impact

7.1 None.

8. Sustainability impact

8.1 None.

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

9.2 The Fund management team; Convenor of the Pensions Audit Sub-Committee; and the former Independent Professional Observer to the Pensions Committee were consulted when developing the 2018/19 IA plan.

10. Background reading/external references

10.1 Public Sector Internal Audit Standards

Quarterly Risk Summary presented to Pensions Committee

Lesley Newdall

Chief Internal Auditor

E-mail: Lesley.newdall@edinburgh.gov.uk | Tel: 0131 469 3216

11. Appendices

None

Pensions Committee

2.00pm, Monday, 26 March 2018

External Audit – Annual Audit Plan 2017/18

Item number	5.3
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for 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 2017/18. This is shown at Appendix 1 - "Scott Moncrieff Annual Audit Plan 2017-18".

Claire Gardiner, Manager, Public Sector Audit, Scott-Moncrieff, will present the Annual Audit Plan 2017-18 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 2017/18 is £45,000, which represents an increase of 1.5% from 2016/17.

Report

External Audit – Annual Audit Plan 2017/18

1. Recommendations

Committee is requested to:

1.1 Note that the planned programme of work to support the statutory audit 2017/18. This is shown at Appendix 1 - “Scott-Moncrieff Annual Audit Plan 2017-18”;

1.2 Note that suitable provision has been made in the approved budget 2017-18 for the audit fee; and

1.3 Note that progress against the Annual Audit Plan 2017-18 will be reported to future meetings of the Pensions Audit Sub-Committee and the Pensions Committee.

2. Background

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

2.2 At its meeting on 20 March 2017, Pensions Committee agreed to:

2.2.1 “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;

2.2.2 Approve the continuation of non-audit services of taxation advice provided by the company’s external auditor to the LPF Group.”

3. 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 2017/18. This is shown at Appendix 1 - “Scott-Moncrieff Annual Audit Plan 2017-18”.

4. Measures of success

4.1 Progress against the Annual Audit Plan 2017-18 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 2017-18. This will be determined in due course.

5. Financial impact

5.1 The proposed audit fee for 2017/18 is £45,000, which represents an increase of 1.5% from 2016/17.

5.2 The Fund has accepted the proposed audit fee of £45,000 for 2017/18 and suitable provision has been made in the 2017/18 budget.

6. Risk, policy, compliance and governance impact

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

7. Equalities impact

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

8. Sustainability impact

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

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1 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.

Stephen S. Moir

Executive Director of Resources

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11. Appendices

Appendix 1 - Scott Moncrieff Annual Audit Plan 2017-18

Scott-Moncrieff
business advisers and accountants

Lothian Pension Funds

External Audit Plan
2017/18

February 2018

Contents

1

Introduction

Introduction

1. This document summarises the work plan for our 2017/18 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 2017/18 financial statements and related matters;
   - a review of arrangements for governance and transparency, financial management, financial sustainability and value for money; and
   - any other work requested by Audit Scotland.

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 funds for the five year period 2016/17 to 2020/21. This document comprises the audit plan for 2017/18 and summarises:

   - the responsibilities of Scott-Moncrieff as the external auditor;
   - our audit strategy;
   - our planned audit work and how we will approach it;
   - our proposed audit outputs and timetable; 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, the quality of our work and our reports would be greatly appreciated at any time. Comments can be reported directly to the audit team or through our online survey: *www.surveymonkey.co.uk/r/S2SPZBX*

8. While this plan is addressed to the Funds, it will be published on Audit Scotland's website *www.audit-scotland.gov.uk*.

2

Respective responsibilities of the auditor and the Funds

Respective responsibilities of the auditor and the Funds

Auditor responsibilities

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.

Our responsibilities

11. Auditor responsibilities are derived from statute, the Code, International Standards on Auditing (UK) (ISAs), professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities (paragraph 13). These are to:

- undertake statutory duties, and comply with professional engagement and ethical standards
- provide an opinion on audited bodies' financial statements
- review and report on, as appropriate, other information such as annual governance statements, management commentaries and remuneration reports
- notify the Controller of Audit when circumstances indicate that a statutory report may be required
- demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies':
  - effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets
  - suitability and effectiveness of corporate governance arrangements
  - financial position and arrangements for securing financial sustainability

12. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Wider scope audit work

13. 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 financial statements, but providing audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.

14. The Code sets out four audit dimensions that frame the wider scope audit work into identifiable audit areas. These are summarised in Exhibit 1.

15. Where the application of the full wider scope is judged by us not to be appropriate then our annual audit work on the wider scope is restricted to:

- Audit work to allow conclusions to be made on the appropriateness of the disclosures in the governance statement; and
- Consideration of the financial sustainability of the organisation and the services that it delivers over the medium and longer term.

16. Our assessment takes into account the size, nature and risks of the organisation.

17. Taking these factors into consideration, we have concluded that application of the full wider scope is appropriate for the Funds.

Funds' responsibilities

18. The Funds' have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives. The Funds' responsibilities are summarised in Exhibit 2.

Exhibit 1: Audit dimensions of wider scope public audit

Financial sustainability

Financial sustainability looks forward to the medium (two to five years) to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

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 is concerned with 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.

Exhibit 2 – Funds' responsibilities

Area	Funds' responsibilities
Financial statements: Annual report and financial statements containing financial statements and other related reports should be prepared.	The Funds and the Chief Financial Officer have responsibility for: • preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation; • maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures; • maintaining proper accounting records; and • preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements.
Financial sustainability: Financial sustainability looks forward to the medium and longer term to consider whether the organisation is planning effectively to continue to fulfill its functions in an affordable and sustainable manner.	The Funds are responsible for putting in place proper arrangements to ensure the financial position is soundly based having regard to: • 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 organisation plans to deal with uncertainty in the medium and long term; and • The impact of planned future policies and foreseeable developments on the financial position.
Financial management: Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.	It is the Funds' responsibility to ensure that 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. 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. 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.

Exhibit 2 – Funds' responsibilities

Area	Funds' responsibilities
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.	The Funds are responsible for establishing arrangements to ensure the proper conduct of their affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Those charged with governance should be involved in monitoring these arrangements. The Funds are also responsible for establishing effective and appropriate internal audit and risk management functions.
Value for money: Value for money is concerned with the appropriate use of resources and ensuring continual improvement of services delivered.	The Funds have a specific responsibility to ensure that arrangements have been made to secure best value. They are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

3

Audit strategy

Audit strategy

Risk-based audit approach

19. 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:

- Discussions with senior officers at Lothian Pension Funds
- Our understanding of the sector and its key priorities and risks
- Guidance from Audit Scotland
- Discussions with Audit Scotland and other auditors
- Discussions with internal audit and reviews of their plans and reports
- Review of the Funds' corporate strategies and plans
- Review of the Funds' corporate risk register

20. 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

21. 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 the Pensions Audit Sub-Committee.

Professional standards and guidance

22. We perform our audit of the annual report and financial statements in accordance with International Standards on Auditing (UK) (ISAs), the International Standard on Quality Control 1 (UK), Ethical Standards, and applicable Practice Notes and other guidance issued by the Financial Reporting Council (FRC).

Partnership working

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

Audit Scotland

24. 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.

25. 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 a local level.

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

Internal audit

27. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the Funds' total audit resource. To achieve this, we aim to take full cognisance of the work of internal audit wherever possible

.

4

Annual report and financial statements

Annual report and financial statements

Introduction

28. Audited bodies' financial statements 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 report and financial statements.

Approach to the audit of the financial statements

29. Our opinion on the financial statements will be based on:

Risk-based audit planning

30. 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 report and financial statements will be based.

An audit of key systems and internal controls

31. We evaluate the key accounting systems and internal controls and determine whether they are adequate to prevent material misstatements in the financial statements.

32. 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' policies and procedures.

33. We will take cognisance of any relevant internal audit reviews of systems and controls.

34. 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 report and financial statements

35. During our final audit we will test and review the material amounts and disclosures in the financial statements. The extent of testing will be based on our risk assessment.

36. Our final audit will seek to provide reasonable assurance that the annual report and financial statements are free from material misstatement and comply with the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 (the Code).

Independent auditor's report

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

38. We also provide an opinion on the consistency of the information in the management commentary, annual governance statement and governance compliance statement.

Group accounts

39. Lothian Pension Fund prepares its financial statements on a group basis. The group consists of Lothian Pension Fund and two special purpose vehicles, LPFE Ltd and LPFI Ltd.

40. The consolidation of the subsidiaries is not expected to result in a material change to the parent's financial statements.

41. As part of our audit we will review the consolidation working papers to ensure the group accounts accurately reflect the activities of the parent and both subsidiaries.

Materiality

42. Materiality is an expression of the relative significance of a matter in the context of the annual report and financial statements 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. We will review our assessment of materiality throughout our audit.

43. 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 report and financial

statements and therefore consider that these should be used in the calculation of overall materiality.

44. ISA 320 states that in certain circumstances it is appropriate to set a materiality amount for particular classes of transaction for which lesser amounts than the overall materiality could influence the decisions of users of the accounts. We considered transactions when dealing with members (i.e. contributions and expenditure incurred providing payments to pensioners) to be of key interest to the users. This is reported in the first section of the Fund Account and contains information about the day to day operation of the Funds. We have therefore set a separate materiality based on the expenditure incurred for providing payments to pensioners.

	Overall materiality £million	Dealings with members materiality £million
Lothian Pension Fund (group)[1]	98.5	10.6
Lothian Pension Fund (single entity)	98.5	10.6
Lothian Buses Pension Fund	7.3	0.6
Scottish Homes Pension Fund	2.6	0.4

45. 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 (50%)	Medium (60%)	Low (75%)
Lothian Pension Fund (group)[1]	49.3	59.1	73.9
Lothian Pension Fund (single entity)	49.3	59.1	73.9
Lothian Buses Pension Fund	3.7	4.4	5.5
Scottish Homes Pension Fund	1.3	1.5	1.9

46. Where transactions, or groups of transactions relate to dealings with members, performance materiality will be set using the percentages outlined in the table above.

47. 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 report and financial statements

48. Auditing standards require that we inform the Pensions Audit Sub-Committee of our assessment of the risk of material misstatement in the annual report and financial statements. 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 Audit Sub-Committee if our assessment changes significantly during the audit.

[1] Lothian Pension Fund group comprises Lothian Pension Fund, LPFE Ltd and LPFI Ltd

Exhibit 3: Key audit risks in the annual report and financial statements

1. 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 financial statements. 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*.

49. 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.

2. 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.

50. 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

3. Risk of fraud in the recognition of expenditure

In 2016, the Public Audit Forum issued Practice Note 10 "The Audit of Public Sector Financial Statements" which applies to the audit of public sector financial statements for periods commencing after June 2016. This practice note recognises that most public sector bodies are net spending bodies and notes that there is an increased risk of material misstatement due to improper recognition of expenditure.

51. We have considered the expenditure streams at the Funds' and we do not consider the risk of fraud in expenditure recognition to be material. We have therefore rebutted this risk at the planning stage. We will, however, continue to monitor this position throughout the audit.

3. Valuation of investments

The Funds held investments of £6.569 billion as at 31 March 2017, of which 30% (£2.069 billion) were classified as level 2 or level 3 financial instruments, meaning the valuation was not based on unadjusted quoted prices in active markets. Judgements are taken by the Investment Managers to value those investments whose prices are not publically available. 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.

52. 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 in accordance with ISA 500.

53. For a sample of investments we will confirm the prices quoted to fund manager reports and independent pricing sources. We will assess the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments.

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 latest triennial valuation was as at 31 March 2017 and sets rates for the three-year period commencing 1 April 2018. 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 data provided to the actuary is not complete and that assumptions used are not appropriate.

54. 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.

5

Wider scope audit

Wider scope audit

Introduction

55. As described in section 2, the Code frames a significant part of our wider scope responsibilities in terms of four audit dimensions. As part of our annual audit we consider and report against these four dimensions; financial sustainability, financial management, governance and transparency and value for money.

56. Our planned audit work against the four dimensions is risk based and proportionate. Our initial assessment builds upon our understanding of the Fund's priorities and risks which we developed in 2016/17, discussions with management and review of the Funds' minutes and key strategy documents. In 2017/18 we have also considered the following risk areas as they relate to the Funds:

- EU withdrawal
- New financial powers
- Ending of public sector pay cap
- Response to cyber security risks
- Openness and transparency.

57. At this stage of our audit planning process, we have not identified any significant risks in relation to the wider scope dimensions. 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.

Financial sustainability

Financial sustainability looks forward to the medium and longer term to consider whether the organisation's planning processes support the future delivery of services.

Consideration	Our audit approach
The Funds produce an annual service plan and budget which focuses on the costs associated with dealings with members and 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 latest triennial valuation took place as at 31 March 2017 and will set the rates from 1 April 2018. The Funding Strategy Statement is informed by the results of this triennial valuation and will create a strategy for each of the three funds. T The Funds' management team are currently developing the revised Funding Strategy Statement ensuring that each is designed to allow the fund to meet the demands of future pension costs.	During our 2017/18 audit we will consider the Fund's financial standing. This will involve a review of the arrangements in place for medium to long term financial planning, budgetary control and financial reporting. It is important that such arrangements are adequate in order to properly control Funds' operations and use of resources. This will include consideration of the results of the actuarial valuation and accompanying revised Funding Strategy Statement.

Financial management

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

Consideration	Our audit approach
The key financial indicator for the across pension funds in Scotland is the return on investments. The Lothian Pension Funds have consistently performed above the Scottish average in recent years. The net assets of the Funds increased in 2016/17, reflecting the level of returns achieved in year and the relatively strong position of the market in year. The performance of investments is monitored by the Pension Committee, who considers the investments control environment and performance over the annual committee cycle in line with a formal long term agenda plan. The Committee also monitors the budget for income and expenditure incurred when dealing with members. It has been noted that in 2017/18 the number of active members has continued to decrease for Lothian Pension Fund and Lothian Buses Pension Fund. This has caused a fall in contributions against an increase in pensioner and lump sum payments. It is projected that all funds will be in a net withdrawals position as at 31 March 2018. The reliance on investment income is therefore increased in order to meet the long term cash flow needs.	During our 2017/18 audit we will review, conclude and report on the following: • 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; • Whether Funds has established appropriate and effective arrangements for the prevention and detection of fraud and corruption; and

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.

Consideration	Our audit approach
The Pensions Committee, supported by an Audit Sub-Committee, has been delegated responsibility for governance by the City of Edinburgh Council, the administering authority. Following the local government elections in May 2017, there have been 2 changes in elected members. An	We will review the effectiveness of the Funds' governance framework and the extent to which the committee roles, membership and terms of reference comply with current guidance: *Delivering good governance in local government*: *framework (2016*). We will consider whether the information provided to

induction programme has been developed for new members to ensure they understand their role and the roles of the committees. The Pensions Committee and Pensions Audit Sub-Committee meetings are held in public, papers are available in advance and minutes of the meetings are published on the City of Edinburgh Council's website.	the committees is sufficient for members to assess the impact of decisions on resources and performance. Our work will include consideration of how risk management has been addressed within the Funds. We will also consider Funds' internal audit arrangements to determine their role in examining the control systems established by management.

Value for money

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

Consideration	Our audit approach
Investments at the Funds are managed through a combination of external fund managers and the Funds' special purpose vehicles, LPFE Ltd and LPFI Ltd. The proportion of funds managed internally has increased over recent years which has resulted in investment management expenses reducing as a proportion of net investment assets. The Funds' performance is reviewed by an external provider on a monthly basis. The external provider compiles information covering monthly, quarterly, yearly and 3 yearly performance measures. This information is presented to the Investment Strategy Panel to allow for scrutiny investment performance of the Funds. The Funds' also focus on administrative performance and have developed a Service Plan covering the period 2016- 2018. The Pensions Committee receive updates on the service plan at each meeting. The Funds make use of a range of service providers including investment managers, an actuary and a custodian. In line with City of Edinburgh Council procedures the Funds maintain a contract register and have considered the position of contracts in year. Where action has been required a tender process has been undertaken. As a result of this process to date the contract with the custodian has been extended and further investment management services have been brought in house. We note there are further tenders due to take place prior to the completion of our audit.	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. We will seek evidence from the Funds that outcomes are improving and there is sufficient focus on improvement and the pace of it. We will review the process for tendering for new providers and consider this against the value for money principles. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. 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.

7

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 2017/18.	February 2018
Independent Auditor's Report	Report	This report will contain our opinions on the truth and fairness of the annual report and financial statements.	September 2018
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 2018

Audit outputs

38. Prior to submitting our outputs, we will discuss all issues with management to confirm factual accuracy and agree a draft action plan where appropriate.

39. 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

40. 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 is reviewed by Audit Scotland each year and adjusted if necessary based on auditors' experience, new requirements, or significant changes to the audited body.

41. 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.

42. For 2017/18 we propose setting the audit fees at 10% above the expected fee level. This reflects the unique nature of the Funds and the level of risk this brings to the audit.

43. The expected fee for the Funds for the 2017/18 audits are as follows:

2017/18	
Auditor remuneration	£39,530
Pooled costs	£3,190
Audit support costs	£2,280
Total expected fee	**£45,000[2]**

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

[2] The audit fee in 2016/17 was £44,350

Audit timetable

45. 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 below:

January 2018

Planning meeting for 2017/18 audit.

↓

March 2018

Presentation of External Audit Plan to the Pensions Audit Sub-Committee. Interim audit visit including a review of key systems

↓

July 2018

Annual report and financial statements presented for audit and final audit visit begins

↓

September 2018

Presentation of our Annual Report on the Audit to the Pensions Audit Sub-Committee

8

Appendices

Appendix 1: Your audit management team

Scott-Moncrieff is one of the largest independent accountancy firms in Scotland. We have 17 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 Semple Street Edinburgh EH3 8BL	25 Bothwell Street Glasgow G2 6NL	Scott-Moncrieff 10 Ardross Street Inverness IV3 5NS
(0131) 473 3500	(0141) 567 4500	(01463) 701 940

Your audit management team

Nick Bennett
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.

Nick will have responsibility for the delivery of the audit.

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 Nick to deliver the audit engagement.

Rachel Wynne
Audit Senior
Rachel.wynne@scott-moncrieff.com

Rachel joined the firm in 2014 as a public sector audit trainee and has since achieved her CA qualification. She has experience delivering external audit services to a range of public sector bodies, including local government.

Rachel will be responsible for the delivery of the onsite work.

Confirmation of independence

International Standard on Auditing (UK) 260 “Communication with those charged with governance” requires us to communicate on a timely basis all facts and matters that may have a bearing on our independence.

Scott-Moncrieff is also responsible for the audit of the financial statements of LPFE Ltd and LPFI Ltd, the subsidiaries of Lothian Pension Fund. In addition to the audit of the subsidiaries, Scott-Moncrieff provides accounts preparation, corporation tax services and ad hoc VAT advice to both LPFE Ltd and LPFI Ltd.

All tax services are provided by an independent tax partner and staff who have no involvement in the audit of the financial statements.

The accounts are prepared from trial balances provided by LPFE Ltd and LPFI Ltd and no significant policies, disclosures, adjustments or estimates are decided by Scott-Moncrieff.

Moore Stephens provided a Financial Conduct Authority Compliance review for LPFI Ltd. The team is independent of Scott-Moncrieff and has no involvement in the audit of Lothian Pension Fund or it’s subsidiaries.

We confirm that we will comply with FRC’s Revised Ethical Standard (June 2016). In our professional judgement, the audit process is independent and our objectivity has not been compromised in any way.

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 Funds and Scott-Moncrieff.

Annual report and financial statements

We will require the annual report and financial statements 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 Partnership during the course of the audit on matters having a material effect on the annual report and financial statements. This will take place by means of a letter of representation, which will require to be signed by the Chief Financial 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 Pension Audit Sub-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

Pensions Committee

2.00pm, Monday, 26 March 2018

Governance Update

Item number	5.4
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

The purpose of this report is to update the Committee on the rotation of the Pension Board chair, training activities over 2017/18 and various other governance matters.

Report

Governance Update

1. Recommendations

Committee is requested to:

1.1 Note the verbal update from the Pension Board regarding the newly appointed chair of the Pension Board effective from 1 April 2018 to 31 March 2019;

1.2 Thank Darren May for his significant contribution during his tenure as the Chair of the Pension Board;

1.3 Thank Eric Adair for his significant contribution to the Fund as a Consultative Panel Member and a Pension Board member;

1.4 Note the update on the Scottish Government's review of structure and governance; and

1.5 Note the Accounts Commission's Local Government Pensions supplement overview prepared by Audit Scotland.

2. 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.

3. 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'.* The 2018/19 chair is required to be from the member representatives 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 one resignation, John Rodgers, (a member representative). Diane Hogarth and Brian Robertson (both member representatives) have joined the Board. At the time of writing, Eric Adair has notified the Fund and Pension Board that he will be submitting his resignation within the coming months. Eric has contributed to the Fund's governance arrangements since 2012 as a member of the Fund's Consultative Panel and thereafter in 2015 as a member of the Pension Board representing the employers of the fund. He also served as chair for 2015/16. The Fund has alerted the employers of the potential for a vacancy on the Pension Board.

City of Edinburgh Council Meeting – 15 March 2018

3.4 At the time of writing, the City of Edinburgh Council is expected to consider the following motion from Councillor Claire Miller:

"Council:

- Recognises the benefits of conducting council business in public, and the benefit that webcasting some council business has brought;
- Notes that some public meetings are held in public but are not currently webcast;
- Calls for a report within one cycle to the next meeting of City of Edinburgh Council into the feasibility, benefits and costs of introducing webcasting for public meetings, including but not limited to the Integration Joint Board, Licensing Board, and Pensions Committee."

3.5 Also, due to a change in the political balance in the Council, an SNP member of the Pensions Committee is expected to be replaced by a representative from the Scottish Liberal Democrats.

3.6 A verbal update on these matters will be provided to Committee.

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

3.7 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.

3.8 Appendix 1 of this paper provides a breakdown of training of the Pension Committee and Board. As at 14 March 2018, six members of the Pensions Committee and all the members of the Pension Board have met the minimum of three days (21 hours) training required under the Fund's training policy.

3.9 The Fund continues to emphasise the importance of training to both Committee and Board members. Taking an active role in ensuring skills, knowledge and understanding are sufficient is vital for both members of the Board and Committee to ensure the effective governance of the Fund. To support this, the Fund provides quarterly reminders of training hours, details of future training opportunities and reading material to all the Pensions Committee and Pension Board members.

Scottish Public Service Pensions Agency Governance Review

3.10 As previously reported to Committee, the Scottish Public Pension Agency (SPPA) 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.

3.11 Appendix 2 provides the most recent Scheme Advisory Board bulletin which provides further updates on the Scheme Advisory Board's activities including an action plan on the implementation of the governance review. The Fund will report to the Committee on any further updates when available.

Accounts Commission Overview of the LGPS

3.12 The Accounts Commission, the public spending watchdog for the Local Government, publish a financial overview of accounts and audit each financial year including a supplementary report on the Local Government Pension Scheme. This is provided in Appendix 3 of this report. It sets out various comparisons of the Pension Funds in Scotland.

4. 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.

5. Financial impact

5.1 None.

6. 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.

7. Equalities impact

7.1 None.

8. Sustainability impact

8.1 None.

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1

Stephen S. Moir

Executive Director of Resources

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11. Appendices

Appendix 1 – Committee and Pension Board Members' Training Record for 2017/18 (to 14 March 2018)
Appendix 2 – Scheme Advisory Board bulletin February 2018
Appendix 3 – Audit Scotland Overview Report LGPS Supplement

Appendix 1

Committee and Pension Board Members' Training Record
From 1 April 2017 to 31 March 2018

Event:	TPR online training	Sarah Smart Session	Internal Training Pension Fund	Induction training	Sarah Smart Session	Audit Sub Committee Preparation	Pension Committee Preparation	Actuarial Valuation Training	Investment Seminar COSLA Office	PLSA Conference	IGG/SPLG Training Agenda	Annual LAPFF Conference	Sarah Smart Session	Audit Sub Committee Preparation	Pension Committee Preparation	Internal training session	PLSA, Invesmtnent Conference	Procurement meeting	Audit Sub Committee Preparation	Pension Committee Preparation	Pensions & Lifetime Savings Conference.	IPO Session	Pension Committee Preparation	Additional training/ reading	Total
Date	n/a	28/6/17	28/6/17	13/9/17	26/9/17	26/9/17	27/9/17	25/10/17	31/10/17	17/11/17	21/11/17	6-8 /12/17	12/12/17	11/12/17	12/12/17	5/2/18	7-9 /03/18	13/3/18	25/3/18	26/3/18	7-8/03/18				
Pensions Committee																									
Maureen Child	**0**	0	0	0	0	0.5	1	0	6	0	0	0	0	0.5	1	3.25	8.75	1						2.5	**24.5**
Claire Miller	**0**	1	3	3	1	0	1	0	6	0	7	0	0.75	0	1	3.25	12	1							**40**
Adam McVey	**0**	1	3	0	0.75	0	1	2	0	0	0	0	0	0	1	0	0	1						1	**10.75**
Alasdair Rankin (Convener)	**0**	0	3	0	0	0	1	2	6	0	0	13.5	0	0	1	0	7.75	1						3	**38.25**
Cameron Rose	**0**	0	3	0	0	0.5	1	2	6	0	0	0	0.5	0.5	1	3.25	12	1							**30.75**
John Anzani	**0**	0	3	0	1	0.5	1	2	6	0	0	13.5	0	0.5	1	3.25	19.75	0.75							**52.25**
Richard Lamont	**0**	0	3	0	0	0	1	2	6	0	0	0	0	0	1	3.25	16.5	0						10	**42.75**
Lothian Pension Funds' Pension Board																									
Employer Representatives																									
Eric Adair (EDI Group)	**0**	0	0	0	0	0	1	0	6	0	0	0	0	0	1	3.25	13.75	0							**25**
Darren May, Chair (Scottish Water)	**0**	0	3	0	0.5	0	1	2	6	3	0	0	1	0	1	3.25	13.75	0						11	**45.5**
Sharon Dalli	**0**	0	0	0	0.5	0	1	0	0	0	0	0	0	0	1	3.25	0	0						21	**26.75**
Alan Williamson	**0**	0	0	0	0.5	0.5	1	0	6	0	0	0	0	0.5	1	3.25	21.5	0						5	**39.25**
Paul Ritchie	**0**	0	3	0	0	0	0	0	0	0	7	0	0	0	0	3.25	8.75	0							**22**
Member Representatives																									
Brian Roberston (UNITE)	**0**	0	0	3	0	0	0	2	0	0	0	0	1	0	1	3.25	21.5	0						1	**32.75**
Jim Anderson (UNISON)	**0**	0	3	0	0	0	1	2	0	3	0	0	0	0	1	3.25	21.5	0						13	**47.75**
Catrina Warren (UNISON)	**0**	0	3	0	0.2	0.5	1	0	6	0	0	0	0	0	0	3.25	0	0						12	**25.95**
Diane Hogarth (UNITE)	**0**	0	0	3	0.3	0	1	2	6	3	7	0	1	0	1	0	0	0						1	**25.3**
Thomas Carr Pollock (GMB)	**0**	**0**	3	0	0	0	1	2	6	0	0	0	0	0	1	3.25	8.75	0							**25**
Total																									**315.25**

Notes regarding additional reading and training:

Cllr McVey had separate induction with Struan Fairbairn on Wed 20 September for 1 hour.

Jim Anderson - PLSA Roadshow 7 September 2017 - 3 hours, Unison Pension Seminar 17 October 2017 4 hours, additional e.g. Professional Pensions etc reading of 1 hour per month.

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

Cllr Alasdair Rankin LAPFF meeting in August 3 hours. **Cllr Alasdair Rankin's hours for 7 March estimate only to be confirmed.**

Richard Lamont - PMI trustee training 10 hours.

Catrina Warren - Unison Pension Seminar Jan 2018 - 6 hours and additional reading 6 hours throughout the year.

Sharon Dalli additional training includes, Finance Transformation Roadshow 17 Nov - 2hours, BTP programme Workshops - 3 hours, PLSA LGPS Conference May 2017- 12 hours, Police pensions post review meeting, April 2017 - 2 hours, BTP pensions integration project, 26 April - 2 hours

Brian Robertson and Diane Hogart - requested further training on Pension Benefits 23 January 2018 - 1 hour.

Maureen Child - Reading credit 2.5 hour

Alan Williamson - additional reading over the course of the year - 5 hours

Scottish Local Government Pension Scheme
www.lgpsab.scot

Scheme Advisory Board

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February 2018

BULLETIN

Structure Review

The Cabinet Secretary for Finance has responded to the SAB's options paper on the structure review. He has asked the SAB to consult on the future structure of the scheme based on the options identified in the report:

- Status quo of eleven funds in Scotland.
- Retain the eleven funds, but with closer collaboration.
- One or more common investment pools.
- Merge the funds into one or more new funds.

SAB officers are drafting a consultation paper and timetable for the next SAB meeting in April.

Audit Scotland overview report

The SAB received a presentation from Audit Scotland on their overview report on local government pension funds. This is a high level look at funds based on their financial accounts. Audit Scotland highlighted the significant increase in asset value and liabilities as well as other challenges facing the scheme. These will be addressed in more detail when the scheme valuation is considered later this year.
http://www.audit-scotland.gov.uk/uploads/docs/report/2017/nr_171128_local_government_finance_supp2.pdf

Governance Review

The SAB agreed an action plan on the implementation of governance review. The main actions for the SLGPS involved strengthening training and communications, particularly with pension boards at fund level.

Annual report

A revised draft report was agreed at the last SAB meeting. The final statistical analysis is being completed and the report should be published later this month.

Regulations

The SPPA reported on draft regulations that had been out for consultation. Some changes will be made and the final regulations will be presented to Parliament in April.

Pension Developments

The FCA's Investor Disclosure Working Group (IDWG) is working on templates for cost and fee disclosure by asset managers to institutional investors, including pension funds. Many of the biggest advisors have already signed up to the LGPS code. The working group has recently published an update of its work.
https://www.fca.org.uk/publication/minutes/idwg-progress-december-2017.pdf

The UK government has announced that it intends to lower the age for automatic enrolment in workplace pensions from 22 to 18. However, the change will not take place until the mid 2020s.

The UK government is consulting on rules that will make it easier for pension schemes to make investment decisions to fight climate change. Friends of the Earth Scotland has published a new analysis of fossil fuel investment in Scotland and UNISON has commissioned a guide on this issue from Share Action.

Further details on our website www.lgpsab.scot

Local Government Pension Scheme 2016/17

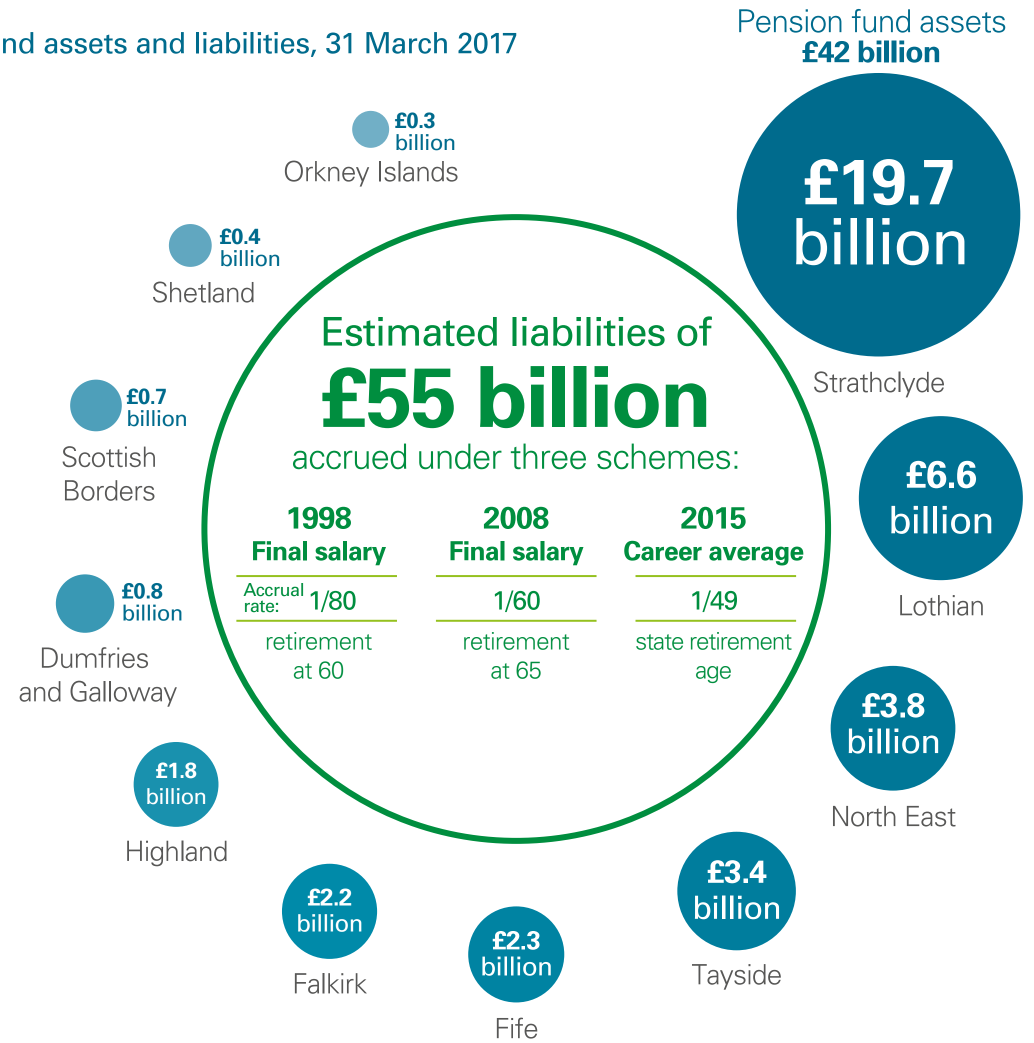
ACCOUNTS COMMISSION

Introduction

1. This supplement accompanies our Local Government in Scotland: Financial Overview 2016/17 and provides an overview of the LGPS in Scotland. We have drawn on the annual reports and accounts of the 11 pension funds administered by councils in Scotland and on the reports of their appointed auditors. In this, the first year of new five year auditor appointments, we are pleased that all 11 pension funds received an unqualified audit opinion on their accounts.

2. It was a good year for pension fund assets, which increased from £34.5 billion to £42 billion. However, the estimated value of liabilities also increased from £42 billion to almost £55 billion (Exhibit 1).

Exhibit 1
LGPS Scotland assets and liabilities, 31 March 2017



Source: Pension Fund Annual Accounts 2016/17

3. The estimated value of LGPS liabilities is in respect of all scheduled and admitted bodies not just councils. Councils have pension liabilities associated with added years awarded on retirement that do not fall on the pension fund and are not included in (Exhibit 1, page 1). Council net pension fund liabilities as at 31 March 2017 were estimated to be £11.5 billion (including unfunded liabilities).

Governance and administration

4. This is the second year of the LGPS 2015 scheme, which links pension benefits to career average earnings (a move away from final salaries under the previous LGPS schemes). We reported last year that pension funds had coped well with the introduction of the scheme and associated governance arrangements, but that the outlook remained challenging.

5. The new governance arrangements introduced under the 2015 scheme are more complex than under the previous LGPS schemes, with more stakeholders being involved. The range of stakeholders is shown in Exhibit 2 (page 3).

6. During 2016/17 the Scottish Scheme Advisory Board reported to the Scottish Minister on the future structure of the LGPS in Scotland. The report has not been made public so any proposed changes to the structure of the LGPS in Scotland are unclear. Irrespective of any proposed changes, a number of pension fund annual reports highlight plans for greater collaboration.

7. A survey[1] undertaken by the Pensions Regulator across all UK public service schemes found improvements in ensuring and demonstrating compliance with the public service code of practice on governance and administration. Auditors confirmed that LPGS pension funds in Scotland had improved arrangements and procedures in this area.

8. During the year the Scottish Public Pensions Agency (SPPA) commissioned KPMG to review governance across all public service pension schemes in Scotland.[2] One of the key issues raised by KPMG is whether there would be benefit in clarifying the role of the LGPS pension boards established under the 2015 LGPS scheme. The remit of LGPS pension boards goes beyond that for other public service schemes, requiring them to consider any pensions matters they deem relevant. The risk is that LGPS boards become overstretched and do not adequately assist scheme managers to comply with regulations and the public service code.

9. Councils rotated the chairs of their pension boards in 2016/17. They have also experienced wider changes in councillor membership of pension committees following the local elections in May 2017. Ensuring that elected members and appointed board members have the requisite skills and knowledge in this highly technical area is an ongoing challenge for pension funds.

Investment performance and pension fund assets

10. Overall, investments performed surprisingly well in a year where several high profile political events including the Brexit referendum and U.S. presidential results, affected investor confidence. The associated fall in the pound resulted in equity prices rising and this contributed to investment returns of around 22 per cent. Exhibit 3 (page 4) shows investment returns for the 11 pension funds.

11. The average return on LGPS investments in Scotland will be strongly influenced by the returns achieved by the larger funds, in particular the Strathclyde fund which accounts for almost 47 per cent of Scotland's £42 billion of LGPS assets.

1 *Public service governance and administration survey – Summary of results and commentary*, Pensions Regulator, May 2017.

2 *Scottish Public Service Pensions Governance Review*, KPMG, February 2017.

Exhibit 2
LGPS governance arrangements

UK

The Pensions Regulator
- Issues codes of practice on governance and administration
- Provides guidance and self assessment tool kits
- Undertakes governance and administration surveys
- Significant breaches of regulation must be reported

Scotland

Scottish Ministers
- Responsible for policy and regulations
- Currently considering a report on the future structure of LGPS

Scottish Public Pensions Agency
- Advise Scottish Ministers on public service policy and regulation
- Commissioned a review of governance in 2016/17

Scottish Scheme Advisory Board
- Advise Scottish Ministers on policy and changes
- Can advise scheme managers and pension boards
- Issued report to Scottish Ministers on future structure of LGPS

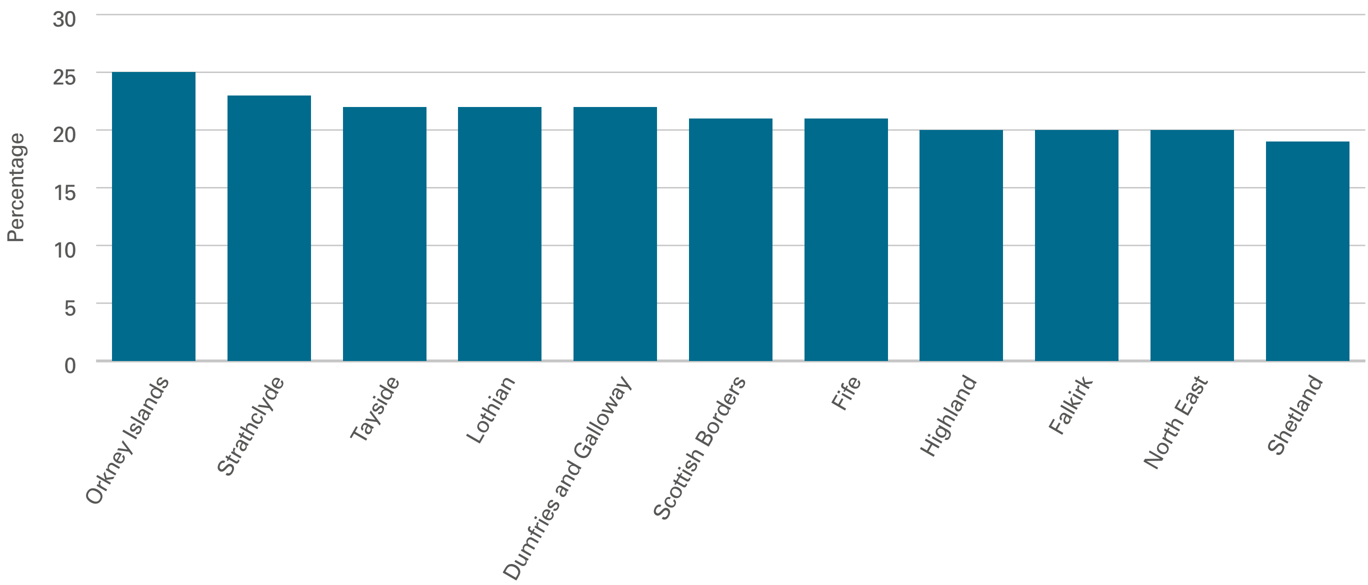
11 administering authorities

Pension Committees
- Responsible for decisions on pension fund policy
- Composed of Councillors but may include representatives and advisors
- New members in May 2017

Pension Boards
- Supports compliance with law and regulation
- Can consider any matter deemed relevant
- Membership 50:50 employer and union representation
- May request Pension Committee to review decisions

Source: Audit Scotland

Exhibit 3
Return on investments as a percentage of opening investment assets 2016/17
Orkney had the highest investment returns in the year but is the smallest fund.



Source: Pension fund annual accounts 2016/17

12. There has been a continued interest across the pensions sector in the transparency of investment management costs. We welcome developments in this area, as even small reductions in cost arising from a better understanding and level of scrutiny can make a difference when compounded over time. In last year's supplement we expressed our support for full disclosure of costs in pension fund annual reports.

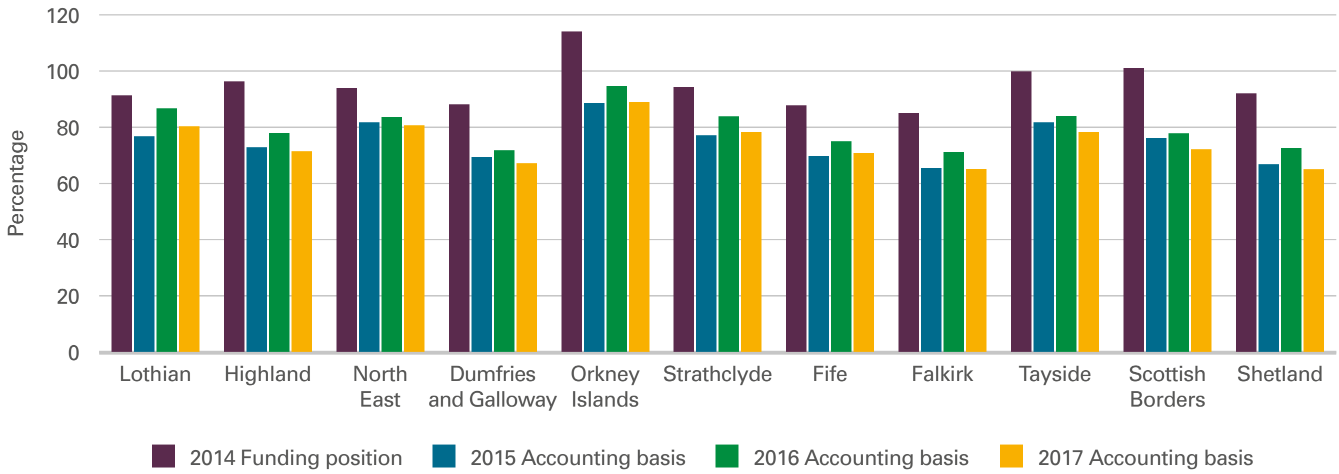
Present value of promised retirement benefits

13. Estimates of the present value of promised retirement benefits or 'pension liabilities' are required under both the pension regulations for funding valuations (forming the basis for employer contributions) and under accounting standards (for disclosure in the pension fund accounts). Funding valuations are carried out every three years whilst estimates of pension liabilities for accounting purposes are updated each year. Pension funds are currently awaiting their final funding valuations for 31 March 2017.

14. Accounting valuations produce higher estimations of liabilities and lower indicative funding levels as a result. Indicative funding levels on an accounting basis for 2017 are broadly similar to those in 2015 (Exhibit 4, page 5).

15. Actuaries will revisit their assumptions and use up to date data to calculate funding valuations as at 31 March 2017. It is this triennial funding valuation that will determine whether employer contributions will need to increase over the next three year period from 2018/19. Any increases for employers will be limited under the cost sharing mechanism in the LGPS 2015.

Exhibit 4
Pension fund assets as a percentage of estimated liabilities 2014 to 2017
Accounting valuations result in lower funding levels than those for funding purposes (2014).



Source: Pension fund annual reports and accounts

Cost control and the employer cost cap

16. Under Section 13 of the Public Service Pension Act 2013 (the 2013 Act) the Government Actuaries Department (GAD) will review the 2017 triennial valuation on behalf of Scottish Ministers. This review will look at the consistency with which actuaries have undertaken valuations in Scotland and their compliance with regulations. The review will also look at the solvency and long term efficiency of the funds and may make recommendations in relation to future cost sharing between employers and active members of the scheme.

17. The cost sharing mechanism in the LGPS 2015 is designed to ensure that the LGPS remains affordable for employers. Under this mechanism (GAD) has established a Scotland wide LGPS employer cost cap of 15.5 per cent. If the cost of providing benefits to members increases by more than two per cent above the employer cost cap then employee contributions and/or benefits will be reviewed.

18. GAD recently undertook a 'dry run' review[3] based on the 2014 funding valuations. This raised no concerns about the solvency or longer term efficiency of the LGPS in Scotland but did raise concerns about inconsistencies in valuations by different actuaries across Scotland's 11 pension funds. We understand that actuaries are looking to address GAD's concerns before reporting in 2018.

3 LGPS SCOTLAND Section 13 Dry Run Report.

Outlook

19. Pension funds face ongoing administrative pressures including those arising from:

- councils severances
- complexities of the new career average scheme.
- guaranteed minimum pension reconcilliations (with HMRC records)
- pensions auto enrolment.

20. To help to reduce their costs and improve services, pension funds are increasingly providing online services to employers and members through programmes of digitalisation. As services evolve pension funds will need to be alert to cyber security risks.

21. New regulatory arrangements for financial markets arising from Markets in Financial Instruments Directive (MIFID 2) will also impact on pension funds from 1 January 2018. MIFID 2 requires all local authorities to be treated as 'retail clients' by their asset managers which would severely limit the ability of pension funds to invest. However, the Financial Conduct Authority rules allow local authorities to opt up to 'professional investor' status allowing fund managers to continue to offer the full range of investments. MIFID 2 was designed to protect the interests of local authorities and care will be needed to ensure that opting up for pension investments does not expose the wider council to increased risks.

22. Delivering investment returns will no doubt remain a challenge for pension funds and pension fund managers. It is unclear to what extent further collaboration between funds will reduce costs and improve performance. It is also unclear whether the Scottish Minister will require pension funds to formally collaborate or propose any structural change following the recent report on the structure of the LGPS in Scotland.

AUDIT SCOTLAND

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Pensions Committee

2.00pm, Monday, 26 March 2018

2017 Actuarial Valuation for Lothian Pension Fund

Item number	5.5
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

The Lothian Pension Fund is required by law to undertake an actuarial valuation once every three years. The pension fund's Actuary assesses the financial health of the pension fund and sets the employer contribution rates required for the next three years. The last actuarial valuation was undertaken as at 31 March 2014.

The actuarial valuation of the Lothian Pension Fund, based on data as at 31 March 2017, has been undertaken and the report from the Actuary is shown in full at Appendix 1.

EDINBVRGH
THE CITY OF EDINBURGH COUNCIL

Report

2017 Actuarial Valuation for Lothian Pension Fund

1. Recommendations

Committee is requested to:

1.1 Note the results of the 2017 Actuarial Valuation report for the Lothian Pension Fund.

2. Background

2.1 "The Local Government Pension Scheme (Scotland) Regulations 2014, Regulation 60 (1)" states that "each administering authority must obtain –

(a) an actuarial valuation of the assets and liabilities of each of its pension funds as at 31 March 2017 and on 31 March in every third year afterwards;

(b) a report by an actuary in respect of the valuation; and

(c) a rates and adjustments certificate prepared by an actuary".

2.2 Accordingly, the actuarial valuation of the Lothian Pension Fund, based on data as at 31 March 2017, must be completed by 31 March 2018.

2.3 The actuarial valuation of the pension fund has three main purposes:

- To assess whether the funding strategy and assumptions are appropriate;
- To assess the financial health of the pension fund; and
- To set the future rates of contributions payable by the employers.

2.4 On 28 September 2016, Pensions Committee approved "the continued use of the Contribution Stability Mechanism (CSM) for long-term secure employers within Lothian Pension Fund for the 2017 actuarial valuation".

2.5 At its meeting on 27 September 2017, Pensions Committee agreed "to adopt the proposed changes as the Fund progresses the 2017 actuarial valuation over the coming months". Such included requisite updates to reflect:

- Financial and demographic assumptions;
- Funding Strategy Statement revisions;
    - Affordability constraints – termination of membership
    - Employer Asset tracking (Unitisation of investments)
    - New investment strategy for employers with maturing liabilities.

2.6 A separate report on the revised Funding Strategy Statement is provided on this agenda.

3. Main report

3.1 The 2017 Actuarial Valuation report for Lothian Pension Fund, as submitted by the Actuary, is attached as Appendix 1. The report is marked as 'Draft' pending the formal approval of the Funding Strategy Statement which is also on Committee's agenda.

Funding Level - Summary

3.2 The table below summarises the financial position of the Fund at 31 March 2017 in respect of benefits earned by members up to this date.

Past Service Position	**2014**	**2017**
Past Service Liabilities £m	4,796	6,743
Market Value of Assets £m	4,379	6,598
Surplus / (Deficit) £m	(417)	(145)
Funding Level %	**91%**	**98%**

3.3 The results show that the Fund had not met its objective of holding sufficient assets to meet the full estimated current cost of past service benefits at 31 March 2017. The funding level, however, has increased from 91% at the previous valuation at 31 March 2014 to 98% at this valuation. The deficit has decreased from £417million at 31 March 2014 to £145million at 31 March 2017.

Analysis of change in solvency

3.4 The main reason for the change in funding level over the period was better than expected asset returns. A fall in real gilt yields has placed a higher value on the pension liabilities, serving to partially offset the effect of this.

3.5 The table below illustrates the various factors that have led to the change in the solvency position between the 2014 and 2017 valuations.

Analysis		**(£m)**
Surplus / deficit at 31 March 2014		**(417)**
Interest on surplus / (deficit)	(62)	
Investment returns greater than expected	1,506	
Contributions greater than cost of accrual	(6)	
Membership experience over the period	438	
Change in demographic assumptions	(43)	
Change in base mortality assumption	28	
Change in longevity improvements assumption	32	
Change in financial assumptions	(1,475)	
Impact of LGPS 50/50 take up	(31)	
Other experience items	(115)	
Surplus / deficit at 31 March 2017		**(145)**

3.6 Further comments on these Items is provided in the valuation report.

Employer Contribution Rates

3.7 The table below summarises the whole Fund Primary and Secondary Contribution Rates at this triennial valuation:

Primary Rate (% of pay)	Secondary Rate (£)		
1 April 2018 – 31 March 2021	2018/2019	2019/2020	2020/2021
31.8	-76,175,000	-76,293,000	-75,433,000

3.8 At the previous formal valuation at 31 March 2014, a different regulatory regime was in force. Therefore, a contribution rate that is directly comparable to the rates above is not provided.

3.9 Employer contribution rates have increased on average compared to the 2014 valuation of the Fund. Primary contributions have increased due to a reduction in future expected investment returns but this has been partially offset by the improved funding levels and hence reduced secondary contributions.

3.10 While these rates illustrate the position of the overall Fund, it should be noted that contribution rates are set for each employer level depending on their individual funding position. The minimum contributions to be paid by each employer from 1 April 2018 to 31 March 2021 are shown in the Rates and Adjustments Certificate in Appendix D of the Actuary's Report, included at Appendix 1.

4. Measures of success

4.1 The funding strategy should ensure that the Fund has sufficient assets to meet pension obligations in the long term. The minimum contribution rates payable by the employer are certified by the Fund's Actuary in accordance with the professional standards of the Institute and Faculty of Actuaries.

5. Financial impact

5.1 The funding strategy should ensure that the Fund has sufficient assets in the long term to meet its liabilities.

5.2 The results of the actuarial valuation have significant financial impact on the Fund's employers. The actuarial valuation sets the minimum contribution rates payable by the employer over the next 3 years.

6. Risk, policy, compliance and governance impact

6.1 The Lothian Pension Fund is required by law to undertake an actuarial valuation once every three years. Regular actuarial assessment of the Fund manages the risk of not meeting funding objectives.

7. Equalities impact

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

8. Sustainability impact

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

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

9.2 Briefings on the draft results of the actuarial valuation were held for members of the Committee and Pension Board in October 2017 and February 2018. These included presentations by the Fund's Actuary.

9.3 Consultation with the Fund's employers has been undertaken on the proposed changes to the Funding Strategy Statement. The Actuary provided a presentation on the actuarial valuation at the Fund's annual employer seminar on 2 November 2017.

9.4 Further meetings and discussions were held with employers in late 2017 and early 2018 to consider the valuation in greater detail, particularly with those employers directly impacted by the changes to the funding approach.

10. Background reading/external references

10.1 None

Stephen S. Moir

Executive Director of Resources

Contact: Clare Scott, Chief Executive Officer, Lothian Pension Fund

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

11. Appendices

Appendix 1: Actuarial Valuation 2017 Lothian Pension Fund

Appendix 1

Lothian Pension Fund

2017 Actuarial Valuation Report

March 2018

DRAFT

Richard Warden
Laura McInroy

Fellows of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP

Contents

Executive summary

We have carried out an actuarial valuation of the Lothian Pension Fund as at 31 March 2017. The results are presented in this report and are briefly summarised below.

Funding position

The table below summarises the funding position of the Fund as at 31 March 2014 and 31 March 2017:

Past Service Position	31 March 2014 (£m)	31 March 2017 (£m)
Past Service Liabilities	4,796	6,743
Market Value of Assets	4,379	6,598
Surplus / (Deficit)	(417)	(145)
Funding Level	**91%**	**98%**

The funding level has improved due to positive membership experience and better than anticipated investment returns. These have been partially offset by a reduction in future expected investment returns. Further details are set out in **Section 4**.

Contribution rates

The table below summarises the whole fund Primary and Secondary Contribution rates at this triennial valuation:

Primary Rate (% of pay) 1 April 2018 - 31 March 2021	Secondary Rate (£) 2018/2019	2019/2020	2020/2021
31.8%	-76,175,000	-76,293,000	-75,433,000

At the previous formal valuation at 31 March 2014, a different regulatory regime was in force. Therefore a contribution rate that is directly comparable to the rates above is not provided.

Employer contribution rates have increased on average compared to the 2014 valuation of the Fund. Primary contributions have increased due to a reduction in future expected investment returns. Improvements in funding levels have reduced secondary contributions which has partially offset the effect of this. However, it should be noted that changes to contribution rates at employer level have been variable.

The Fund operates a Contribution Stability Mechanism (CSM) for larger open employers with long term funding horizons and a strong financial covenant. The CSM is to designed to provide greater certainty on contribution rates within specified parameters over the period of the mechanism whilst maintaining a target of full funding. The CSM that was introduced at the 2014 valuation was reviewed at this valuation and found to remain appropriate in relation to contribution rates over the three year period starting on 1 April 2018. A full review of the CSM will be carried out as part of the 2020 valuation.

The minimum contributions to be paid by each employer from 1 April 2018 to 31 March 2021 are shown in the Rates and Adjustments Certificate in **Appendix D**.

Please note the figures in the tables throughout this document have been rounded. As a result, the sum of figures within the tables may not add up due to rounding.

1 Introduction

City of Edinburgh Council ("the Administering Authority") has commissioned us to carry out a formal actuarial valuation of the Lothian Pension Fund ("the Fund") as at 31 March 2017 to fulfil its obligations under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014 ("the Regulations"). Therefore, the totality of our advice in relation to this formal valuation has been addressed to the Administering Authority and it is the only intended user of this advice. All reliances, limitations and caveats, including 3rd party exclusions are set out in **Section 7** of this report.

The purpose of the actuarial valuation is to assess the value of the assets and liabilities of the Fund as at 31 March 2017 and to calculate the required rate of employers' contributions to the Fund for the period from 1 April 2018 to 31 March 2021. This report summarises the results of the valuation and the underlying advice provided to the Administering Authority throughout the valuation process.

This report is the culmination of various other communications which set out our advice in relation to the valuation, in particular:

- Our 2017 valuation toolkit which set out our proposed valuation methodology;
- Correspondence relating to data including the Data Report dated 5 March 2018;
- The Initial Results report dated 28 September 2017 which outlined the whole fund results and proposed valuation assumptions; and
- The Employer Results Schedules and Employer Results Report which set out our recommended employer contribution rates.

2 Valuation Approach

The valuation is a planning exercise for the Fund, to assess the monies needed to meet the benefits owed to its members as they fall due. As part of the valuation process the Fund reviews its funding strategy to ensure that an appropriate contribution plan and investment strategy is in place.

It is important to realise that the actual cost of the pension fund (i.e. how much money it will ultimately have to pay out to its members in the form of benefits) is unknown. This cost will not be known with certainty until the last benefit is paid to the last pensioner. The purpose of this valuation is to estimate what this cost will be, so that the Fund can then develop a funding strategy to meet it.

Setting the funding strategy for an open defined benefit pension fund such as the Lothian Pension Fund is complex. Firstly, the time period is very long; benefits earned in the LGPS today will be paid out over a period of the next 80 years or more and it remains open to new joiners and accrual of benefits. Secondly, the LGPS remains a defined benefit scheme so there are significant uncertainties in the final cost of the benefits to be paid. Finally, in order to reduce employer costs, the Lothian Pension Fund invests in a return seeking investment strategy which can result in high levels of asset volatility.

Such a valuation can only ever be an estimate as the future cannot be predicted with certainty. However, as actuaries, we can use our understanding of the Fund and the factors that affect it to set the pace of funding in conjunction with the Administering Authority. The pace of this funding can vary according to the level of prudence that is built into the valuation method and assumptions.

The approach to setting employer contribution rates is as follows:

Step 1: The Fund sets a funding target (or funding basis) which defines the target amount of assets to be held to meet the future cashflows. The assumptions underlying the funding target are discussed further in the next section. A measurement is made at the valuation date to compare the assets held with the funding target.

Step 2: The Fund sets the time horizon over which the funding target is to be reached

Step 3: The Fund sets contributions that aim to meet the funding target over the set time horizon.

For this valuation, as for the previous valuation, our calculations identify separately the expected cost of members' benefits in respect of scheme membership completed before the valuation date ("past service") and that which is expected to be completed after the valuation date ("future service").

Past service

The principal measurement here is the comparison of the funding position at the valuation date against the funding target. The market value of the Fund's assets as at the valuation date are compared against the value placed on the Fund's liabilities in today's terms (calculated using a market-based approach). By maintaining a link to the market in both cases, this helps ensure that the assets and liabilities are valued in a consistent manner. Our calculation of the Fund's liabilities also explicitly allows for expected future pay and pension increases. The assumptions used in the assessment of the funding position at the valuation date are detailed in the next section.

The funding level is the ratio of assets to liabilities at the valuation date. A funding level of less/more than 100% implies that there is a deficit/surplus in the Fund at the valuation date against the funding target.

Funding plans are set to eliminate any deficit (or surplus) over the set time horizon and therefore get back to a funding level of 100%. To do so, additional contributions may be required to be paid into the Fund; these contributions are known as the "secondary rate".

Future service

In addition to benefits that have already been earned by members prior to the valuation date, employee members will continue to earn new benefits in the future. The cost of these new benefits must be met by both employers and employees. The employers' share of this cost is known as the "primary rate".

For employers that continue to admit new entrants to the Fund, we have calculated the primary rate as the cost of benefits being earned by members over the year following the valuation, taking account of expected future salary increase until retirement. If new entrants are admitted to the Fund to the extent that the overall membership profile remains broadly unchanged (and if the actuarial assumptions are unchanged) then the future service rate should be reasonably stable. This funding method we have used is known as the Projected Unit Method.

However, some participating employers may have a policy of not admitting new entrants. In this case, the membership profile will inevitably begin to age. Under these circumstances, the Projected Unit Method is arguably no longer appropriate and will not promote sufficient stability in the future service rate. For these employers, we have adopted a funding method known as the Attained Age Method, which effectively looks at the cost of benefits that members will earn over the entirety of their remaining working lifetimes (rather than just the year following the valuation). Combining this primary rate with any secondary rate required to repay a deficit (or reduce a surplus) gives us the Employer's total contribution rate.

Benefits

The scheme rules and benefits are set out in the Regulations. For further details, please refer to the timeline regulations on http://www.scotlgpsregs.org/.

3 Assumptions

Due to the long term nature of the Fund, assumptions about the future are required to place a value of the benefits earned to date and the cost of benefits that will be earned in the future. These assumptions broadly fall into two categories – financial and demographic.

Financial assumptions

Financial assumptions relate to the **size** of members' benefits. For example, how members' pensions will increase over time. In addition, the financial assumptions also help us to estimate how much members' benefits will cost the Fund in today's money by making an assumption about the return on the Fund's investments in future.

Discount rate

In order to place a current value on the future benefit payments from the Fund, an assumption about future investment returns is required in order to "discount" future benefit payments back to the valuation date.

For a funding valuation such as this, the discount rate is required by the Regulations to incorporate a degree of prudence. The discount rate is set by taking into account the Fund's current and expected future investment strategy and, in particular, how this strategy is expected to outperform the returns from Government bonds over the long term. The additional margin for returns in excess of that available on Government bonds is called the Asset Outperformance Assumption (AOA).

The selection of an appropriate AOA is a matter of judgement and the degree of risk inherent in the Fund's investment strategy should always be considered as fully as possible. The Fund now operates three different investment strategies aimed at different employer groups:

1. Primary - a long-term investment strategy designed for open employers, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer

2. Medium Risk - this strategy is being introduced from 1 April 2018, and is designed for closed employers where exit is likely to be in the medium to longer term. It will act as a transition between the Primary Strategy and the Lower Risk Strategy, with investments will be targeted to represent 50% allocation from both the Primary Strategy and the Lower Risk Strategy.

3. Lower Risk - this strategy was introduced from 1 April 2015. It is designed for closed employers which have a short expected duration in the Fund and invests only in index-linked Government bonds.

The Fund is satisfied that AOAs of 1.5% p.a., 0.75% p.a. and 0.0% p.a. respectively for these three strategies are prudent assumptions for the purposes of this valuation. This is the same as the AOAs used at the 2014 valuation for the Primary and Lower risk strategies (the Medium risk strategy was not in place at that time).

For the avoidance of doubt, the results shown in this report are based on an AOA of 1.5% p.a. The contribution rate for each employer is however calculated by reference to the relevant investment strategy.

Price inflation / benefit increases

Benefit increases are awarded in line with the Consumer Prices Index (CPI). As there continues to be no deep market for CPI linked financial instruments, the Fund derives the expected level of future CPI with reference to the Retail Prices Index (RPI).

Similar to previous valuations, the assumption for RPI is derived as the difference between the yield on long dated fixed interest and index-linked government bonds. In line with recent experience and projections by the Bank of England, CPI is assumed to be, on average, 1.0% p.a. lower than RPI over the long term (compared to 0.8% p.a. as at the 2014 valuation).

Salary increases

Due to the change to a CARE scheme from 2015, there is now a closed group of membership in the Fund with benefits linked to final salary. The run-off of this final salary linked liability was modelled, taking into account the short-term restrictions in public sector pay growth. The results of this modelling and analysis were reported in our "2017 valuation – Pay growth assumption" paper dated 8 September 2017. Based on the results of this modelling the Fund set a salary growth assumption of RPI plus 0.7% (compared to an assumption of 2.0% per annum for 2 years followed by 1.5% above RPI at the 2014 valuation).

A summary of the financial assumptions underpinning the target funding basis and adopted during the assessment of the liabilities of the Fund as at 31 March 2017 (alongside those adopted at the last valuation for comparison) are shown below.

Financial assumptions	31 March 2014	31 March 2017
Discount rate (p.a.)		
Return on long-dated gilts	3.5%	1.7%
Asset Outperformance Assumption*	1.5%	1.5%
Discount rate	**5.0%**	**3.2%**
Benefit increases (p.a.)		
Retail Prices Inflation (RPI)	3.5%	3.4%
Assumed RPI/CPI gap*	(0.8%)	(1.0%)
Benefit increase assumption (CPI)	**2.7%**	**2.4%**
Salary increases (p.a.)		
Retail Prices Inflation (RPI)	3.5%	3.4%
Increases in excess of RPI*	1.5%	0.7%
Salary increase assumption	**5.0%****	**4.1%**

**Applied arithmetically in 2014 and geometrically in 2017*

*** 2.0% p.a. for 2014/15 and 2015/16, reverting to 5.0% thereafter. Excludes promotional increases.*

Demographic assumptions

Longevity

The main demographic assumption to which the valuation results are most sensitive is that relating to the longevity of the Fund's members. The longevity assumptions result in the following typical future life expectancies from age 65 (figures for 2014 are shown for comparison):

	31 March 2014	31 March 2017
Male		
Pensioners	22.1 years	21.7 years
Non-pensioners	24.2 years	24.7 years
Female		
Pensioners	23.7 years	24.3 years
Non-pensioners	26.3 years	27.5 years

Further details of the longevity assumptions adopted for this valuation can be found in **Appendix B**. Note that the figures for non-pensioners assume they are aged 45 at the valuation date.

Other demographic assumptions

We are in the unique position of having a very large local authority data set from which to derive our other demographic assumptions. We have analysed the trends and patterns that are present in the membership of local authority funds and tailored our demographic assumptions to reflect LGPS experience. Details of the other demographic assumptions adopted by the Fund are set out in **Appendix B**.

Further comments on the assumptions

We are required to include a degree of prudence within the valuation. This has been achieved by explicitly allowing for a margin of prudence in the discount rate. All other proposed assumptions represent our "best estimate" of future experience. If the discount rate was chosen to be best estimate (i.e. to have a 50% probability the Fund's investment strategy will outperform the chosen discount rate), the discount rate would be set at around 5.0% p.a.

4 Results

The Administering Authority has prepared a Funding Strategy Statement which sets out its funding objectives for the Fund. In broad terms, the main valuation objectives are to hold sufficient assets in the Fund to meet the assessed cost of members' accrued benefits on the target funding basis ("the Funding Objective") and to set employer contributions which ensure both the long term solvency and the long term cost efficiency of the Fund ("the Contribution Objective").

Funding Position Relative to Funding Target

In assessing the extent to which the Funding Objective was met at the valuation date, we have used the actuarial assumptions described in the previous section of this report for the target funding basis and the funding method also earlier described. The table below compares the value of the assets and liabilities at 31 March 2017. The 31 March 2014 results are also shown for reference.

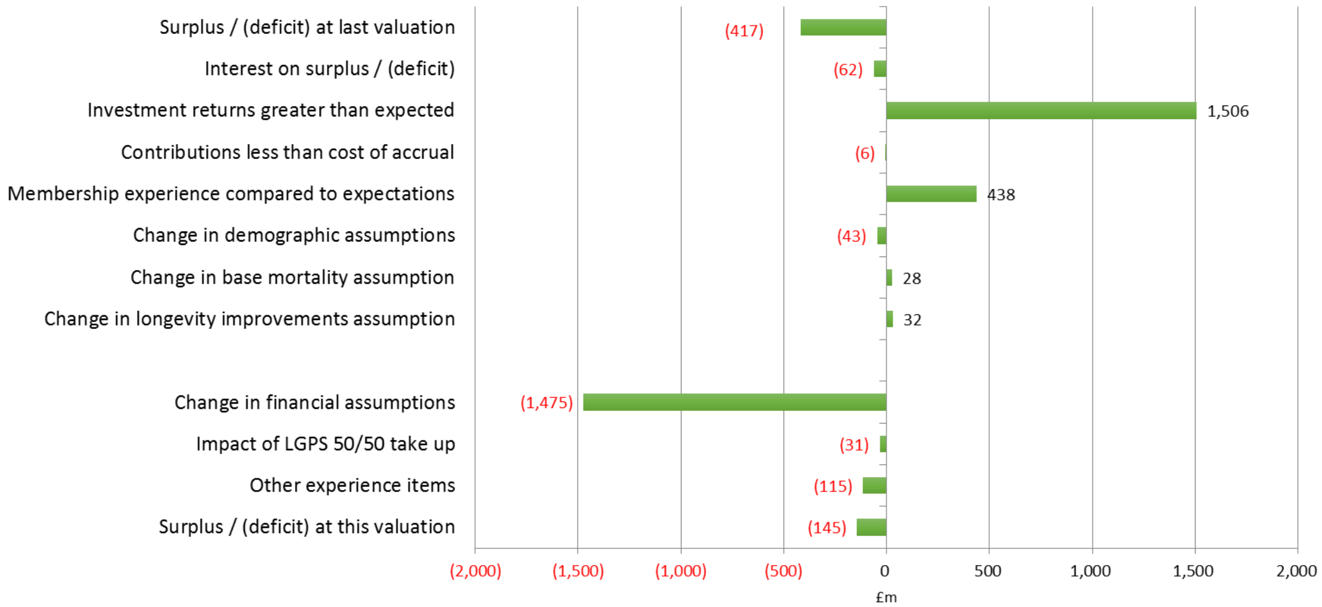
A funding level of 100% would correspond to the Funding Objective being met at the valuation date.

Valuation Date	31 March 2014	31 March 2017
Past Service Liabilities	**(£m)**	**(£m)**
Actives (CARE)	-	430
Actives (Final Salary)	2,276	2,695
Deferred Pensioners	564	944
Pensioners	1,956	2,674
Total Liabilities	**4,796**	**6,743**
Assets	**4,379**	**6,598**
Surplus / (Deficit)	**(417)**	**(145)**
Funding Level	**91%**	**98%**

The Funding Objective was not met: there was a shortfall of assets relative to the assessed cost of members' benefits on the target funding basis of £145m.

Summary of changes to the funding position

The chart below illustrates the factors that caused the changes in the funding position between 31 March 2014 and 31 March 2017:



Further comments on this chart are set out below:

- There is an interest loss of £62m. This is broadly three years of compound interest at 5.0% p.a. applied to the previous valuation deficit of £417m (and can be thought of as the investment return that would have been achieved on the extra assets the Fund would have held if fully funded).
- Investment returns being higher than expected since 2014 lead to a gain of £1,506m. This is roughly the difference between the actual three-year return (51.0%) and expected three-year return (15.8%) applied to the whole fund assets from the previous valuation of £4,379m, with a further allowance made for cashflows during the period.
- The impact of the change in demographic assumptions has been a loss of around £43m.
- The change in mortality assumptions (baseline and improvements) has given rise to a gain of £60m. .
- The change in financial conditions since the previous valuation has led to a loss of £1,475m. This is due to a decrease in the real discount rate between 2014 and 2017. This has partially been offset by the increase to 1.0% p.a. of the assumed gap between RPI and CPI and a reduction in the expected future salary growth for benefits linked to final salary.
- Membership experience over the 3 years has led to a gain of £406m. The most material items of membership experience have been:
    - Lower than expected salary increases leading to a gain of £229m
    - Lower than expected pension increases leading to gain of £176m
    - Lower than expected take up of the 50:50 scheme leading to a loss of £31m.

Projection of the funding position

The progression of the funding position will depend on various factors including future asset performance, economic conditions and membership movements. If the financial and demographic assumptions we have made at this valuation are borne out in practice, and there are no changes to the valuation assumptions, we project that the funding level at the 2020 valuation date will be 95%. This allows for contributions to be paid as detailed below.

Employer Contribution Rates

The Contribution Objective is achieved by setting employer contributions which are likely to be sufficient to meet both the cost of new benefits accruing and to address any funding surplus or deficit relative to the funding target over the agreed time horizon. A secondary objective is to maintain relatively stable employer contribution rates.

We have used the methodology set out in **Section 2** of this report as well as the Fund's Funding Strategy Statement to set employer contributions rates from 1 April 2018. These are set out in the Rates and Adjustments Certificate as set out in **Appendix D.**

The table below summarises the whole fund Primary and Secondary Contribution rates at this valuation. The Primary rate is the payroll weighted average of the underlying individual employer primary rates and the Secondary rate is the total of the underlying individual employer secondary rates, calculated in accordance with the Regulations and CIPFA guidance.

Primary Rate (% of pay) 1 April 2018 - 31 March 2021	Secondary Rate (£) 2018/2019	2019/2020	2020/2021
31.8%	-76,175,000	-76,293,000	-75,433,000

The Primary rate also includes an allowance of 0.3% of pensionable pay for the Fund's expenses.

The Fund's "Common Contribution rate" as at 31 March 2014 was 23.1% of pay. However, it should be noted that the change in regulatory regime and guidance on contribution rates means that any direct comparison between the whole fund rate at 2017 and the 2014 Common Contribution Rate is not appropriate.

5 Risk Assessment

The valuation results depend critically on the actuarial assumptions that are made about the future of the Fund. If all of the assumptions made at this valuation were exactly borne out in practice then the results presented in this document would represent the true cost of the Fund as it currently stands at 31 March 2017.

However, no one can predict the future with certainty and it is unlikely that future experience will exactly match the assumptions. The future therefore presents a variety of risks to the Fund and these should be considered as part of the valuation process. In particular:

- The main risks to the financial health of the Fund should be **identified**.
- Where possible, the financial significance of these risks should be **quantified**.
- Consideration should be given as to how these risks can then be **controlled** or **mitigated**.
- These risks should then be **monitored** to assess whether any mitigation is actually working.

This section investigates the potential implications of the actuarial assumptions not being borne out in practice.

Set out below is a brief assessment of the main risks and their effect on the valuation past service funding position results.

Sensitivity of past service funding position results to changes in assumptions

The table below gives an indication of the sensitivity of the funding position to small changes in two of the main financial assumptions used:

Discount Rates (p.a.)		Benefit Increases (p.a.)			
		2.7%	2.4%	2.1%	
	2.7%	(980) 87%	(655) 91%	(342) 95%	(Deficit) Funding Level
	3.2%	(447) 94%	(145) 98%	145 102%	(Deficit) Funding Level
	3.7%	45 101%	326 105%	595 110%	(Deficit) Funding Level

The valuation results are also very sensitive to unexpected changes in future longevity. All else being equal, if longevity improves in the future at a faster pace than allowed for in the valuation assumptions, the funding level will decline and the required employer contribution rates will increase.

The proposed valuation assumption assumes that in the longer term mortality rates will fall at a rate of 1.25% each year. The more prudent assumption shown in the table below for sensitivity analysis assumes that mortality rates will fall at a rate of 1.5% each year in the longer term.

	1.25% long term rate of improvement	1.5% long term rate of improvement
(Deficit) Funding Level	(145) 98%	(223) 97%

This is not an exhaustive list of the assumptions used in the valuation. For example, changes to the assumed level of withdrawals and ill health retirements will also have an effect on the valuation results.

Note that the tables show the effect of changes to each assumption in isolation. In reality, it is perfectly possible for the experience of the Fund to deviate from more than one of our assumptions simultaneously and so the precise effect on the funding position is therefore more complex. Furthermore, the range of assumptions shown here is by no means exhaustive and should not be considered as the limits of how extreme experience could actually be.

Sensitivity of contribution rates to changes in assumptions

The employer contribution rates are dependent on a number of factors including the membership profile, current financial conditions, the outlook for future financial conditions, and demographic trends such as longevity. Changes in each of these factors can have a material impact on the contribution rates (both primary and secondary rates). We have not sought to quantify the impact of differences in the assumptions because of the complex interactions between them.

Funding risks

Employers participating in the Fund are exposed to a number of risks. These include, but are not limited to:

- Market risks – these include investment returns being less than anticipated or liabilities increasing more than expected due to changes in market conditions underlying the financial assumptions (e.g. inflation or pay increases above that assumed in **Section 3**).
- Demographic risks – these include anything that affects the timing or type of benefits (e.g. members living longer than anticipated, fewer members opting into the 50/50 option, etc.). In particular, early retirement on ill-health grounds can result in significant funding strains.
- Regulatory risks – changes in the Regulations could materially affect the benefits that members become entitled to. It is difficult to predict the nature of any such changes but it is not inconceivable that they could affect not just the cost of benefits earned after the change but could also have a retrospective effect on the past service position.
- Administration and Governance risks – failures in administration processes can lead to incorrect actuarial calculations. For example, where membership data is not up to date (e.g. leaver forms not being submitted in a timely matter) material inaccuracies in respect of the level of deficit and contributions may occur at future valuations
- Environmental risks – i.e. risks relating to environmental changes, and their impact on Fund employers and investments: such risks exist and may prove to be material. Given the lack of relevant quantitative information available specifically relevant to the Fund, we have not explicitly incorporated such risks in our advice on the 2017 valuation. The Administering Authority and the Employers may wish to seek direct advice on these risks.

Investment risk

The Fund holds some of its assets in return seeking assets such as equities to help reduce employers' costs. However, these types of investments can result in high levels of asset volatility. Therefore, there is a risk that future investment returns are below expectations and the funding target is not met. This will require additional contributions from employers to fund any deficit.

Whilst the Fund takes steps to ensure that the level of investment risk is managed and monitored via strategy reviews and performance monitoring, it can never be fully mitigated.

Managing the risks

Whilst there are certain things, such as the performance of investment markets or the life expectancy of members, that are not directly within the control of the pension fund, that does not mean that nothing can be done to understand them further and to mitigate their effect. Although these risks are difficult (or impossible) to eliminate, steps can be taken to manage them.

Ways in which some of these risks can be managed could be:

- Set aside a specific reserve to act as a cushion against adverse future experience (possibly by selecting a set of actuarial assumptions that are deliberately more prudent).
- Take steps internally to monitor the decisions taken by members (e.g. 50:50 scheme take-up, commutation) and employers (e.g. relating to early / ill health retirements or salary increases) in a bid to curtail any adverse impact on the Fund.
- Pooling certain employers together at the valuation and then setting a single (pooled) contribution rate that they will all pay. This can help to stabilise contribution rates (at the expense of cross-subsidy between the employers in the pool during the period between valuations). The Fund currently has a pool for small open Community Admission Bodies.
- Carrying out a review of the future security of the Fund's employers (i.e. assessing the strength of employer covenants) and ultimately their ability to continue to pay contributions or make good future funding deficits. The Fund carried this out as part of the 2017 valuation.
- Undertake an asset-liability modelling exercise that investigates the effect on the Fund of possible investment scenarios that may arise in the future. An assessment can then be made as to whether long term, secure employers in the Fund can stabilise their future contribution rates (thus introducing more certainty into their future budgets) without jeopardising the long-term health of the Fund. The Fund carried out such an exercise at the 2014 valuation, and has set up a contribution stability mechanism for long term and secure employers. It was reviewed and found to remain fit for purpose at the 2017 valuation, with the next full modelling exercise being due at the 2020 valuation.
- Managing ill health liabilities e.g. via ill health "budgets" or external insurance, to mitigate the risk of an ill health retirement impacting on solvency and funding level of an individual employer where appropriate.
- Monitoring different employer characteristics in order to build up a picture of the risks posed. Examples include membership movements, cash flow positions and employer events such as cessations. The Fund carries out quarterly membership monitoring.
- Regularly reviewing the Fund's membership data to ensure it is complete, up to date and accurate.

6 Related issues

The Fund's valuation operates within a broader framework, and this document should therefore be considered alongside the following:

- the Funding Strategy Statement, which in particular highlights how different types of employer in different circumstances have their contributions calculated;
- the Statement of Investment Principles (e.g. the discount rate must be consistent with the Fund's asset strategy);
- the general governance of the Fund, such as meetings of the Pensions Committee, decisions delegated to officers, the Fund's business plan, etc;
- the Fund's risk register;
- the information the Fund holds about the participating employers.

Further recommendations

Valuation frequency

Under the provisions of the LGPS regulations, the next formal valuation of the Fund is due to be carried out as at 31 March 2020. In light of the uncertainty of future financial conditions, we recommend that the financial position of the Fund (and for individual employers in some cases) is monitored by means of interim funding reviews. This will give early warning of changes to funding positions and possible revisions to funding plans.

Investment strategy and risk management

We recommend that the Administering Authority continues to regularly review its investment strategy and ongoing risk management programme.

New employers joining the Fund

Any new employers or admission bodies joining the Fund should be referred to the Fund Actuary to assess the required level of contribution. If members are transferring from a ceding employer, that employer's rate may also need to be reviewed depending on the numbers involved. Please see Appendix A of the Funding Strategy Statement for further details regarding the Fund's admission policy.

Additional payments

Employers may make voluntary additional contributions to recover any funding shortfall over a shorter period, subject to agreement with the Administering Authority and after receiving the relevant actuarial advice.

Further sums should be paid to the Fund by employers to meet the capital costs of any unreduced early retirements, reduced early retirements before age 60 and/or augmentation (i.e. additional membership or additional pension) using the methods and factors issued by me from time to time or as otherwise agreed.

In addition, payments may be required to be made to the Fund by employers to meet the capital costs of any ill-health retirements that exceed those allowed for within our assumptions.

Cessations and bulk transfers

Any employer who ceases to participate in the Fund should be referred to us in accordance with Regulation 62 of the Regulations.

Any bulk movement of scheme members:

- involving 10 or more scheme members being transferred from or to another LGPS fund, or
- involving 2 or more scheme members being transferred from or to a non-LGPS pension arrangement;

should be referred to us to consider the impact on the Fund.

Please refer to Appendices B and C of the Funding Strategy Statement for further details regarding the policies on cessations and bulk transfers.

7 Reliances and limitations

Third parties

This document has been prepared for the sole use of City of Edinburgh Council in its role as Administering Authority of the Fund and not for any other third party. Hymans Robertson LLP makes no representation or warranties to any third party as to the accuracy or completeness of this report. This report will therefore not address the particular interests or concerns of any such third party.

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The Report must not be used for any commercial purposes unless Hymans Robertson LLP agrees in advance.

Component reports

As set out in **Section 1** and **Section 6**, the totality of our advice pertaining to the valuation is set out over a number of component communications and complies with the various professional and regulatory requirements related to public sector actuarial valuations in Scotland. The reliances, limitations and caveats within this report and each component report apply equally across the totality of our advice.

Model limitations

The models used to calculate the assets, liabilities, contribution rates and the level of indemnity make some necessary simplifying assumptions. I do not consider these simplifications to be material and I am satisfied that they are appropriate for the purposes described in this report.

Limited purpose

This document has been prepared to fulfil the statutory obligations of the Administering Authority to carry out a formal actuarial valuation. None of the figures should be used for accounting purposes (e.g. under FRS102 or IAS19) or for any other purpose (e.g. a termination valuation under Regulation 62).

Reliance on data

The results of the valuation are dependent on the quality of the data provided to us by the Administering Authority for the specific purpose of this valuation. We have previously issued a separate report confirming that the data provided is fit for the purposes of this valuation and have commented on the quality of the data provided. The data used in our calculations is as per our report of 5 March 2018.

Actuarial standards

The following Technical Actuarial Standards[1] are applicable in relation to this report and have been complied with:

- TAS 100 – Principles for technical actuarial work;
- TAS 300 – Pensions.

No material deviations have been made from the above actuarial standards.

[1] Technical Actuarial Standards (TASs) are issued by the Financial Reporting Council (FRC) and set standards for certain items of actuarial work, including the information and advice contained in this report.

Compliance statement

The totality of our advice complies with the Regulations as they pertain to actuarial valuations.

Richard Warden

Fellow of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

14 March 2018

Laura McInroy

Fellow of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

14 March 2018

Appendix A: Data

This section contains a summary of the membership, investment and accounting data provided by the Administering Authority for the purposes of this valuation (the corresponding membership and investment data from the previous valuation is also shown for reference). For further details of the data, and the checks and amendments performed in the course of this valuation, please refer to our separate data report.

Membership data – whole fund

Employee members

	31 March 2014		31 March 2017		
	Number	Pensionable Pay* (£000)	Number	Pensionable Pay* (£000)	CARE Pot (£000)
Total employee membership	31,536	648,929	32,010	669,426	24,911

*actual pay (not full-time equivalent)

Deferred pensioners

	31 March 2014		31 March 2017	
	Number	Deferred pension (£000)	Number	Deferred pension (£000)
Total deferred membership	17,094	32,444	18,383	41,772

The figures above also include any “frozen refunds” and “undecided leavers” members at the valuation date.

Current pensioners, spouses and children

	31 March 2014		31 March 2017	
	Number	Pension (£000)	Number	Pension (£000)
Members	20,143	115,476	22,483	135,803
Dependants	3,750	10,645	3,660	11,288
Children	162	319	166	351
Total pensioner members	**24,055**	**126,440**	**26,309**	**147,442**

Note that the membership numbers in the table above refer to the number of records provided to us and so will include an element of double-counting in respect of any members who are in receipt (or potentially in receipt of) more than one benefit.

Membership Profile	Average Age (years)		FWL (years)	
	2014	2017	2014	2017
Employees (CARE)	-	48.3	12.1	14.7
Employees (Final Salary)	51.1	50.9		
Deferred Pensioners	50.3	50.2	-	-
Pensioners	66.6	66.7	-	-

The average ages are weighted by liability.

The expected future working lifetime (FWL) indicates the anticipated length of time that the average employee member will remain as a contributor to the Fund. Note that it allows for the possibility of members leaving, retiring early or dying before retirement.

Assets at 31 March 2017

As the Fund tracks employer asset values on a monthly basis using actual cashflows, the asset values at 31 March 2017 are on a 'cash' basis. This is different to the basis used to prepare the Fund's Annual Report and Accounts (which is on an 'accruals' basis). Therefore the asset value at 31 March 2017 will not match that disclosed in the Fund's Annual Report and Accounts. The figures below are based on the Fund's Annual Report and Accounts and have been used to check the monthly data submitted for the purpose of asset tracking.

A summary of the Fund's assets provided by the Administering Authority (excluding members' money-purchase Additional Voluntary Contributions) as at 31 March 2017 is as follows:

Asset class	31 March 2017 (Market Value) (£000)	Allocation %
UK equities	251,423	4%
UK fixed interest gilts	159,307	2%
UK corporate bonds	0	0%
UK index-linked gilts	505,109	8%
Overseas equities*	4,804,037	72%
Overseas bonds**	235,908	4%
Property	452,612	7%
Cash and net current assets	187,034	3%
Total	**6,595,430**	**100%**

**Includes Private Equity, Infrastructure and Commodities*

*** Includes Private Debt and Timber*

Accounting data – revenue account for the three years to 31 March 2017

Consolidated accounts (£000)	Year to			Total
	31 March 2015	30 March 2016	31 March 2017	
Income				
Employer - normal contributions	136,379	140,376	140,884	417,639
Employer - additional contributions	11	16	24	51
Employer - early retirement and augmentation strain contributions	6,047	19,480	12,827	38,354
Employee - normal contributions	41,526	42,061	41,954	125,541
Employee - additional contributions	817	739	624	2,180
Transfers In Received (including group and individual)	6,452	2,780	5,536	14,768
Other Income	0	0	0	0
Total Income	**191,232**	**205,452**	**201,849**	**598,533**
Expenditure				
Gross Retirement Pensions	128,701	133,624	141,778	404,103
Lump Sum Retirement Benefits	31,456	46,315	48,895	126,666
Death in Service Lump sum	3,593	5,336	6,384	15,313
Death in Deferment Lump Sum	0	0	0	0
Death in Retirement Lump Sum	0	0	0	0
Gross Refund of Contributions	830	936	976	2,742
Transfers out (including bulk and individual)	5,580	6,075	11,098	22,753
Fees and Expenses	1,780	1,743	1,895	5,418
Total Expenditure	**171,940**	**194,029**	**211,026**	**576,995**
Net Cashflow	**19,292**	**11,423**	**-9,177**	**21,538**
Assets at start of year	**4,377,536**	**5,106,232**	**5,434,014**	**4,377,536**
Net cashflow	**19,292**	**11,423**	**-9,177**	**21,538**
Change in value	**709,404**	**316,359**	**1,170,593**	**2,196,356**
Assets at end of year	**5,106,232**	**5,434,014**	**6,595,430**	**6,595,430**
Approximate rate of return on assets	**16.2%**	**6.2%**	**21.6%**	**50.0%**

Note that the figures above are based on the Fund accounts provided to us for the purposes of this valuation, which were fully audited at the time of our valuation calculations.

Appendix B: Assumptions

Financial assumptions

Financial assumptions	31 March 2014 (% p.a.)	31 March 2017 (% p.a.)
Discount rate	5.0%	3.2%
Retail Price inflation	3.5%	3.4%
Pay increases*	5.0%**	4.1%
Pension increases:		
pension in excess of GMP	2.7%	2.4%
post-88 GMP	2.7%	2.4%
pre-88 GMP	0.0%	0.0%
Revaluation of deferred pension	2.7%	2.4%
Revaluation of accrued CARE pension	2.7%	2.4%
Expenses	0.3%	0.3%

**An allowance is also made for promotional pay increases (see table below).*

*** 2.0% p.a. for 2014/15 and 2015/16, reverting to 5.0% p.a. thereafter.*

Longevity assumptions

As the fund is a member of Club Vita, the baseline longevity assumptions are a bespoke set of Vita Curves that are tailored to fit the membership profile of the Fund. These curves are based on the data the Fund has provided us with for the purposes of this valuation. Full details of these are available on request.

We have also allowed for future improvements in mortality based on the CMI 2016 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.25% p.a..

Other demographic valuation assumptions

Retirements in normal health	We have adopted the retirement age pattern assumption as specified by the Scheme Advisory Board in England & Wales for preparing their Key Performance Indicators. Further details about this assumption are available on request.
Retirements in ill health	Allowance has been made for ill-health retirements before Normal Pension Age (see table below).
Withdrawals	Allowance has been made for withdrawals from service (see table below).
Family details	A varying proportion of members are assumed to be married (or have an adult dependant) at retirement or on earlier death. For example, at age 60 this is assumed to be 90% for males and 85% for females. Husbands are assumed to be 3 years older than wives.

Commutation	50% of future retirements elect to exchange pension for additional tax free cash up to HMRC limits for service to 1 April 2009 (equivalent 75% for service from 1 April 2009).
50:50 option	0.0% of members will choose the 50:50 option.

The tables below show details of the assumptions actually used for specimen ages. The promotional pay scale is an annual average for all employees at each age. It is in addition to the allowance for general pay inflation described above. For membership movements, the percentages represent the probability that an individual at each age leaves service within the following twelve months. The abbreviations FT and PT refer to full-time and part-time respectively.

Males

Age	Salary Scale	Incidence per 1000 active members per annum						
		Death Before Retirement	Withdrawals		Ill Health Tier 1		Ill Health Tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.27	96.58	223.33	0.00	0.00	0.00	0.00
25	117	0.27	63.79	147.52	0.15	0.02	0.13	0.02
30	131	0.32	45.25	104.64	0.28	0.04	0.23	0.03
35	144	0.38	35.35	81.74	0.55	0.18	0.46	0.15
40	150	0.64	28.44	65.77	0.83	0.30	0.69	0.24
45	157	1.07	23.28	53.82	1.32	0.59	1.09	0.49
50	162	1.72	18.03	41.69	2.48	1.38	2.59	1.45
55	162	2.68	17.32	40.05	7.77	5.17	4.67	3.11
60	162	4.83	15.43	35.67	13.21	9.05	3.87	2.65
65	162	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Females

Age	Salary Scale	Incidence per 1000 active members per annum						
		Death Before Retirement	Withdrawals		Ill Health Tier 1		Ill Health Tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.14	76.49	129.80	0.00	0.00	0.00	0.00
25	117	0.14	51.45	87.32	0.19	0.16	0.15	0.13
30	131	0.21	43.12	73.18	0.25	0.21	0.21	0.18
35	144	0.34	37.19	63.11	0.48	0.40	0.40	0.33
40	150	0.55	30.93	52.49	0.72	0.60	0.60	0.50
45	157	0.89	25.46	43.21	0.96	0.80	0.79	0.66
50	162	1.30	19.40	32.93	1.76	1.44	1.84	1.51
55	162	1.71	18.15	30.80	6.43	5.22	3.87	3.14
60	162	2.19	14.59	24.76	13.55	10.94	3.97	3.20
65	162	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Appendix C: Events since valuation date

Post-valuation events

These valuation results are in effect a snapshot of the Fund as at 31 March 2017. Since that date, various events have had an effect on the financial position of the Fund. Whilst we have not explicitly altered the valuation results to allow for these events, a short discussion of these “post-valuation events” can still be beneficial in understanding the variability of pension funding.

In the period from the valuation date to end February 2018, asset returns have been better than expected which improves the Fund’s funding position. This has been mostly offset by a fall in yields which places a higher value on the past service liabilities. Overall, the funding position at end February 2018 is expected to be broadly similar to that at 31 March 2017. It should be noted that the above is for information only: the figures in this report have all been prepared using membership data, audited asset information and market-based assumptions all as at 31 March 2017. In particular, we do not propose amending any of the contribution rates listed in the Rates and Adjustments Certificate on the basis of these market changes.

Appendix D: Rates and adjustments certificate

In accordance with regulation 60(4) of the Regulations we have made an assessment of the contributions that should be paid into the Fund by participating employers for the period 1 April 2018 to 31 March 2021 in order to maintain the solvency of the Fund.

The method and assumptions used to calculate the contributions set out in the Rates and Adjustments certificate are detailed in the Funding Strategy Statement dated March 2018 and our report on the actuarial valuation dated 14 March 2018.

Regulation 60(8) requires a statement of the assumptions on which the certificate is given regarding the number of members, and the associated of liabilities arising, who will become entitled to payment of pensions under the regulations of the LGPS. These assumptions can be found in Appendix B of the 31 March 2017 formal valuation report dated 14 March 2018. These assumptions cover members who become entitled to payment of pension via normal retirement and ill health retirement. Further members will become entitled due to involuntary early retirement (for redundancy and efficiency reasons) for which no allowance has been made.

The required minimum contribution rates are set out below.

Employer code	Employer/Pool name	Primary Rate (%) 1 April 2018 - 31 March 2021	Minimum Contributions for the Year Ending					
			Secondary Rate			Total Contribution Rate		
			2018/2019	2019/2020	2020/2021	2018/2019	2019/2020	2020/2021
Scheduled Bodies (Main Investment Strategy)								
The City of Edinburgh Council	The City of Edinburgh Council	31.8%	-11.2% plus £3,064,300	-10.7% plus £3,064,300	-10.2% plus £3,064,300	20.6% plus £3,064,300	21.1% plus £3,064,300	21.6% plus £3,064,300
Midlothian Council	Midlothian Council	31.7%	-11.0% plus £339,500	-10.5% plus £339,500	-10.0% plus £339,500	20.7% plus £339,500	21.2% plus £339,500	21.7% plus £339,500
East Lothian Council	East Lothian Council	32.0%	-11.1% plus £503,300	-10.6% plus £503,300	-10.1% plus £503,300	20.9% plus £503,300	21.4% plus £503,300	21.9% plus £503,300
West Lothian Council	West Lothian Council	31.9%	-11.4% plus £404,100	-10.9% plus £404,100	-10.4% plus £404,100	20.5% plus £404,100	21.0% plus £404,100	21.5% plus £404,100
8	Heriot-Watt University	32.2%	-11.1% plus £385,900	-10.6% plus £385,900	-10.1% plus £385,900	21.1% plus £385,900	21.6% plus £385,900	22.1% plus £385,900
105	West Lothian College	31.5%	-12.7%	-12.2%	-11.7%	18.8%	19.3%	19.8%
109	Edinburgh College	30.2%	-12.4% plus £229,900	-12.4% plus £229,900	-12.4% plus £229,900	17.8% plus £229,900	17.8% plus £229,900	17.8% plus £229,900
134	Lothian Valuation Joint Board	32.8%	-11.4% plus £3,100	-11.0% plus £3,100	-11.0% plus £3,100	21.4% plus £3,100	21.8% plus £3,100	21.8% plus £3,100
135	Scottish Water (See Note 1)	30.9%	-11.2%	-10.7%	-10.2%	19.7%	20.2%	20.7%
155	Visit Scotland	29.1%	-13.9% plus £75,500	-13.9% plus £75,500	-13.9% plus £75,500	15.2% plus £75,500	15.2% plus £75,500	15.2% plus £75,500
209	SESTRAN	27.7%	-8.7% plus £10,500	-8.2% plus £10,500	-8.2% plus £10,500	19.0% plus £10,500	19.5% plus £10,500	19.5% plus £10,500
899	Scottish Fire and Rescue Service	31.7%	-12.2%	-11.7%	-11.2%	19.5%	20.0%	20.5%
Scottish Police Authority	Scottish Police Authority	32.2%	-13.5% plus £119,100	-13.1% plus £119,100	-12.8% plus £119,100	18.7% plus £119,100	19.1% plus £119,100	19.4% plus £119,100
Transferee Admission Bodies (Main Investment Strategy)								
139	CGI	34.3%	-2.3%	-1.9%	-1.4%	32.0%	32.4%	32.9%
140	Dacoll	34.7%	-2.1%	-1.1%	£100	32.6%	33.6%	34.7% plus £100
165	Amey Services	34.6%	-34.6%	-34.6%	-34.6%	-	-	-
178	Morrison Facilities Services	35.0%	-35.0%	-35.0%	-35.0%	-	-	-
200	Forth & Oban Ltd	33.0%	-18.0%	-18.0%	-18.0%	15.0%	15.0%	15.0%
207	LPFE Limited	30.5%	-6.7%	-3.4%	-0.1%	23.8%	27.1%	30.4%
212	Skanska	36.7%	£1,500	£1,500	£1,500	36.7% plus £1,500	36.7% plus £1,500	36.7% plus £1,500
214	NSL Services Group	35.8%	-35.8%	-35.8%	-35.8%	-	-	-
220	Mitie PFI CEC PP2	35.6%	-35.6%	-35.6%	-35.6%	-	-	-
222	Compass-Chartwell	35.5%	-35.5%	-35.5%	-35.5%	-	-	-
224	BaxterStorey	35.7%	-35.7%	-35.7%	-35.7%	-	-	-
225	Bellrock	34.0%	-2.7%	-2.7%	-2.7%	31.3%	31.3%	31.3%
Small Open Community Admission Bodies Pool (Main Investment Strategy)								
46	Museums Galleries Scotland	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
64	Citadel Youth Centre	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
87	Family Advice & Information Resource	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
90	Handicabs (Lothian) Limited	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
113	Weslo Housing Management	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
117	Scottish Schools Education Research	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
118	Royal Edinburgh Military Tattoo	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
119	Family and Community Development West Lothian	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
121	Edinburgh Development Group	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
123	Scottish Adoption Agency	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
143	First Step	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
147	Melville Housing Association	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
154	St Andrew's Children's Society Limited	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
156	Canongate Youth Project	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
172	Homes for Life Housing Partnership	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
174	Capital City Partnership	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
196	HWU Students Association	31.6%	-10.9%	-9.6%	-8.4%	20.7%	22.0%	23.2%
Other Open Community Admission Bodies (Main Investment Strategy)								
15	Newbattle College	32.0%	-13.1%	-13.1%	-13.1%	18.9%	18.9%	18.9%
21	Audit Scotland	30.5%	-12.8% plus £76,800	-12.3% plus £76,800	-11.8% plus £76,800	17.7% plus £76,800	18.2% plus £76,800	18.7% plus £76,800
28	Convention of Scottish Local Authorities	30.2%	-4.8%	-3.5%	-2.3%	25.4%	26.7%	27.9%
30	Queen Margaret University	30.9%	-11.9% plus £31,900	-11.4% plus £31,900	-10.9% plus £31,900	19.0% plus £31,900	19.5% plus £31,900	20.0% plus £31,900
36	Barony Housing Association Ltd	33.0%	-15.3%	-15.3%	-15.3%	17.7%	17.7%	17.7%
51	Edinburgh Napier University	30.6%	-11.4% plus £166,000	-10.9% plus £166,000	-10.4% plus £166,000	19.2% plus £166,000	19.7% plus £166,000	20.2% plus £166,000
91	EDI Group (see Note 2)	32.1%	£566,800	-	-	32.1% plus £566,800	-	-
133	Children's Hospice Association Scotland	30.7%	-15.5%	-15.0%	-14.5%	15.2%	15.7%	16.2%
157	West Lothian Leisure	31.0%	-16.3%	-16.3%	-16.3%	14.7%	14.7%	14.7%
210	Improvement Service	29.5%	-12.3% plus £27,200	-12.3% plus £27,200	-12.3% plus £27,200	17.2% plus £27,200	17.2% plus £27,200	17.2% plus £27,200
218	Scottish Futures Trust	29.7%	-11.9% plus £81,000	-11.9% plus £81,000	-11.9% plus £81,000	17.8% plus £81,000	17.8% plus £81,000	17.8% plus £81,000
219	Enjoy East Lothian	30.2%	-16.1%	-15.6%	-15.1%	14.1%	14.6%	15.1%
223	Children's Hearing Scotland	29.7%	-14.9% plus £19,400	-14.9% plus £19,400	-14.9% plus £19,400	14.8% plus £19,400	14.8% plus £19,400	14.8% plus £19,400
CABs with Ongoing Cessation Agreement (Main Investment Strategy)								
159	Edinburgh Leisure	34.8%	-14.0%	-11.6%	-9.3%	20.8%	23.2%	25.5%
170	Into Work	36.7%	-36.7%	-36.7%	-36.7%	-	-	-
171	Edinburgh World Heritage Trust (see Note 3)	37.8%	-9.8% plus £3,800	-	-	28.0% plus £3,800	-	-
193	Health in Mind	36.6%	-22.9%	-22.9%	-22.9%	13.7%	13.7%	13.7%
217	Scottish Legal Complaints Commission (SLCC)	33.0%	-15.5%	-15.5%	-15.5%	17.5%	17.5%	17.5%

Employer code	Employer/Pool name	Primary Rate (%) 1 April 2018 - 31 March 2021	Minimum Contributions for the Year Ending					
			Secondary Rate			Total Contribution Rate		
			2018/2019	2019/2020	2020/2021	2018/2019	2019/2020	2020/2021
Closed Community Admission Bodies (Medium Risk Investment Strategy)								
9	University of Edinburgh (E.C.A.)	41.8%	£404,200	£500,700	£597,200	41.8% plus £404,200	41.8% plus £500,700	41.8% plus £597,200
17	Donaldson's Trust	40.9%	-11.3%	-4.0%	£33,400	29.6%	36.9%	40.9% plus £33,400
22	Hanover (Scotland) Housing Association	41.4%	£51,000	£119,300	£187,600	41.4% plus £51,000	41.4% plus £119,300	41.4% plus £187,600
34	St Columba's Hospice	40.9%	-11.3%	-4.0%	£33,400	29.6%	36.9%	40.9% plus £33,400
44	Edinburgh International Festival Society	42.7%	-1.2%	£43,500	£90,000	41.5%	42.7% plus £43,500	42.7% plus £90,000
53	Edinburgh Cyrenians Trust	42.1%	-14.8%	-9.8%	-4.8%	27.3%	32.3%	37.3%
77	Waverley Care Ltd	41.1%	-15.3%	-12.6%	-10.0%	25.8%	28.5%	31.1%
78	ELCAP	42.1%	-15.7%	-11.5%	-7.4%	26.4%	30.6%	34.7%
79	Freespace	42.0%	-19.7%	-19.7%	-19.7%	22.3%	22.3%	22.3%
104	SRUC	42.9%	£50,400	£109,200	£168,000	42.9% plus £50,400	42.9% plus £109,200	42.9% plus £168,000
158	Royal Society of Edinburgh	41.4%	-16.1%	-13.9%	-11.7%	25.3%	27.5%	29.7%
160	Edinburgh Business School	43.1%	-6.4%	£23,000	£64,600	36.7%	43.1% plus £23,000	43.1% plus £64,600
183	Young Scot Enterprise	41.8%	-7.8%	£9,100	£36,200	34.0%	41.8% plus £9,100	41.8% plus £36,200
Closed Community Admission Bodies (Low Risk Investment Strategy)								
11	Homeless Action Scotland (see Note 3)	52.0%	-27.0% plus £4,200	-	-	25.0% plus £4,200	-	-
16	Dean Orphanage & Cauvins Trust	49.5%	£140,100	£140,100	£140,100	49.5% plus £140,100	49.5% plus £140,100	49.5% plus £140,100
38	Four Square (Scotland)	49.0%	£78,100	£78,100	£78,100	49.0% plus £78,100	49.0% plus £78,100	49.0% plus £78,100
50	Centre for the Moving Image (The) (see Note 3)	50.3%	-14.5%	-	-	35.8%	-	-
55	Open Door Accommodation Project	50.4%	£46,400	£46,400	£46,400	50.4% plus £46,400	50.4% plus £46,400	50.4% plus £46,400
59	Penumbra	48.5%	£156,600	£156,600	£156,600	48.5% plus £156,600	48.5% plus £156,600	48.5% plus £156,600
89	North Edinburgh Dementia Care	48.3%	£5,200	£5,200	£5,200	48.3% plus £5,200	48.3% plus £5,200	48.3% plus £5,200
131	West Granton Community Centre	47.2%	£2,400	£2,400	£2,400	47.2% plus £2,400	47.2% plus £2,400	47.2% plus £2,400
173	Pilton Equalities Project	51.9%	£22,500	£22,500	£22,500	51.9% plus £22,500	51.9% plus £22,500	51.9% plus £22,500
185	Youthlink Scotland	48.0%	£9,700	£9,700	£9,700	48.0% plus £9,700	48.0% plus £9,700	48.0% plus £9,700
187	Stepping Out Project	53.6%	£400	£400	£400	53.6% plus £400	53.6% plus £400	53.6% plus £400
188	Scotland's Learning Partnership (see Note 3)	50.5%	-33.4% plus £4,900	-	-	17.1% plus £4,900	-	-
199	Wester Hailes Land & Property	48.2%	£34,100	£34,100	£34,100	48.2% plus £34,100	48.2% plus £34,100	48.2% plus £34,100

Notes:

1 Scottish Water meets the criteria for participation in the Fund's Contribution Stability Mechanism (CSM). For the period from 1 April 2018 to 31 March 2021 the Employer has decided to temporarily opt out of the CSM and instead pay its non-stabilised 2017 valuation contribution rate. The Employer's non-stabilised 2017 contributions are a primary rate of 30.9% of payroll, plus a secondary rate of £415,000 per annum. Furthermore, the Employer pre-paid its calculated secondary rate in March 2018 via an actuarially reduced lump payment of £1,188,000. The contributions shown in the Rates and Adjustments certificate are the minimum contributions the Fund requires the Employer to pay (i.e. the stabilised contribution rate). In practice, it is expected that the Employer will pay 30.9% of payroll for each of the 3 years commencing 1 April 2018.

2 EDI Group is expected to cease participation in the Fund in December 2018, therefore contributions for the period 1 April 2018 to 31 December 2018 have been certified. Should the employer not cease participation at this time, a revised contribution rate will be certified.

3 This employer has contacted the Fund to note its intention to cease participation in the Fund. Participation will cease on 1 July 2018, therefore contributions for the period 1 April 2018 to 30 June 2018 only have been certified. Should the employer not cease participation at this time, a revised contribution rate will be certified.

4 Contributions should be paid into Lothian Pension Fund ('the Fund') at a frequency in accordance with the requirements of the Regulations.

5 Further sums should be paid to the Fund to meet the costs of any non-ill health early retirements and/or augmentations (i.e. additional pension) using methods and factors issued by me from time to time, or GAD guidance if I consider it to be appropriate.

6 In addition, further sums may be required to be paid to the Fund by employers to meet the capital costs of any ill-health retirements that exceed those included within my assumptions.

7 The certified contribution rates represent the minimum level of contributions to be paid. Employing authorities may pay further amounts at any time, and future periodic contributions may be adjusted on a basis approved by the Fund actuary.

Signature:		
Date:	14 March 2018	14 March 2018
Name:	Richard Warden	Laura McInroy
Qualification:	Fellow of the Institute and Faculty of Actuaries	Fellow of the Institute and Faculty of Actuaries
Firm:	Hymans Robertson LLP	Hymans Robertson LLP
	20 Waterloo Street	20 Waterloo Street
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Pensions Committee

2.00pm, Monday, 26 March 2018

2017 Actuarial Valuation for Lothian Buses Pension Fund

Item number	5.6
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

The Lothian Buses Pension Fund is required by law to undertake an actuarial valuation once every three years. The Fund's Actuary assesses the financial health of the pension fund and sets the employer contribution rates required for the next three years.

This report presents the results of the actuarial valuation of the Lothian Buses Pension Fund as at 31 March 2017.

A revised Admission Agreement and Shareholder Guarantee for Lothian Buses plc, formally clarifying the position of the four Councils as guarantors of the pension liabilities in proportion to their respective shareholdings, will be concluded shortly. This will serve to strengthen governance and affirm the employer covenant. The Actuary's certification of the results of the actuarial valuation is predicated upon this assurance and he has reserved the right to revise the certification of the minimum contribution rate(s) should there be any undue delay in the formal signing.

EDINBVRGH
THE CITY OF EDINBURGH COUNCIL

Report

2017 Actuarial Valuation for Lothian Buses Pension Fund

1. Recommendations

Committee is requested to:

1.1 Note the results of the 2017 Actuarial Valuation report for the Lothian Buses Pension Fund; and

1.2 Note that the Actuary's certification of the results of the actuarial valuation is predicated upon a revised Admission Agreement and Shareholder Guarantee for Lothian Buses plc and he has reserved the right to revise the certification of the minimum contribution rate(s) should there be any undue delay in the formal signing.

2. Background

2.1 The Lothian Buses Pension Fund was established in 1986, under The Local Government Superannuation (Funds) (Scotland) Regulations 1986 (SSI 115/1986), as a sub Fund of Lothian Pension Fund.

2.2 The Lothian Buses Pension Fund is required by law to undertake an actuarial valuation once every three years. Based on data as at 31 March 2017, this actuarial valuation must be completed by 31 March 2018.

2.3 The actuarial valuation of the pension fund has three main purposes:

(a) To assess whether the funding strategy and assumptions are appropriate;

(b) To assess the financial health of the pension fund; and

(c) To set the future rates of contributions payable by the employer.

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

2.5 After discussion with shareholder and the company, the investment strategy review, as reported to Committee in March 2016, assumed that Lothian Buses would continue to pay deficit contributions (if required) after the last active member has left the Fund. The Admission Agreement would be being updated accordingly. The funding position and required employer contributions would be reviewed at triennial actuarial valuation in the normal way. With this clarity, the Fund could continue to adopt a long-term investment approach.

2.6 The investment review was aided by asset liability modelling which highlighted the potential impact of the future funding level volatility on the company's balance sheet and contributions. The largest funding risks identified were those driven by the liability value, which is a function of changes in long term interest rates and inflation, and the equity risk, which is expected to diminish over the very long term.

2.7 In March 2016, Pensions Committee agreed a revised Investment Strategy for 2016-21 reflecting the increasing maturity of the scheme. "The strategy reduces the long-term allocation to equities (including private equity) from 55% to 40% by the end of 2021 and increases the allocation to index-linked gilts from 15% to 20% within the same timeframe. It recognises a gradually changing risk profile for the Fund, but retains significant exposure to real investments, such as index-linked gilts and equities, which have a history of protecting or enhancing purchasing power, after the effects of inflation have been taken into account".

3. Main report

3.1 A copy of the actuarial valuation of the Lothian Buses Pension Fund as at 31 March 2017 is attached at Appendix 1. This provides full details of the financial and demographic assumptions and methodology which have been adopted by the Fund's Actuary. The report is marked as 'Draft' pending the formal approval of the Funding Strategy Statement which is also on Committee's agenda.

Admission Agreement and Shareholder Guarantee

3.2 As previously advised to Pensions Committee, an updated admission agreement for Lothian Buses plc to the Local Government Pension Scheme (LGPS) is currently being progressed. This will reflect regulatory requirements and affirm the guarantor obligations of the company's shareholders in respect of pension liabilities. It is anticipated that this will be formally concluded very shortly.

3.3 In the event of any employer default, which is emphasised is not anticipated, then pension liabilities will be met by the four Lothian Councils in proportion to their respective company shareholding.

3.4 Importantly, this agreement will also allow the company to continue to pay contributions to the Fund after there are no active members.

Liabilities and Funding Level as at 31 March 2017

3.5 Historically, the funding position of the Lothian Buses Pension Fund has been assessed on an ongoing basis, using a discount rate allowing for investment returns in excess of government bond yields. The table below summarises the financial position of the Fund at 31 March 2017 in respect of benefits earned by members up to this date on this basis.

	2014 Ongoing basis	2017 Ongoing basis
Past Service Liabilities £m	289	404
Market Value of Assets £m	337	488
Surplus / (Deficit) £m	48	84
Funding Level %	**117%**	**121%**

3.6 On the ongoing basis, the funding level has risen from 117% at the previous valuation at 31 March 2014 to 121% at this valuation. This has resulted in the surplus of £48million at 31 March 2014 increasing to a surplus of £84million at 31 March 2017. The improvement of the funding position on this basis reflects the favourable conditions since the previous valuation. In particular, investment returns for the three years to 31 March 2017 at 46.8% were significantly higher than anticipated. The table at Page 9 of Appendix 1, “Analysis of change in solvency – ongoing assumptions” illustrates, in totality, the various factors that caused the funding position to improve between 31 March 2014 and 31 March 2017 and the extent of this influence.

3.7 As the Fund has been closed to new entrants since 1 January 2008, inevitably the liabilities will gradually mature. In this context, the funding level has also been measured on a more prudent basis, discounting the liabilities using government bond (gilts) yields at 31 March 2017. This increases the liabilities by £143million and reduces the funding level to 89%. The results on the gilts basis, with comparison to the previous actuarial valuation, are as follows:

	2014 Gilts basis	2017 Gilts basis
Past Service Liabilities £m	382	547
Total – Assets £m	337	488
Surplus / (Deficit) £m	(44)	(59)
Funding Level %	**88%**	**89%**

Contribution Rates

3.8 The theoretical contribution rates calculated by the Actuary, on both funding bases, are shown in the table below.

Contribution rates (% of pay)	**31 March 2014**	**31 March 2017**	**31 March 2014**	**31 March 2017**
	Ongoing		Gilts	
Employer Primary Rate (formerly defined as Future Service Rate)	24.1%	33.1%	34.2%	49.4%
Employer Secondary Rate (formerly defined as Past service adjustment) [1]	-13.0%	-21.9%	11.0%	14.1%
Total employer contribution rate	**11.1%**	**11.2%**	**45.2%**	**63.5%**

[1] Spread over Future Working Lifetime

3.9 As is evident, the difference in the pace of funding between the respective bases and the potential implications for both the company and its shareholders is very significant. Rationale to support the updated Admission Agreement and Shareholder Guarantee is clear.

3.10 At the 2014 actuarial valuation, in recognition of the increasing maturity of the Fund and the need for prudence, the actuary certified minimum contributions of 24.1% of payroll for the period 1 January 2017 – 31 March 2018. Contributions at this level are currently in payment by the company.

3.11 Subject to the conclusion of the revised Admission Agreement and Shareholder Guarantee (as outlined in preceding paragraphs), the Actuary has confirmed that he is content to prescribe minimum employer contributions frozen at the current rate in payment, that is 24.1% of payroll, for the period encompassed by this actuarial valuation, 1 April 2018 to 31 March 2021.

3.12 In support of certification on this basis, the Actuary has further commented:

a. “The shareholders of Lothian Buses Limited acting as guarantors provides considerable security and certainty to the Fund that the cost of the liabilities will be met in full.

b. A ‘gilt based’ funding target becomes less imminent as the strength of the guarantee should allow the employer to continue to pay contributions after its last active member leaves employment. The investment strategy is planned to become less risky over time, but the funding time horizon would extend beyond the point at which all active members have left employment.

c. The agreed rate lies between the “theoretical” contribution rates at this valuation of 11.2% and 63.5% of pay based on ongoing and gilts assumptions respectively, and a time horizon of around 12 years. Asset and liability projections suggest that the agreed rate provides a strong likelihood of full funding over the longer term.”

3.13 The Actuary, therefore, reserves the right to revise the certification of the minimum contribution rate(s) should there be any undue delay in the formal signing of the revised Admission Agreement and Shareholder Guarantee.

Funding Strategy Statement

3.14 A revised Funding Strategy Statement for the Lothian Pension Fund, incorporating the Lothian Buses Pension Fund, is reported separately on this agenda.

Conclusions

3.15 The Actuarial Valuation for the Lothian Buses Pension Fund as at 31 March 2017 has been completed. The funding level on an ongoing basis as at 31 March 2017 was 121%% and on a gilts basis was 89%.

3.16 Minimum contributions from the employer will remain at the current level of 24.1% for the next three years, subject to a revised Admission Agreement and Shareholder Guarantee.

4. Measures of success

4.1 The funding strategy should ensure that the Fund has sufficient assets to meet pension obligations in the long term. The minimum contribution rates payable by the employer are certified by the Fund's Actuary in accordance with the professional standards of the Institute and Faculty of Actuaries.

5. Financial impact

5.1 The actuarial valuation sets the contribution rates payable by the employer over the next three years. The minimum employer contribution rates payable by company are as stated. The company has confirmed its acceptance of these rates.

6. Risk, policy, compliance and governance impact

6.1 The Lothian Buses Pension Fund is required by law to undertake an actuarial valuation once every three years. Regular actuarial assessment of the Fund reduces the risk of not meeting funding objectives.

6.2 The Lothian Buses admission agreement is being updated to reflect regulatory requirements of the Local Government Pension Scheme and to affirm the guarantor obligations of the company's shareholders in respect of pension liabilities.

7. Equalities impact

7.1 There are no equalities implications arising from this report.

8. Sustainability impact

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

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings. Appropriate liaison and consultation with representatives of Lothian Buses plc and the union representative from Lothian Buses has been undertaken.

10. Background reading/external references

10.1 None

Stephen S. Moir

Executive Director of Resources

Contact: John Burns, Chief Finance Officer, Lothian Pension Fund

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11. Appendices

Appendix 1 - Actuarial Valuation 2017 Lothian Buses Pension Fund

Appendix 1

Lothian Buses Pension Fund

2017 Actuarial Valuation Report

March 2018

DRAFT

Richard Warden
Laura McInroy

Fellows of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP

Contents

Executive summary

We have carried out an actuarial valuation of the Lothian Buses Pension Fund (LBPF) as at 31 March 2017. The results are presented in this report and are briefly summarised below.

Funding position

The table below summarises the funding position of the Fund on both ongoing and gilts assumptions as at 31 March 2014 and 31 March 2017:

Ongoing Assumptions

Past Service Position	31 March 2014 (£m)	31 March 2017 (£m)
Past Service Liabilities	289	404
Market Value of Assets	337	488
Surplus / (Deficit)	48	84
Funding Level	**117%**	**121%**

Gilts Assumptions

Past Service Position	31 March 2014 (£m)	31 March 2017 (£m)
Past Service Liabilities	382	547
Market Value of Assets	337	488
Surplus / (Deficit)	(45)	(59)
Funding Level	**88%**	**89%**

The funding level has improved due to positive membership experience and better than anticipated investment returns. These have been partially offset by a reduction in future expected investment returns. Further details are set out in **Section 4**.

Guarantor position and merger

The shareholders of Lothian Buses Limited (City of Edinburgh Council, West Lothian Council, Midlothian Council and East Lothian Council) have agreed to act as guarantor to the liabilities of LBPF. We understand that the admission agreement will be updated to reflect this, and that the agreement will also allow Lothian Buses to continue to pay contributions to the Fund after the last active member leaves (on the premise that a guarantee from the shareholders of Lothian Buses Limited provides a high level of security). A merger of the assets and liabilities of LBPF into the Lothian Pension Fund (LPF) is being considered by the Pensions Committee at its meeting in March 2018. If the merger goes ahead, the associated assets and liabilities of LBPF would be "notionally ring-fenced" from the shareholders' other assets and liabilities in the LPF and subject to a bespoke investment strategy.

Contribution rates

The Fund has agreed to freeze the current total employer rate at 24.1% of pay over the 3 year period until the next valuation. This decision recognises that:

- The shareholders of Lothian Buses Limited acting as guarantor provides considerable security and certainty to the Fund that the cost of the liabilities will be met in full.
- A 'gilt based' funding target becomes less imminent as the strength of the guarantee should allow the employer to continue to pay contributions after its last active member leaves employment. The investment strategy is planned to become less risky over time, but the funding time horizon would extend beyond the point at which all active members have left employment.

- The agreed rate lies between the "theoretical" contribution rates at this valuation of 11.2% and 63.5% of pay based on ongoing and gilts assumptions respectively, and a time horizon of around 12 years. Asset and liability projections suggest that the agreed rate provides a strong likelihood of full funding over the longer term.

The table below summarises the whole fund Primary and Secondary Contribution rates at this triennial valuation:

Primary Rate (% of pay)	Secondary Rate (% of pay)		
1 April 2018 - 31 March 2021	2018/2019	2019/2020	2020/2021
33.1%	- 9.0%	- 9.0%	- 9.0%

At the previous formal valuation at 31 March 2014, a different regulatory regime was in force. Therefore a contribution rate that is directly comparative to the rates above is not provided.

This minimum contribution to be paid from 1 April 2018 to 31 March 2021 is shown in the Rates and Adjustment Certificate in **Appendix D**.

Please note the figures in the tables throughout this document have been rounded. As a result, the sum of figures within the tables may not add up due to rounding.

1 Introduction

The City of Edinburgh Council ("the Administering Authority") has commissioned us to carry out a formal actuarial valuation of the Lothian Buses Pension Fund ("the Fund") as at 31 March 2017 to fulfil its obligations under Regulation 60 of The Local Government Pension Scheme (Scotland) Regulations 2014 ("the Regulations"). Therefore, the totality of our advice in relation to this formal valuation has been addressed to the Administering Authority and it is the only intended user of this advice. All reliances, limitations and caveats, including third party exclusions are set out in Section 7 of this report.

The purpose of the actuarial valuation is to assess the value of the assets and liabilities of the Fund as at 31 March 2017 and to calculate the required rate of employer contributions to the Fund for the period from 1 April 2018 to 31 March 2021. This report summarises the results of the valuation and the underlying advice provided to the Administering Authority throughout the valuation process.

This report is the culmination of various other communications which set out our advice in relation to the valuation, in particular:

- Our 2017 valuation toolkit which set out our proposed valuation methodology;
- Correspondence relating to data including the Data Report dated 5 March 2018;
- The Initial Results report dated 13 November 2017 which outlined the whole fund results and valuation assumptions;
- Correspondence relating to the shareholders of Lothian Buses Limited guarantee and the proposed employer contribution rates;
- The Funding Strategy Statement confirming the approach to setting contribution rates.

2 Valuation Approach

The valuation is a planning exercise for the Fund, to assess the monies needed to meet the benefits owed to its members as they fall due. As part of the valuation process the Fund reviews its funding strategy to ensure that an appropriate contribution plan and investment strategy is in place.

It is important to realise that the actual cost of the pension fund (i.e. how much money it will ultimately have to pay out to its members in the form of benefits) is unknown. This cost will not be known with certainty until the last benefit is paid to the last pensioner. The purpose of this valuation is to estimate what this cost will be, so that the Fund can then develop a funding strategy to meet it.

Setting the funding strategy for a defined benefit pension fund such as the Lothian Buses Pension Fund is complex. Firstly, the time period is very long; benefits earned in the LGPS today will be paid out over a period of the next 80 years or more and it remains open to the accrual of benefits. Secondly, the LGPS remains a defined benefit scheme so there are significant uncertainties in the final cost of the benefits to be paid. Finally, in order to reduce employer costs, the Lothian Buses Pension Fund invests in a return seeking investment strategy which can result in high levels of asset volatility.

Such a valuation can only ever be an estimate as the future cannot be predicted with certainty. However, as actuaries, we can use our understanding of the Fund and the factors that affect it to set the pace of funding in conjunction with the Administering Authority. The pace of this funding can vary according to the level of prudence that is built into the valuation method and assumptions.

The shareholders of Lothian Buses Limited (City of Edinburgh Council, West Lothian Council, Midlothian Council and East Lothian Council) have agreed to act as guarantor to the Lothian Buses Pension Fund liabilities. We understand that the admission agreement will be updated to reflect this, and that the agreement will also allow Lothian Buses to continue to pay contributions to the Fund after the last active member leaves (on the premise that a guarantee from the shareholders of Lothian Buses Limited provides a high level of security). This provides considerable certainty to the Fund that the cost of the liabilities will be met in full and more flexibility in the pace of funding the liabilities.

For this valuation, as for the previous valuation, our calculations identify separately the expected cost of members' benefits in respect of scheme membership completed before the valuation date ("past service") and that which is expected to be completed after the valuation date ("future service").

Past service

The principal measurement here is the comparison of the funding position at the valuation date against the funding target. The market value of the Fund's assets as at the valuation date is compared against the value placed on the Fund's liabilities in today's terms (calculated using a market-based approach). By maintaining a link to the market in both cases, this helps ensure that the assets and liabilities are valued in a consistent manner. Our calculation of the Fund's liabilities also explicitly allows for expected future pay and pension increases. The assumptions used in the assessment of the funding position at the valuation date are detailed in the next section.

The funding level is the ratio of assets to liabilities at the valuation date. A funding level of less/more than 100% implies that there is a deficit/surplus in the Fund at the valuation date against the funding target.

Funding plans are set to eliminate any deficit (or surplus) over the set time horizon and therefore get back to a funding level of 100%. To do so, additional contributions may be required to be paid into the Fund; these contributions are known as the "secondary rate".

Future service

In addition to benefits that have already been earned by members prior to the valuation date, employee members will continue to earn new benefits in the future. The cost of these new benefits must be met by both employers and employees. The employers' share of this cost is known as the "primary rate".

The primary rate is determined with the aim of meeting the funding target in respect of these new benefits at the end of the set time horizon. The primary rate will depend on the profile of the membership (amongst other factors). For example, the rate is higher for older members as there is less time to earn investment returns before the member's pension comes into payment.

For valuation results for the Fund, I have calculated the future service rate as the cost of benefits members will earn over the entirety of their remaining working lifetime, taking account of expected future salary increases until retirement and revaluation of accrued CARE benefits in line with CPI. This funding method is known as the Attained Age Method and is appropriate for funds which are no longer admitting new entrants.

For the reasons outlined above regarding the uncertainty of the future, there is no guarantee that the amount paid for the primary rate will be sufficient to meet the cost of the benefits that accrue. Similarly, there is no guarantee that the secondary contributions will result in a 100% funding level at the end of the time horizon.

Benefits

The scheme rules and benefits are set out in the Regulations. For further details, please refer to the timeline regulations on http://www.scotlgpsregs.org/.

3 Assumptions

Due to the long term nature of the Fund, assumptions about the future are required to place a value of the benefits earned to date and the cost of benefits that will be earned in the future. These assumptions broadly fall into two categories – financial and demographic.

Financial assumptions

Financial assumptions relate to the **size** of members' benefits. For example, how members' pensions will increase over time. In addition, the financial assumptions also help us to estimate how much members' benefits will cost the Fund in today's money by making an assumption about the return on the Fund's investments in future.

For measuring the funding level, the liabilities of the Fund are reported on a single set of financial assumptions about the future, based on financial market data as at 31 March 2017.

Discount rate

In order to place a current value on the future benefit payments from the Fund, an assumption about future investment returns is required in order to "discount" future benefit payments back to the valuation date.

For a funding valuation such as this, the discount rate is required by Regulations to incorporate a degree of prudence. The discount rate is set by taking into account the Fund's current and expected future investment strategy and, in particular, how this strategy is expected to outperform the returns from Government bonds over the long term. The additional margin for returns in excess of that available on Government bonds is called the Asset Outperformance Assumption (AOA).

The selection of an appropriate AOA is a matter of judgement and the degree of risk inherent in the Fund's investment strategy should always be considered as fully as possible. Following discussion the Fund is satisfied that an AOA of 1.5% p.a. is a prudent assumption for the purposes of this valuation. An AOA of 1.5% was used at the 2014 valuation.

Results using an AOA of 0.0% p.a. have also been provided. These recognise the plan to reduce the degree of risk included in the Fund's investment strategy.

Price inflation / benefit increases

Benefit increases are awarded in line with the Consumer Prices Index (CPI). As there continues to be no deep market for CPI linked financial instruments, the Fund derives the expected level of future CPI with reference to the Retail Prices Index (RPI).

Similar to previous valuations, the assumption for RPI is derived as the difference between the yield on long dated fixed interest and index-linked government bonds. In line with recent experience and projections by the Bank of England, CPI is expected to be, on average, 1.0% lower than RPI over the long term (compared to 0.8% as at the 2014 valuation).

Salary increases

Due to the change to a CARE scheme from 2015, there is now a closed group of membership in the Fund with benefits linked to final salary. The run-off of this final salary linked liability was modelled, taking into account the short-term restrictions in public sector pay growth. The results of this modelling and analysis were reported in the "2017 valuation – Pay growth assumption" paper on 8 September 2017. Based on the results of this modelling the Fund set a salary growth assumption of RPI plus 0.7% (compared to 2.0% p.a. for two years, and 1.5% above RPI thereafter at the 2014 valuation).

A summary of the financial assumptions underpinning the target funding basis and adopted during the assessment of the liabilities of the Fund as at 31 March 2017 (alongside those adopted at the last valuation for comparison) are shown below.

Financial assumptions	31 March 2014	31 March 2017
Discount rate (p.a.)		
Return on long-dated gilts	3.5%	1.7%
Asset Outperformance Assumption*	1.5%	1.5%
Discount rate	**5.0%**	**3.2%**
Benefit increases (p.a.)		
Retail Prices Inflation (RPI)	3.5%	3.4%
Assumed RPI/CPI† gap*	(0.8%)	(1.0%)
Benefit increase assumption (CPI)	**2.7%**	**2.4%**
Salary increases (p.a.)		
Retail Prices Inflation (RPI)	3.5%	3.4%
Increases in excess of RPI*	1.5%	0.7%
Salary increase assumption* **	**5.0%****	**4.1%**

† Consumer Prices Index

**Applied arithmetically in 2014 and geometrically in 2017*

*** 2.0% p.a. for 2014/15 and 2015/16, reverting to 5.0% thereafter*

**** excluding promotional increases*

Demographic assumptions

Demographic assumptions typically try to forecast when benefits will come into payment and what form these will take. For example, when members will retire (e.g. at their normal retirement age or earlier), how long they will then survive and whether a dependant's pension will be paid.

Longevity

The main demographic assumption to which the valuation results are most sensitive is that relating to the longevity of the Fund's members. The longevity assumptions result in the following typical future life expectancies from age 65 (figures for 2014 are shown for comparison):

	31 March 2014	31 March 2017
Male		
Pensioners	20.4 years	19.7 years
Non-pensioners	23.5 years	21.9 years
Female		
Pensioners	22.6 years	22.3 years
Non-pensioners	25.9 years	24.8 years

Further details of the longevity assumptions adopted for this valuation can be found in **Appendix B**. Note that the figures for non-pensioners assume they are aged 45 at the valuation date.

Retirement age pattern

We have adopted the retirement age pattern assumption as specified by the England and Wales LGPS Scheme Advisory Board for preparing Key Performance Indicators.

Other demographic assumptions

We are in the unique position of having a very large local authority data set from which to derive our other demographic assumptions. We have analysed the trends and patterns that are present in the membership of local authority funds and tailored our demographic assumptions to reflect LGPS experience. Details of the other demographic assumptions adopted by the Fund are set out in **Appendix B**.

Further comments on the assumptions

We are required to include a degree of prudence within the valuation. This has been achieved by explicitly allowing for a margin of prudence in the discount rate. All other proposed assumptions represent our “best estimate” of future experience.

If the discount rate was chosen to be best estimate (i.e. to have a 50% probability that the Fund’s current investment strategy will outperform the chosen discount rate over the longer term), the pre and post retirement discount rate would be around 5% p.a.

4 Results

The Administering Authority has prepared a Funding Strategy Statement which sets out its funding objectives for the Fund. In broad terms, the main valuation objectives are to hold sufficient assets in the Fund to meet the assessed cost of members' accrued benefits on the target funding basis ("the Funding Objective") and to set employer contributions which ensure both the long term solvency and the long term cost efficiency of the Fund ("the Contribution Objective").

Funding Position Relative to Funding Target

In assessing the extent to which the Funding Objective was met at the valuation date, we have used the ongoing actuarial assumptions described in the previous section of this report for the target funding basis and the funding method also earlier described. The table below compares the value of the assets and liabilities at 31 March 2017. The 31 March 2014 results are also shown for reference.

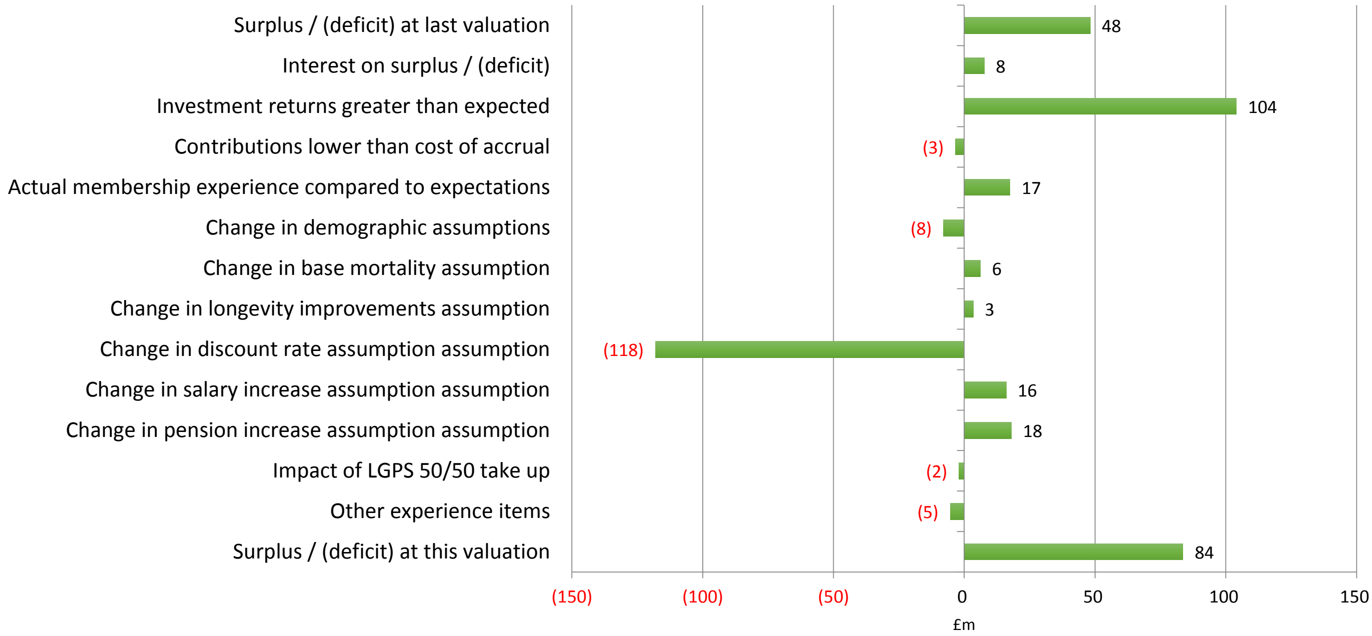
A funding level of 100% would correspond to the Funding Objective being met at the valuation date.

Valuation Date	31 March 2014	31 March 2017
Past Service Liabilities	**(£m)**	**(£m)**
Actives (CARE)	-	21
Actives (Final Salary)	139	182
Deferred Pensioners	41	59
Pensioners	109	142
Total Liabilities	**289**	**404**
Assets	**337**	**488**
Surplus / (Deficit)	**48**	**84**
Funding Level	**117%**	**121%**

The Funding Objective was met. There was a surplus of assets relative to the assessed cost of members' benefits on the target funding basis of £84m.

Summary of changes to the funding position

The chart below illustrates the factors that caused the changes in the funding position between 31 March 2014 and 31 March 2017:



Further comments on this chart are set out below:

- There is an interest gain of £8m. This is broadly three years of compound interest at 5.0% p.a. applied to the previous valuation surplus of £48m.
- Investment returns being higher than expected since 2014 lead to a gain of £104m. This is roughly the difference between the actual three-year return (46.8%) and expected three-year return (15.8%) applied to the whole fund assets from the previous valuation of £337m, with a further allowance made for cashflows during the period.
- The impact of the change in demographic assumptions has been a loss of around £8m.
- The change in longevity assumptions (baseline and improvements) has given rise to a gain of £9m.
- The change in financial assumptions since the previous valuation has led to a loss of £84m. The approximate impact of changing each financial assumption in turn has been as follows:
  - Changing the discount rate leads to a loss of £118m.
  - Changing the salary increase assumption leads to a gain of £16m.
  - Changing the pension increase assumption leads to a gain of £18m.

  As can be seen from the figures above, the impact of the decrease in the real discount rate between 2014 and 2017 has been partially offset by the increase to 1.0% p.a. of the assumed gap between RPI and CPI and a reduction in the expected future salary growth for benefits linked to final salary
- Membership experience over the 3 years has led to a gain of £17m. The most material items of membership experience have been:
  - Lower than expected salary increases leading to a gain of £5m
  - Lower than expected pension increases leading to gain of £10m
  - Lower than expected ill health retirements leading to a gain of £1m.

Projection of the funding position

The progression of the funding position will depend on various factors including future asset performance, economic conditions and membership movements. If the financial and demographic assumptions we have made at this valuation are borne out in practice, and there are no changes to the valuation assumptions, we project that the funding level at the 2020 valuation date will be 118%. This allows for contributions to be paid as detailed below and assumes returns in line with the discount rate adopted for this valuation. No allowance has been made for the future de-risking of the investment strategy.

Employer Contribution Rates

The Contribution Objective is achieved by setting employer contributions which are likely to be sufficient to meet both the cost of new benefits accruing and to address any funding surplus or deficit relative to the funding target over the agreed time horizon. A secondary objective is to maintain relatively stable employer contribution rates.

The shareholders of Lothian Buses Limited have agreed to act as guarantor to the Lothian Buses Pension Fund liabilities. We understand that the admission agreement will be updated to reflect this, and that the agreement will also allow Lothian Buses to continue to pay contributions to the Fund after the last active member leaves (on the premise that a guarantee from the shareholders of Lothian Buses Limited provides a high level of security). This provides considerable certainty to the Fund that the cost of the liabilities will be met in full and more flexibility in the pace of funding the liabilities.

Taking the guarantee into account, the employer contribution rates from 1 April 2018 are set out in the Rates and Adjustments Certificate shown in **Appendix D.**

The table below summarises the whole fund Primary and Secondary Contribution rates at this valuation.

Primary Rate (% of pay)	Secondary Rate (% of pay)		
1 April 2018 - 31 March 2021	2018/2019	2019/2020	2020/2021
33.1%	- 9.0%	- 9.0%	- 9.0%

The total rate has been agreed by the Fund to be frozen at the current rate of 24.1% covering the three year period from 1 April 2018 to 31 March 2021. This includes an allowance of 0.3% of pensionable pay for the Fund's expenses.

The Fund's "Common Contribution rate" as at 31 March 2014 based on ongoing assumptions was 11.1% of pay. Due to changes in the regulatory regime and guidance on contribution rates, the "Common Contribution rate" terminology is no longer appropriate. However, for comparison purposes only, the following table shows the "theoretical" contribution rates that would be payable from 1 April 2018 using the ongoing assumptions outlined in Section 3, with 2014 figures shown for comparison:

Ongoing basis	31 March 2014 (% of pay)	31 March 2017 (% of pay)
Employer Primary Rate (incl expenses)	24.1%	33.1%
Employer Secondary Rate (spread over FWL*)	(13.0%)	(21.9%)
Total employer rate (incl. expenses)	**11.1%**	**11.2%**

**Future working lifetime: 11.7 years in 2014, 11.8 years in 2017*

Solvency Results using Gilts Assumptions

The current investment strategy of the Fund includes a high proportion of equity type assets (such as equities and property). In the long term, it is expected that such assets will outperform gilts, which are generally considered to be a closer match to the future benefit outflows of the Fund. The scale of this outperformance is a matter of judgement based on available evidence. In deriving the discount rate for the purposes of this valuation, we have assumed that the assets held by the Fund will outperform index-linked gilts by 1.5% p.a.. We consider this to be a prudent assumption.

However, over time the Fund will mature and it is likely that the investment strategy will “de-risk” as the employer (which is closed to new entrants) moves closer to exit. The following table shows the effect on the valuation results if no advance credit is taken for additional outperformance above gilt returns (i.e. if a ‘gilts basis’ was used to value the liabilities).

Valuation Date	31 March 2014	31 March 2017
Past Service Liabilities	**(£m)**	**(£m)**
Actives (CARE)	-	31
Actives (Final Salary)	196	261
Deferred Pensioners	57	83
Pensioners	128	171
Total Liabilities	**382**	**547**
Assets	**337**	**488**
Surplus / (Deficit)	**(45)**	**(59)**
Funding Level	**88%**	**89%**

The Fund’s “Common Contribution rate” as at 31 March 2014 based on gilts assumptions was 45.2% of pay. Due to changes in the regulatory regime and guidance on contribution rates, the “Common Contribution rate” terminology is no longer appropriate. However, for comparison purposes only, the following table shows the “theoretical” contribution rates that would be payable from 1 April 2018 using gilts assumptions, with 2014 figures shown for comparison:

Gilts basis	31 March 2014 (% of pay)	31 March 2017 (% of pay)
Employer Primary Rate (incl expenses)	34.2%	49.4%
Employer Secondary Rate (spread over FWL*)	11.0%	14.1%
Total employer rate (incl. expenses)	**45.2%**	**63.5%**

**Future working lifetime: 11.7 years in 2014, 11.8 years in 2017*

5 Risk Assessment

The valuation results depend critically on the actuarial assumptions that are made about the future of the Fund. If all of the assumptions made at this valuation were exactly borne out in practice then the results presented in this document would represent the true cost of the Fund as it currently stands at 31 March 2017.

However, no one can predict the future with certainty and it is unlikely that future experience will exactly match the assumptions. The future therefore presents a variety of risks to the Fund and these should be considered as part of the valuation process. In particular:

- The main risks to the financial health of the Fund should be **identified**.
- Where possible, the financial significance of these risks should be **quantified**.
- Consideration should be given as to how these risks can then be **controlled** or **mitigated**.
- These risks should then be **monitored** to assess whether any mitigation is actually working.

This section investigates the potential implications of the actuarial assumptions not being borne out in practice.

Set out below is a brief assessment of the main risks and their effect on the valuation past service funding position results.

Sensitivity of past service funding position results to changes in assumptions

The table below gives an indication of the sensitivity of the funding position to small changes in two of the main financial assumptions used:

		Benefit Increases (p.a.)			
Discount Rates (p.a.)		2.7%	2.4%	2.1%	
	2.7%	35 108%	54 112%	72 117%	(Deficit) Funding Level
	3.2%	66 116%	84 121%	101 126%	(Deficit) Funding Level
	3.7%	95 124%	111 129%	127 135%	(Deficit) Funding Level

The valuation results are also very sensitive to unexpected changes in future longevity. All else being equal, if longevity improves in the future at a faster pace than allowed for in the valuation assumptions, the funding level will decline and the required employer contribution rates will increase.

The proposed valuation assumption assumes that in the longer term mortality rates will improve at a rate of 1.25% each year. The more prudent assumptions shown for sensitivity analysis assumes that mortality rates will improve at a rate of 1.5% each year in the longer term.

	1.25% long term rate of improvement	1.5% long term rate of improvement
Surplus	84	79
Funding Level	121%	119%

This is not an exhaustive list of the assumptions used in the valuation. For example, changes to the assumed level of withdrawals and ill health retirements will also have an effect on the valuation results.

Note that the tables show the effect of changes to each assumption in isolation. In reality, it is perfectly possible for the experience of the Fund to deviate from more than one of our assumptions simultaneously and so the precise effect on the funding position is therefore more complex. Furthermore, the range of assumptions shown here is by no means exhaustive and should not be considered as the limits of how extreme experience could actually be.

Funding risks

The Fund is exposed to a number of risks. These include, but are not limited to:

- Market risks – these include investment returns being less than anticipated or liabilities increasing more than expected due to changes in market conditions underlying the financial assumptions (e.g. inflation or pay increases above that assumed in **Section 3**).
- Demographic risks – these include anything that affects the timing or type of benefits (e.g. members living longer than anticipated, fewer members opting into the 50/50 option, etc.). In particular, early retirement on ill-health grounds can result in significant funding strains.
- Regulatory risks – changes in the Regulations could materially affect the benefits that members become entitled to. It is difficult to predict the nature of any such changes but it is not inconceivable that they could affect not just the cost of benefits earned after the change but could also have a retrospective effect on the past service position.
- Administration and Governance risks – failures in administration processes can lead to incorrect actuarial calculations. For example, where membership data is not up to date (e.g. leaver forms not being submitted in a timely matter) material inaccuracies in respect of the level of deficit and contributions may occur at future valuations
- Environmental risks – i.e. risks relating to environmental changes, and their impact on the Fund employer and investments: such risks exist and may prove to be material. Given the lack of relevant quantitative information available specifically relevant to the Fund, we have not explicitly incorporated such risks in our advice on the 2017 valuation. The Administering Authority and the Employer may wish to seek direct advice on these risks.

Investment risk

The Fund holds some of its assets in return seeking assets such as equities to help reduce employers' costs. However, these types of investments can result in high levels of asset volatility. Therefore, there is a risk that future investment returns are below expectations and the funding target is not met. This will require additional contributions from the Employer to fund any deficit.

Whilst the Fund takes steps to ensure that the level of investment risk is managed and monitored via strategy reviews and performance monitoring, it can never be fully mitigated.

Managing the risks

Whilst there are certain things, such as the performance of investment markets or the life expectancy of members, that are not directly within the control of the pension fund, that does not mean that nothing can be done to understand them further and to mitigate their effect. Although these risks are difficult (or impossible) to eliminate, steps can be taken to manage them.

Ways in which some of these risks can be managed could be:

- Set aside a specific reserve to act as a cushion against adverse future experience (possibly by selecting a set of actuarial assumptions that are deliberately more prudent).
- Take steps internally to monitor the decisions taken by members (e.g. 50:50 scheme take-up, commutation) and the employer (e.g. relating to early / ill health retirements or salary increases) in a bid to curtail any adverse impact on the Fund.
- Undertake an asset-liability modelling exercise that investigates the effect on the Fund of possible investment scenarios that may arise in the future.

- Managing ill health liabilities e.g. via ill health “budgets” or external insurance, to mitigate the risk of an ill health retirement impacting on the funding level.
- Regularly reviewing the Fund’s membership data to ensure it is complete, up to date and accurate.

6 Related issues

The Fund's valuation operates within a broader framework, and this document should therefore be considered alongside the following:

- the Funding Strategy Statement, which in particular highlights how the Employer has its contributions calculated;
- the Statement of Investment Principles (e.g. the discount rate must be consistent with the Fund's asset strategy);
- the general governance of the Fund, such as meetings of the Pensions Committee, decisions delegated to officers, the Fund's business plan, etc;
- the Fund's risk register.

Further recommendations

Valuation frequency

Under the provisions of the LGPS regulations, and subject to any merger of the Fund into the Lothian Pension Fund, the next formal valuation of the Fund is due to be carried out as at 31 March 2020. In light of the uncertainty of future financial conditions, we recommend that the financial position of the Fund is monitored by means of interim funding reviews. This will give early warning of changes to funding positions and possible revisions to funding plans.

Investment strategy and risk management

We recommend that the Administering Authority continues to regularly review its investment strategy and ongoing risk management programme.

7 Reliances and limitations

Third parties

This document has been prepared for the sole use of City of Edinburgh Council in its role as Administering Authority of the Fund and not for any other third party. Hymans Robertson LLP makes no representation or warranties to any third party as to the accuracy or completeness of this report. This report will therefore not address the particular interests or concerns of any such third party.

As this report has not been prepared for a third party, no reliance by any third party will be placed on it. It follows that there is no duty or liability by Hymans Robertson LLP (or its members, partners, officers, employees and agents) to any party other than City of Edinburgh Council. Hymans Robertson LLP therefore disclaims all liability and responsibility arising from any reliance on or use of this report by any person having access to this report or by anyone who may be informed of the contents of the Report.

The Report must not be used for any commercial purposes unless Hymans Robertson LLP agrees in advance.

Component reports

As set out in **Section 1** and **Section 6**, the totality of our advice pertaining to the valuation is set out over a number of component communications and complies with the various professional and regulatory requirements related to public sector actuarial valuations in Scotland. The reliances, limitations and caveats within this report and each component report apply equally across the totality of our advice.

Model limitations

The models used to calculate the assets, liabilities, contribution rates and the level of indemnity make some necessary simplifying assumptions. I do not consider these simplifications to be material and I am satisfied that they are appropriate for the purposes described in this report.

Limited purpose

This document has been prepared to fulfil the statutory obligations of the Administering Authority to carry out a formal actuarial valuation. None of the figures should be used for accounting purposes (e.g. under FRS102 or IAS19) or for any other purpose (e.g. a termination valuation under Regulation 62).

Reliance on data

The results of the valuation are dependent on the quality of the data provided to us by the Administering Authority for the specific purpose of this valuation. We have previously issued a separate report confirming that the data provided is fit for the purposes of this valuation and have commented on the quality of the data provided. The data used in our calculations is as per our report of 5 March 2018.

Actuarial standards

The following Technical Actuarial Standards[1] are applicable in relation to this report and have been complied with:

- TAS 100 – Principles for technical actuarial work;
- TAS 300 – Pensions.

No material deviations have been made from the above actuarial standards.

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[1] Technical Actuarial Standards (TASs) are issued by the Financial Reporting Council (FRC) and set standards for certain items of actuarial work, including the information and advice contained in this report.

Compliance statement

The totality of our advice complies with the Regulations as they pertain to actuarial valuations.

Richard Warden

Fellow of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

13 March 2018

Laura McInroy

Fellow of the Institute and Faculty of Actuaries

Appendix A: Data

This section contains a summary of the membership, investment and accounting data provided by the Administering Authority for the purposes of this valuation (the corresponding membership and investment data from the previous valuation is also shown for reference). For further details of the data, and the checks and amendments performed in the course of this valuation, please refer to our separate data report.

Membership data – whole fund

Employee members

	31 March 2014		31 March 2017		
	Number	Pensionable Pay* (£000)	Number	Pensionable Pay* (£000)	CARE Pot (£000)
Total employee membership	1,193	32,655	1,070	31,292	1,274

*actual pay (not full-time equivalent)

Deferred pensioners

	31 March 2014		31 March 2017	
	Number	Deferred pension (£000)	Number	Deferred pension (£000)
Total deferred membership	1,252	2,412	1,079	2,554

The figures above also include any “frozen refunds” and “undecided leavers” members at the valuation date.

Current pensioners, spouses and children

	31 March 2014		31 March 2017	
	Number	Pension (£000)	Number	Pension (£000)
Members	1,183	6,705	1,273	7,589
Dependants	309	873	342	1,011
Children	19	26	14	20
Total pensioner members	**1,511**	**7,605**	**1,629**	**8,620**

Note that the membership numbers in the table above refer to the number of records provided to us and so will include an element of double-counting in respect of any members who are in receipt (or potentially in receipt of) more than one benefit.

Membership Profile	Average Age (years)		FWL (years)	
	2014	2017	2014	2017
Employees (CARE)	-	51.2	11.7	11.8
Employees (Final Salary)	52.0	52.0		
Deferred Pensioners	50.9	51.6	-	-
Pensioners	67.4	67.4	-	-

The average ages are weighted by liability.

The expected future working lifetime (FWL) indicates the anticipated length of time that the average employee member will remain as a contributor to the Fund. Note that it allows for the possibility of members leaving, retiring early or dying before retirement.

Assets at 31 March 2017

A summary of the Fund's assets provided by the Administering Authority (excluding members' money-purchase Additional Voluntary Contributions) as at 31 March 2017 and 31 March 2014 is as follows:

Asset class	31 March 2014 (Market Value) (£000)	Allocation %	31 March 2017 (Market Value) (£000)	Allocation %
UK equities	0	0%	0	0%
UK fixed interest gilts	24	7%	30	6%
UK corporate bonds	1	0%	7	1%
UK index-linked gilts	37	11%	74	15%
Overseas equities	219	65%	273	57%
Overseas bonds	0	0%	0	0%
Property	46	14%	89	18%
Cash and net current assets	9	3%	15	3%
Total	**337**	**100%**	**488**	**100%**

Note that, for the purposes of determining the funding position at 31 March 2017, the asset value we have used also includes the present value of expected future early retirement strain payments (amounting to £0m).

Accounting data – revenue account for the three years to 31 March 2017

Consolidated accounts (£000)	Year to			
	31 March 2015	30 March 2016	31 March 2017	Total
Income				
Employer - normal contributions	7,094	7,538	7,731	22,363
Employer - additional contributions	0	0	0	0
Employer - early retirement and augmentation strain contributions	0	0	0	0
Employee - normal contributions	2,139	2,104	2,035	6,278
Employee - additional contributions	23	25	25	73
Transfers In Received (including group and individual)	0	0	10	10
Other Income	0	0	0	0
Total Income	**9,256**	**9,667**	**9,801**	**28,724**
Expenditure				
Gross Retirement Pensions	7,790	8,087	8,425	24,302
Lump Sum Retirement Benefits	2,864	2,101	3,277	8,242
Death in Service Lump sum	262	530	295	1,087
Death in Deferment Lump Sum	0	0	0	0
Death in Retirement Lump Sum	0	0	0	0
Gross Refund of Contributions	0	2	9	11
Transfers out (including bulk and individual)	17	129	418	564
Fees and Expenses	112	102	98	312
Total Expenditure	**11,045**	**10,951**	**12,522**	**34,518**
Net Cashflow	**-1,789**	**-1,284**	**-2,721**	**-5,794**
Assets at start of year	**337,125**	**385,784**	**394,431**	**337,125**
Net cashflow	**-1,789**	**-1,284**	**-2,721**	**-5,794**
Change in value	**50,448**	**9,931**	**96,433**	**156,812**
Assets at end of year	**385,784**	**394,431**	**488,143**	**488,143**
Approximate rate of return on assets	**15.0%**	**2.6%**	**24.5%**	**46.9%**

Note that the figures above are based on the Fund accounts provided to us for the purposes of this valuation, which were fully audited at the time of our valuation calculations.

Appendix B: Assumptions

Financial assumptions

Financial assumptions	31 March 2014 (% p.a.)	31 March 2017 (% p.a.)
Discount rate	5.0%	3.2%
Price inflation (CPI)	2.7%	2.4%
Pay increases*	5.0%**	4.1%
Pension increases:		
pension in excess of GMP	2.7%	2.4%
post-88 GMP	2.7%	2.4%
pre-88 GMP	0.0%	0.0%
Revaluation of deferred pension	2.7%	2.4%
Revaluation of accrued CARE pension	2.7%	2.4%
Expenses	0.3%	0.3%

*An allowance is also made for promotional pay increases (see table below).

**2.0% p.a. for 2014/15 and 2015/16, reverting to 5.0% p.a. thereafter.

Longevity assumptions

As the fund is a member of Club Vita, the baseline longevity assumptions are a bespoke set of Vita Curves that are tailored to fit the membership profile of the Fund. These curves are based on the data the Fund has provided us with for the purposes of this valuation and incorporate an allowance for the results of the Bus & Coach Scheme Longevity Study undertaken by Club Vita in 2016. Full details of these are available on request.

We have also allowed for future improvements in mortality based on the CMI 2016 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.25% p.a.

Other demographic valuation assumptions

Retirements in normal health	We have adopted the retirement age pattern assumption as specified by the LGPS Scheme Advisory Board in England & Wales for preparing their Key Performance Indicators. Further details about this assumption are available on request.
Retirements in ill health	Allowance has been made for ill-health retirements before Normal Pension Age (see table below).
Withdrawals	Allowance has been made for withdrawals from service (see table below).
Family details	A varying proportion of members are assumed to be married (or have an adult dependant) at retirement or on earlier death. For example, at age 60 this is assumed to be 90% for males and 85% for females. Husbands are assumed to be 3 years older than wives.
Commutation	50% of future retirements elect to exchange pension for additional tax free cash up to HMRC limits for service to 1 April 2009 (equivalent 75% for service from 1 April 2009).
50:50 option	0.0% of members will choose the 50:50 option.

The tables below show details of the assumptions actually used for specimen ages. The promotional pay scale is an annual average for all employees at each age. It is in addition to the allowance for general pay inflation described above. For membership movements, the percentages represent the probability that an individual at each age leaves service within the following twelve months. The abbreviations FT and PT refer to full-time and part-time respectively.

Males

Age	Salary Scale	Incidence per 1000 active members per annum						
		Death Before Retirement	Withdrawals		Ill Health Tier 1		Ill Health Tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.27	96.58	223.33	0.00	0.00	0.00	0.00
25	117	0.27	63.79	147.52	0.15	0.02	0.13	0.02
30	131	0.32	45.25	104.64	0.28	0.04	0.23	0.03
35	144	0.38	35.35	81.74	0.55	0.18	0.46	0.15
40	150	0.64	28.44	65.77	0.83	0.30	0.69	0.24
45	157	1.07	23.28	53.82	1.32	0.59	1.09	0.49
50	162	1.72	18.03	41.69	2.48	1.38	2.59	1.45
55	162	2.68	17.32	40.05	7.77	5.17	4.67	3.11
60	162	4.83	15.43	35.67	13.21	9.05	3.87	2.65
65	162	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Females

Age	Salary Scale	Incidence per 1000 active members per annum						
		Death Before Retirement	Withdrawals		Ill Health Tier 1		Ill Health Tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.14	76.49	129.80	0.00	0.00	0.00	0.00
25	117	0.14	51.45	87.32	0.19	0.16	0.15	0.13
30	131	0.21	43.12	73.18	0.25	0.21	0.21	0.18
35	144	0.34	37.19	63.11	0.48	0.40	0.40	0.33
40	150	0.55	30.93	52.49	0.72	0.60	0.60	0.50
45	157	0.89	25.46	43.21	0.96	0.80	0.79	0.66
50	162	1.30	19.40	32.93	1.76	1.44	1.84	1.51
55	162	1.71	18.15	30.80	6.43	5.22	3.87	3.14
60	162	2.19	14.59	24.76	13.55	10.94	3.97	3.20
65	162	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Appendix C: Events since valuation date

Post-valuation events

These valuation results are in effect a snapshot of the Fund as at 31 March 2017. Since that date, various events have had an effect on the financial position of the Fund. Whilst we have not explicitly altered the valuation results to allow for these events, a short discussion of these “post-valuation events” can still be beneficial in understanding the variability of pension funding.

In the period from the valuation date to early March 2018, the Fund asset returns have been higher than expected and real gilt yields have risen (giving lower liabilities). As a result of this, the funding position is expected to have improved since 31 March 2017.

It should be noted that the above is for information only: the figures in this report have all been prepared using membership data, audited asset information and market-based assumptions all as at 31 March 2017. In particular, we do not propose amending any of the contribution rates listed in the Rates and Adjustments Certificate on the basis of these market changes.

Appendix D: Rates and adjustments certificate

In accordance with regulation 60(4) of the Regulations we have made an assessment of the contributions that should be paid into the Fund by participating employers for the period 1 April 2018 to 31 March 2021 in order to maintain the solvency of the Fund.

The method and assumptions used to calculate the contributions set out in the Rates and Adjustments certificate are detailed in the Funding Strategy Statement dated TBC and our report on the actuarial valuation dated TBC.

Regulation 60(8) requires a statement of the assumptions on which the certificate is given regarding the number of members, and the associated of liabilities arising, who will become entitled to payment of pensions under the regulations of the LGPS. These assumptions can be found in Appendix D of the 31 March 2017 formal valuation report dated TBC. These assumptions cover members who become entitled to payment of pension via normal retirement and ill health retirement. Further members will become entitled due to involuntary early retirement (for redundancy and efficiency reasons) for which no allowance has been made.

The required minimum contribution rates are set out below.

Primary rate (% of pay) 1 April 2018 to 31 March 2021	Minimum Contributions for the Year Ending					
	Secondary Rate			Total Contribution Rate		
	2018/2019	2019/2020	2020/2021	2018/2019	2019/2020	2020/2021
33.1%	- 9.0%	- 9.0%	- 9.0%	24.1%	24.1%	24.1%

Notes:

1. Contributions should be paid into Lothian Buses Pension Fund (‘the Fund’) at a frequency in accordance with the requirements of the Regulations.
2. Further sums should be paid to the Fund to meet the costs of any non-ill health early retirements and/or augmentations (i.e. additional pension) using methods and factors issued by me from time to time, or GAD guidance if I consider it to be appropriate.
3. In addition, further sums may be required to be paid to the Fund by the Employer to meet the capital costs of any ill-health retirements that exceed those included within my assumptions.
4. The certified contribution rates represent the minimum level of contributions to be paid. The Employer may pay further amounts at any time, and future periodic contributions may be adjusted on a basis approved by the Fund actuary.

Signature:		
Date:	13 March 2018	13 March 2018
Name:	Richard Warden	Laura McInroy
Qualification:	Fellow of the Institute and Faculty of Actuaries	Fellow of the Institute and Faculty of Actuaries
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	20 Waterloo Street	20 Waterloo Street
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Pensions Committee

2.00pm, Monday, 26 March 2018

Merger of Lothian Buses Pension Fund and Lothian Pension Fund

Item number	5.7
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

The report seeks approval to the transfer of the assets and liabilities of the Lothian Buses Pension Fund into the Lothian Pension Fund, subject to the satisfactory completion of a revised admission agreement and shareholder guarantee (as referred to in the separate report "2017 Actuarial Valuation for Lothian Buses Pension Fund"). The merger would then proceed at the earliest suitable date, this to be determined by the Executive Director of Resources.

Prior consultation has taken place with the respective stakeholder interests of both the Lothian Buses Pension Fund and Lothian Pension Fund.

Report

Merger of Lothian Buses Pension Fund and Lothian Pension Fund

1. Recommendations

Committee is requested to:

1.1 Note the consultation which has taken place with the respective stakeholder interests of both the Lothian Buses Pension Fund and Lothian Pension Fund;

1.2 Note the significant advantages to be derived from consolidation of the two Funds, including investment diversification opportunity and economies of scale;

1.3 Note that the assurance that the interests of members of the Lothian Buses Pension Fund (employees and former employees of Lothian Buses Limited and its predecessor, Lothian Transport plc), would be unaffected;

1.4 Note the separate report on "2017 Actuarial Valuation for Lothian Buses Pension Fund", specifically:

1.4.1 Lothian Buses Limited, as employer, will continue to retain a bespoke investment strategy which will be reviewed over the coming months. This review will recognise the increasing maturity profile of the membership and ensure that the risks inherent in the investment strategy are deemed appropriate.

1.4.2 An updated admission agreement for Lothian Buses Limited to the Local Government Pension Scheme (LGPS) is currently being progressed. This will reflect both regulatory requirements of and affirm the guarantor obligations of the company's shareholders in respect of pension liabilities. It is anticipated that this will be formally concluded very shortly. In the event of any employer default, which is emphasised is not anticipated, then pension liabilities will be met by the four Lothian Councils in proportion to their respective company shareholding; and

1.5 Approve the merger of the assets and liabilities of the Lothian Buses Pension Fund into the Lothian Pension Fund at the earliest suitable date (to be determined by the Executive Director of Resources) subject to the satisfactory completion of a revised admission agreement and shareholder guarantee.

2. Background

2.1 The investment strategy review completed in 2016 highlighted that Lothian Buses Pension Fund was defined in regulations as a sub-fund of Lothian Pension Fund and there was an option for the Fund to be subsumed into Lothian Pension Fund.

2.2 The Pensions Committee agreed in March 2016 that the option for Lothian Buses Pension Fund to be merged into Lothian Pension Fund should be explored in consultation with stakeholders.

2.3 A merger was seen to provide a potential solution to the issue of achieving the different target allocations to unlisted assets (infrastructure and private debt) for Lothian Buses Pension Fund and Lothian Pension Fund. Currently any unlisted investments made for both funds are split in a fixed proportion of 7/93. “Lothian Buses Pension Fund would benefit from increased diversification and additional efficiencies would be expected in accounting, actuarial valuations and investment manager arrangements”.

3. Main report

Employer asset tracking and retention of bespoke investment strategy for Lothian Buses Limited

3.1 The revised Funding Strategy Statement (reported separately on this agenda) states “Lothian Pension Fund is a multi-employer fund. Previously, individual employer asset shares have been calculated triennially at formal valuations by the Fund’s Actuary using an analysis of surplus technique and tracked between valuations using a cash flow or roll forward approach. However, in order to enhance the transparency, accuracy and auditability of individual employer asset allocations and reduce any cross-subsidy between participating employers, from 1 April 2014 the Fund introduced an employer asset tracking system based on cash flows. This is a form of unitisation of investments, where each investment or disinvestment of monies involves the purchase or selling of units in the fund. By sub-dividing the assets into units, the fund can more easily and accurately track each individual employer’s assets. Changes in the value of the underlying assets are reflected by changes in unit prices.

3.2 Such unitisation therefore provides an efficient way of accurately apportioning assets to individual employers by allowing for employer cash flows and investment returns achieved by the Fund. In addition, this provides a mechanism for facilitating and managing a range of investment strategies within the single Fund to meet the needs of employers with different maturity profiles, funding levels or investment objectives.”

3.3 Importantly, therefore, Lothian Buses, as a potential employer within Lothian Pension Fund, could retain its own bespoke investment strategy, distinct from that of other employers.

Benefits of Merger

3.4 These are summarised as follows:

a. **Increased investment diversification**

Merger would create opportunities across asset classes to obtain greater diversification for Lothian Buses Pension Fund than it has had as a relatively small, standalone Fund. The Fund's listed equity exposure, currently provided by two portfolios, is quite concentrated compared to the nine portfolios in Lothian Pension Fund.

b. **Consistency of investment approach**

Both Funds currently invest in a number of portfolios that are not common across both, including Baillie Gifford Global Alpha, Baillie Gifford Investment Grade Fund, Standard Life Pooled Property Fund, Harris, Nordea and several internal equity portfolios. Further, currency hedging is used by Lothian Pension Fund and not Lothian Buses Pension Fund. A merger provides the opportunity for greater consistency within asset classes, together with the benefits of greater scale.

c. **Reduced number of investment portfolios**

Merger would reduce the number of portfolios to be managed and monitored by the investment team and Investment Strategy Panel leading to better allocation and focus of resources.

d. **Cash management**

Greater efficiency in cash management can be expected. Instead of maintenance of two cash balances for each portfolio for each Fund, a single cash balance would reduce frictional balances and save on administration.

e. **Investment administration and accounting**

Cost and time efficiencies have been identified in the areas of financial reporting, transaction fees and the global custodian's current unitisation system and its reporting. A merger would lead to a single set of financial statements and reduce external audit and actuarial fees.

Implications of "No Change"

3.5 It is also worth considering the negative implications of maintaining the status quo as Lothian Buses Pension Fund implements its investment strategy. Without merger, a bespoke investment implementation would be required, which would potentially result in a greater number of relatively small portfolios. For example:

a. duplication of internally managed global portfolios for Lothian Buses Pension Fund. (Its equity allocation will reduce over time which may limit the diversification which can be achieved);

b. creation of additional account(s) for unlisted assets (infrastructure and debt) with a higher allocation of investments to Lothian Buses Pension Fund compared to the fixed 93/7 apportionment currently used. Subsequent changes to strategy could mean the need for further accounts;

c. associated custodian and internal resource costs.

Employer covenant

3.6 A revised Admission Agreement for Lothian Buses Limited, formally clarifying the position of the four Councils as guarantors in proportion to their respective shareholdings, will be sought prior to the transfer of assets and liabilities.

Stakeholder consultation

3.7 Consultation has taken place with the respective stakeholder interests of both the Lothian Buses Pension Fund and Lothian Pension Fund has taken place over recent months. These include:

a. Lothian Buses Limited;
b. The Pensions Board, including the employer and employee (Trades Unions) representatives of the two Funds;
c. The four Lothian Councils as company shareholders and as employers within Lothian Pension Fund; and
d. All other employers within Lothian Pension Fund.

3.8 Assurance is provided that the proposed merger is purely an administrative change and will not affect members (employees and former employees) of either Fund.

3.9 A stakeholder consultation document was issued in February 2018. This is shown in full at Appendix 1. It is not anticipated that there should be any potential significant concerns raised. An oral update on the feedback from the stakeholder consultation will be provided to Committee.

4. Measures of success

4.1 The financial advantages secured through the transfer of assets and liabilities from Lothian Buses Pension Fund to Lothian Pension Fund will be reflected in future investment performance and actuarial valuations of Lothian Pension Fund and be reported to Committee in due course.

5. Financial impact

5.1 Investment efficiencies and administrative savings would result from the transfer of assets and liabilities from Lothian Buses Pension Fund to Lothian Pension Fund. Investment opportunities would also be enhanced. To a large extent, however, the scale of such benefits will be dependent upon future financial market conditions and asset allocation. It is likely that the savings will be at least £0.75m - £1.0m per annum, although these would not be realised immediately but over time.

6. Risk, policy, compliance and governance impact

6.1 A revised Admission Agreement for Lothian Buses Limited, formally clarifying the position of the four Councils as guarantors of the pension liabilities in proportion to their respective shareholdings, will be put in place prior to the transfer of assets and liabilities. This will serve to strengthen governance and affirm the employer covenant.

7. Equalities impact

7.1 There are no equalities implications arising from this report.

8. Sustainability impact

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

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

9.2 Consultation with Lothian Buses Limited and union representatives for Lothian Buses members has been undertaken.

10. Background reading/external references

10.1 None

Stephen S. Moir

Executive Director of Resources

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11. Appendices

Appendix 1 - Stakeholder Consultation – Proposed merger (consolidation) of Lothian Buses Pension Fund into Lothian Pension Fund - Frequently Asked Questions (FAQs)

Lothian Pension Fund –Stakeholder Consultation
Proposed merger (consolidation) of Lothian Buses Pension Fund into Lothian Pension Fund

The Pensions Committee of the City of Edinburgh Council agreed that the option for Lothian Buses Pension Fund to be merged into Lothian Pension Fund should be explored in consultation with stakeholders. A report will be put to the Committee in March to consider the issues raised during the consultation. This Frequently Asked Questions (FAQ) document sets out common questions and answers for stakeholders.

FAQs

Q What is being proposed?
A. It is proposed to transfer the assets and liabilities of the Lothian Buses Pension Fund into the Lothian Pension Fund. Lothian Buses Pension Fund owns assets valued at approximately £0.5bn, while Lothian Pension Fund's assets are valued at approximately £6.8bn (January 2018).

Q. Will the members of Lothian Buses Pension Fund (employees and former employees of Lothian Buses Limit and its predecessor, Lothian Region Transport) be affected?
A. No, this change will not affect members, it is purely an administrative change. All Local Government Pension Scheme (LGPS) members' benefits will remain unchanged. Active members will remain in the Scheme.

Q. Will the members of Lothian Pension Fund be affected?
A. No, as above, this change will not affect members.

Q Why is the merger being proposed?
A. Lothian Buses Pension Fund was established in 1986 by agreement between Lothian Regional Council and Lothian Region Transport. It was set up as a 'further fund' within the meaning of the Local Government Superannuation Funds (Scotland) Regulations 1986 (i.e. a sub-fund of Lothian Pension Fund).

Currently, Lothian Buses Pension Fund is considered to be a 'stand-alone' Fund - it has its own investments, actuarial valuation and accounts.

However, there is the option for the Buses Fund to be subsumed into the main Lothian Pension Fund. The Investment Strategy Panel have agreed that, from an investment perspective, a merger would be sensible.

Benefits of merger are summarised as follows:
- Benefits of scale associated with greater consistency of investments across the two Funds, whilst retaining a bespoke investment strategy for Lothian Buses
- Improved efficiency due to unnecessary duplication of various fees
- An increased opportunity set of investments.

Q. What would happen in the event of Lothian Buses defaulting on its liabilities?
A. Lothian Buses is owned by four councils (the City of Edinburgh, West Lothian, East Lothian and Midlothian). A revised Admission Agreement formally clarifying the position of the four Councils as guarantors will be sought prior to the transfer of assets and liabilities. Therefore, these Councils will act as guarantors in the event of the Lothian Buses defaulting on its liabilities.

Q. Is a revised Admission Agreement required in terms of the Actuarial Valuation 2017, which has to be approved by Pensions Committee prior to 31 March 2018?
A. Yes, the Actuary has stated that such explicit guarantee is required to permit "Lothian Buses to continue to pay contributions to the Fund after the last active member leaves" and so that "there would be no need to target a 100% gilts strategy at the cessation date if the funding time horizon extends beyond that point". This increased flexibility is likely to be very much in the mutual interests of the company and its shareholders.

Q. How will the assets of the Lothian Buses Pension Fund be protected?
A. Lothian Pension Fund uses a dedicated employer asset tracking software system that allows for flexible allocation of investments (unitisation) for all employers within the same Fund. As such, Lothian Buses, as an employer, can retain its own unique investment strategy, distinct from that of other employers in Lothian Pension Fund.

Q. Will the proposal impact upon the funding of other employers within Lothian Pension Fund?
A. No, as discussed above, a revised Admission Agreement would be sought which would confirm that the Councils are the guarantors.

Q. Why are employers within Lothian Pension Fund being consulted?
A. Although this is not a statutory requirement, it is considered best practice to provide requisite assurance that no such employer should be disadvantaged and also to accord the opportunity to every employer to feedback any concerns prior to any final decision.

Q. Will Lothian Buses continue to be an employer member of the LGPS?
A. Yes, the company's admission to the LPGS is not being terminated.

Q. Will Lothian Buses be exposed to additional risk of an employer in Lothian Pension Fund defaulting?
A. At present, with "ringfencing" as a "sub Fund", Lothian Buses has been viewed as being isolated from the risk of other employers in the Lothian Pension Fund defaulting. The Funding Strategy Statement has established the policy of "alignment" whereby liabilities on default of one employer, with no guarantor, are assigned or apportioned to another employer(s) where a clear linkage exists, e.g. geographical or funding relationship. This provision ensures that smaller, stand-alone employers within the Fund are protected, with the burden typically being borne by the Councils. Lothian Buses would not be "aligned" to any other employer, so it will not be exposed to additional risk of an employer in Lothian Pension Fund defaulting.

Q. Has legal opinion been sought in relation to the merger?
A. Yes. The specialist external legal advice emphasised that consultation with stakeholders should be undertaken.

Q. Have other Scottish LGPS funds merged funds?
A. Yes, both Strathclyde and Tayside have merged their transport funds with their main funds.

Q How will the Regulatory detail be concluded?
A. Scottish Ministers, through the Scottish Public Pensions Agency, the Pensions Regulator and HMRC will all be informed of the change.

Q. Is the proposed merger supported by Lothian Buses?
A. Yes, discussions with company representatives support the proposal being submitted for this wider consultation. Formal approval of the revised Admission Agreement will, however, be required by the company's Board.

Q. Who is being consulted?
A. The main stakeholders, which are:

- Lothian Buses Limited;
- The Pensions Board, including the employer and employee (Trades Unions) representatives of the two Funds;
- The four Lothian Councils as company shareholders and as employers within Lothian Pension Fund;
- All other employers within Lothian Pension Fund.

Q. Who has authority to approve the merger?
A. City of Edinburgh Council, in its role as administering authority of the LGPS for the Lothian area, will be required to approve the merger. Its Pensions Committee has delegated authority to approve the merger.

Q. What are the next steps
A. The steps are:

- A report will be submitted to the Pensions Committee of the City of Edinburgh Council in March detailing the responses to the consultation.
- If the merger is approved, the merger is expected to take place during the 2018/19 financial year.

Responses to this consultation are requested by 16 March 2018.
Please respond to employer.pensions@edinburgh.gov.uk

February 2018

Pensions Committee

2.00pm, Monday, 26 March 2018

2017 Actuarial Valuation for Scottish Homes Pension Fund

Item number	5.8
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

The Scottish Homes Pension Fund is required by law to undertake an actuarial valuation once every three years. The Fund's Actuary assesses the financial health of the pension fund and sets the employer contribution rates required for the next three years.

This report presents the results of the actuarial valuation of the Scottish Homes Pension Fund as at 31 March 2017.

The funding level at 31 March 2017 was 104.7%, increased from 88.8% from the 2014 actuarial valuation. This Actual Funding Level (AFL) of 104.7% is greater than the Target Funding Level (TFL) of 93.0%, as specified in the Scottish Government Guarantee. Accordingly, no deficit contributions are required from the Scottish Government (as Guarantor) for the period from 1 April 2018 to 31 March 2021.

The Scottish Government, however, is required to pay a total of £70,000 per annum towards the cost of administration expenses over the three years from 1 April 2018 to 31 March 2021.

Consultation has been undertaken with the Scottish Government on the potential benefits offered by a revised Funding Agreement. The Scottish Government, however, has recently advised that it does not wish to revisit such.

EDINBVRGH
THE CITY OF EDINBURGH COUNCIL

2017 Actuarial Valuation for Scottish Homes Pension Fund

1. Recommendations

Committee is requested to:

1.1 Note the results of the 2017 actuarial valuation for the Scottish Homes Pension Fund;

1.2 Note that the funding level of the Scottish Homes Pension Fund at 31 March 2017 was 104.7%. This Actual Funding Level (AFL) of 104.7% is greater than the Target Funding Level (TFL) of 93.0%, as specified in the Scottish Government Guarantee. Accordingly, no deficit contributions are required from the Scottish Government (as Guarantor) for the period from 1 April 2018 to 31 March 2021;

1.3 Note that the Scottish Government is required to pay a total of £70,000 per annum towards the cost of administration expenses over the three years from 1 April 2018 to 31 March 2021;

1.4 Note that the Scottish Government was consulted on the potential benefits offered by a revised Funding Agreement, incorporating an amended investment strategy for the Fund; and

1.5 Note that the Scottish Government has recently advised that it does not wish to revise the Funding Agreement and that the equity and property investments are being sold with proceeds being reinvested in index-linked gilts, in accordance with the current Funding Agreement.

2. Background

2.1 The City of Edinburgh Council took over the administration of the deferred and pensioner liabilities of Scottish Homes in July 2005. An agreement between the Scottish Government and the City of Edinburgh Council (‘the Guarantee’) was put in place in June 2005. The Scottish Government acts as the ‘Guarantor’ for the Fund liabilities.

2.2 The Scottish Homes Pension Fund is required by law to undertake an actuarial valuation once every three years. Based on data as at 31 March 2017, this actuarial valuation must be completed by 31 March 2018.

2.3 The actuarial valuation of a pension fund has three main purposes:

- To assess whether the funding strategy and assumptions are appropriate;

- To assess the financial health of the pension fund; and
- To set the future rates of contributions payable by the employer / guarantor.

2.4 The funding strategy for the Scottish Homes Pension Fund and the valuation methodology is set out in the Guarantee. The strategy assesses the funding level using prudent financial assumptions and sets target funding levels for the Fund at each actuarial valuation. It also sets out the conditions which will trigger contributions to be payable by the Scottish Government.

2.5 The Guarantee provides guidance on the investment strategy for the Fund including the expectation that the allocation to equities is reduced over time and the desire of the Scottish Government to 'lock away any surpluses that may occur over time by accelerating the transfer into bonds'.

2.6 A report by the Executive Director of Resources entitled "Annual Investment Update – Scottish Homes Pension Fund" was considered by Pensions Committee, at its meeting on 27 September 2017. This commented that "Changes to the Fund's asset allocation based on funding level progress were agreed by the Pensions Committee in December 2014. During 2016/17, there were a number of changes to asset allocation reflecting further improvements in the estimated funding level. The equity strategic allocation was decreased over the year from 30% to 17.5%. The portfolio structure has also been revised, resulting in a portfolio where the expected cash flows will more closely match the expected liability outflows for the Fund. The bulk of the Fund's assets are also now managed in-house, resulting in reduced ongoing investment manager fees. Committee has previously agreed that the Executive Director of Resources should progress an updated funding agreement with Scottish Government, in consultation with the Actuary, Investment Strategy Panel and Convener of the Pensions Committee."

3. Main report

2017 Actuarial Valuation

3.1 The 2017 Actuarial Valuation report is provided in Appendix 1. The report is marked as 'Draft' pending the formal approval of the Funding Strategy Statement which is also on Committee's agenda.

3.2 Liability cashflows (projected benefit payments) have been estimated based on financial and demographic assumptions, as detailed in the appendix.

3.3 The table below summarises the financial position of the Fund at 31 March 2017, with the result at the 2014 formal valuation shown for comparison.

Valuation Date	**2014**	**2017**
	£M	**£M**
Past Service Liabilities	153.5	162.9
Market Value of Assets	136.3	170.6
Surplus / (Deficit)	(17.1)	7.7
Actual Funding Level %	**88.8%**	**104.7%**
Target Funding Level %	**91.5%**	**93.0%**

3.4 The Fund's Actuary has commented "The assets have grown substantially over the inter-valuation period. This is a result of much better than assumed asset returns. The strong investment return has more than offset the increase in liabilities".

3.5 The Target Funding Level (TFL), as set out in the Guarantee, is 93.0% at 31 March 2017. The Actual Funding Level (AFL) is greater than the TFL at the 2017 valuation date and therefore no deficit contributions are required from the Scottish Government (as Guarantor) for the period from 1 April 2018 to 31 March 2021.

3.6 The Guarantor, however, should also meet the cost of administration expenses. To ensure prudence, therefore, the Guarantor is required to pay a total of £70,000 per annum over the three years from 1 April 2018. Investment expenses will be met from the current funding surplus.

Investment Strategy

3.7 The funding agreement with the Scottish Government and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over the time.

3.8 The Scottish Government has previously stated that it does not wish to explore the purchase of insurance (annuities) contracts for the Fund. These could provide greater (and potentially full) protection from all risks, including longevity. This option would only be pursued further should there be intimation of a change in its stance by the Scottish Government.

3.9 A summary of the movements in strategic allocation of the investments is shown below:

SCOTTISH HOMES PENSION FUND	Sep-16 Strategy Allocation %	Oct-17 Strategy Allocation %	Jan-17 Strategy Allocation %	Mar-17 Strategy Allocation %	Jun-17 Strategy Allocation %	Sep-17 Strategy Allocation %
Equities	25.0	22.5	20.0	17.5	15.0	10.0
Bonds	70.0	72.5	75.0	77.5	80.0	85.0
Property	5.0	5.0	5.0	5.0	5.0	5.0
Total Fund	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

3.10 The Fund's officers have advised the Scottish Government that with the funding level in excess of 100%, the investments are expected to be fully invested in index-linked gilts as required under the current funding agreement. Investment in such assets provides a less volatile funding level. However, the expected income and investment returns from index-linked gilts is lower than other asset classes (such as equities, property and corporate debt). Furthermore, index-linked gilts cannot provide an exact match for the liabilities and longevity risks remain. Hence, there will continue to be a risk of further contributions being required from Scottish Government. Other funding options, specifically less restrictive investment strategies (which include assets other than index-linked gilts), were being explored, with the objective being to provide investment income which would match the benefit outgoings more closely. Such a strategy would have expected to deliver a lower risk of contributions being required and an expectation of a buffer to cover unexpected experience. Revisions to the funding agreement would be required to implement such a strategy. Consultation with the Scottish Government took place on this basis.

3.11 The Scottish Government confirmed its agreement to delaying the further transfer from equities to index linked gilts which adherence to the Guarantee would have dictated, pending its consideration of the options.

3.12 In late February 2018, however, the Scottish Government advised that it does not wish to revisit the Funding Agreement. With the Actual Funding Level standing at 104.7% as at 31 March 2017, at the time of writing the equity and property investments are being sold with proceeds being invested in index-linked gilts, in accordance with the Funding Agreement.

4. Measures of success

4.1 The Guarantee agreement with the Scottish Government sets out the target funding levels for the Scottish Homes Pension Fund every 3 years until 2044. Actual funding levels are measured against the target funding levels on a regular basis.

5. Financial impact

5.1 The funding strategy, together with the Guarantee from the Scottish Government, should ensure that the Fund has sufficient assets in the long term. The results of the actuarial valuation have a financial impact on the Scottish Government as guarantor. The actuarial valuation sets the contribution rates payable by the Scottish Government over the next 3 years.

6. Risk, policy, compliance and governance impact

6.1 The investment strategy of the pension fund is one of the main determinants of risk, in terms of volatility of funding level and contributions payable by the Scottish Government.

7. Equalities impact

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

8. Sustainability impact

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

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

9.2 The Scottish Government has been consulted during the actuarial valuation process.

10. Background reading/external references

10.1 None

Stephen S. Moir

Executive Director of Resources

Contact: Clare Scott, Chief Executive Officer, Lothian Pension Fund

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11. Appendices

Appendix 1 – 2017 Actuarial Valuation Report for Scottish Homes Pension Fund

Appendix 1

Scottish Homes Pension Fund

2017 Actuarial Valuation Report

March 2018

DRAFT

Richard Warden
Laura McInroy

Fellows of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP

Contents

Executive summary

We have carried out an actuarial valuation of the Scottish Homes Pension Fund ("the Fund") as at 31 March 2017.

The Scottish Government (previously known as the Scottish Executive) acts as the 'Guarantor' for the Fund's liabilities. The results are presented in this report and are summarised below.

Funding position

The table below summarises the funding position of the Fund as at 31 March 2014 and 31 March 2017:

Past Service Position	31 March 2014 (£m)	31 March 2017 (£m)
Past Service Liabilities	153.5	162.9
Market Value of Assets	136.3	170.6
Surplus / (Deficit)	(17.1)	7.7
Funding Level	**88.8%**	**104.7%**

The Actual Funding Level (AFL) has improved due primarily to better than anticipated investment returns. This has been partially offset by a reduction in future expected investment returns. Further details are set out in **Section 4**.

Contribution rates

The Target Funding Level (TFL), as set out in the Funding Agreement, is 93.0% at 31 March 2017. The AFL is greater than the TFL at the 2017 valuation date and therefore no deficit contributions are required from the Guarantor for the period from 1 April 2018 to 31 March 2021.

The Guarantor has a responsibility to pay towards the cost of administration expenses. The Fund's current best estimate of these is £70,000 per annum.

In addition, the Guarantor is responsible for meeting the cost of investment expenses. Given the Fund's surplus, we and the Administering Authority are comfortable that investment expenses can be met directly from the Fund over the next three years.

The Guarantor is therefore being asked to pay total contributions to the Fund of £70,000 per annum from 1 April 2018 to 31 March 2021. This contribution requirement is set out in the Rates and Adjustments Certificate in **Appendix D**.

Please note the figures in the tables throughout this document have been rounded. As a result, the sum of figures within the tables may not add up due to rounding.

1 Introduction

The deferred pensioner and pensioner members of the Scottish Homes Pension Fund were transferred to the City of Edinburgh Council ("the Administering Authority") prior to the wind-up of the Scottish Homes Residuary Body. The Administering Authority assumed the management of its assets and liabilities from 1 July 2005.

The Scottish Government (formerly the Scottish Executive) acts as the Guarantor for the transferred liabilities. The Guarantor's intention is that over time the transferred assets together with any additional contributions required should be sufficient to fund the former Scottish Homes Pension Fund liabilities.

The Administering Authority has commissioned us to carry out a formal actuarial valuation of the Scottish Homes Pension Fund ("the Fund") as at 31 March 2017 to fulfil its obligations under Regulation 60 of The Local Government Pension Scheme (Scotland) Regulations 2014 ("the Regulations"). Therefore, the totality of our advice in relation to this formal valuation has been addressed to the Administering Authority and it is the only intended users of this advice. All reliances, limitations and caveats, including third party exclusions are set out in Section 7 of this report.

The purpose of the actuarial valuation is to assess the value of the assets and liabilities of the Fund as at 31 March 2017 and to calculate the required rate of Guarantor contributions to the Fund for the period from 1 April 2018 to 31 March 2021. This report summarises the results of the valuation and the underlying advice provided to the Administering Authority throughout the valuation process.

This report is the culmination of various other communications which set out our advice in relation to the valuation, in particular:

- Correspondence relating to data including the Data Report dated 5 March 2018;
- The Initial Results report dated 12 December 2017 which outlined the whole fund results and proposed valuation assumptions;
- The operation of the Scottish Executive Funding Agreement dated 29 June 2005, confirming the approach to determining contributions payable to the Fund by the Scottish Government (the "Funding Agreement").

2 Valuation Approach

The valuation is a planning exercise for the Fund, to assess the monies needed to meet the benefits owed to its members as they fall due. The scheme rules and benefits are set out in the Regulations. For further details, please refer to the timeline regulations on http://www.scotlgpsregs.org/.

It is important to realise that the actual cost of the pension fund (i.e. how much money it will ultimately have to pay out to its members in the form of benefits) is unknown. This cost will not be known with certainty until the last benefit is paid to the last pensioner. The purpose of this valuation is to estimate what this cost will be. Such a valuation can only ever be an estimate as the future cannot be predicted with certainty.

The principal measurement is the comparison of the funding position at the valuation date against the funding target. The market value of the Fund's assets as at the valuation date are compared against the value placed on the Fund's liabilities in today's terms (calculated using a market-based approach). By maintaining a link to the market in both cases, this helps ensure that the assets and liabilities are valued in a consistent manner. The assumptions used in the assessment of the funding position at the valuation date are detailed in the next section.

The funding level is the ratio of assets to liabilities at the valuation date. A funding level of less/more than 100% implies that there is a deficit/surplus in the Fund at the valuation date against the funding target.

3 Assumptions

Assumptions must be made about the factors affecting the Fund's finances in the future. These assumptions broadly fall into two categories – financial and demographic.

The Scottish Government acts as the 'Guarantor' for the Fund liabilities.

Financial assumptions

Financial assumptions relate to the **size** of members' benefits. For example, how members' pensions will increase over time. In addition, the financial assumptions also help us to estimate how much members' benefits will cost the Fund in today's money by making an assumption about the return on the Fund's investments in future.

Discount rate

In order to place a current value on the future benefit payments from the Fund, an assumption about future investment returns is required in order to "discount" future benefit payments back to the valuation date.

The terms of the Funding Agreement impose restrictions on the discount rate that is used to calculate the value of the past service liabilities. In particular, no allowance for anticipated out-performance resulting from investment in assets that are riskier than Government bonds, such as equities and property, should be included. In any event, the Fund intends to de-risk its investment strategy to invest solely in Government bonds and will no longer hold riskier assets.

The discount rate is in line with the Bank of England nominal yield curve at the valuation date. This means that each future cashflow has been discounted at an appropriate spot rate dependent on the expected timing of the cashflow. This approach is similar to the 2014 valuation.

Price inflation / benefit increases

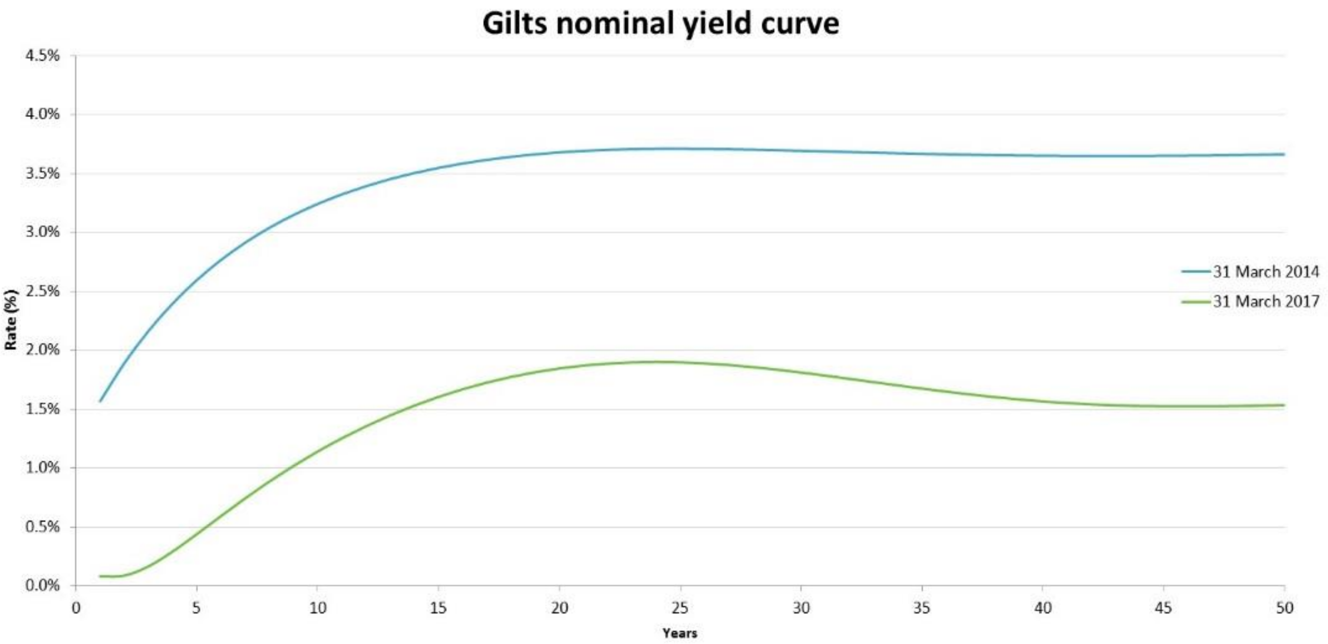
Benefit increases are awarded in line with the Consumer Prices Index (CPI). As there continues to be no deep market for CPI linked financial instruments, the Fund derives the expected level of future CPI with reference to the Retail Prices Index (RPI).

Similar to the previous valuation, the assumption for RPI is derived from the Bank of England implied inflation (RPI) curve to recognise differing expected inflation assumptions at different durations. We expect the average long term difference between RPI and CPI to be 1.0% p.a. (compared to 0.8% p.a. at the 2014 valuation).

A summary of the main financial assumptions adopted for the valuation of members' benefits is shown below (the assumptions at the 2014 valuation are shown for comparison).

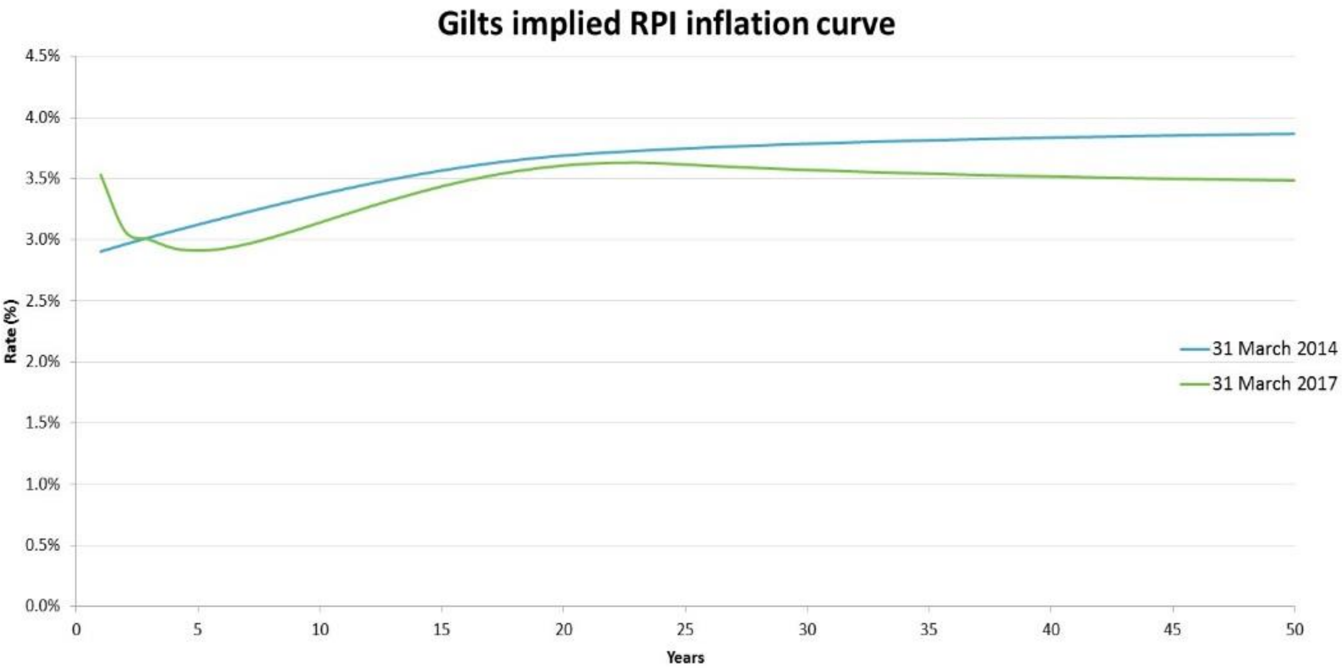
Financial Assumptions	31 March 2014	31 March 2017
Discount rate	Bank of England nominal yield curve	Bank of England nominal yield curve
Benefit increases	Bank of England implied inflation (RPI) curve less 0.8% p.a.	Bank of England implied inflation (RPI) curve less 1.0% p.a.

The chart below shows the nominal spot yields for a Government-backed loan (i.e. the yield to maturity of a zero coupon bond) as at 31 March 2017 (the equivalent curve as at 31 March 2014 is shown for comparison).



Source: Bank of England

The chart below shows the Bank of England implied inflation curve over a range of maturities at 31 March 2017 (the equivalent curve as at 31 March 2014 is shown for comparison). This is derived from the yields on both fixed and index linked gilts.



Source: Bank of England

Demographic assumptions

Demographic assumptions typically try to forecast when benefits will come into payment and what form these will take. For example, when members will retire (e.g. at their normal retirement age or earlier), how long they will then survive and whether a dependant's pension will be paid.

Longevity

The main demographic assumption to which the valuation results are most sensitive is that relating to the longevity of the Fund's members. The longevity assumptions result in the following typical future life expectancies from age 65 (figures for 2014 are shown for comparison):

	31 March 2014	31 March 2017
Male		
Pensioners	24.5 years	22.4 years
Non-pensioners	26.8 years	24.8 years
Female		
Pensioners	25.4 years	24.8 years
Non-pensioners	28.6 years	27.8 years

Further details of the longevity assumptions adopted for this valuation can be found in **Appendix B**. Note that the figures for non-pensioners assume they are aged 45 at the valuation date.

Retirement age pattern

We have adopted the retirement age pattern assumption as specified by the England and Wales Scheme Advisory Board for preparing Key Performance Indicators.

Other demographic assumptions

We are in the unique position of having a very large local authority data set from which to derive our other demographic assumptions. We have analysed the trends and patterns that are present in the membership of local authority funds and tailored our demographic assumptions to reflect LGPS experience. Details of the other demographic assumptions adopted by the Fund are set out in **Appendix B**.

Further comments on the assumptions

We understand that, as a result of the Fund's surplus funding position, and following discussion with the Guarantor, the Administering Authority is removing all exposure to volatile asset classes (e.g. equities) in favour of low risk assets (i.e. index-linked government bonds). The discount rate assumption (government bond yields) is based on returns from very low risk assets, and should broadly match the future investment returns that can be anticipated from the Fund's assets given the change in asset allocation.

Taken in aggregate, we believe the proposed funding basis results in a sufficiently prudent estimate of the Fund's pension liabilities.

4 Results

Funding level and surplus / (deficit)

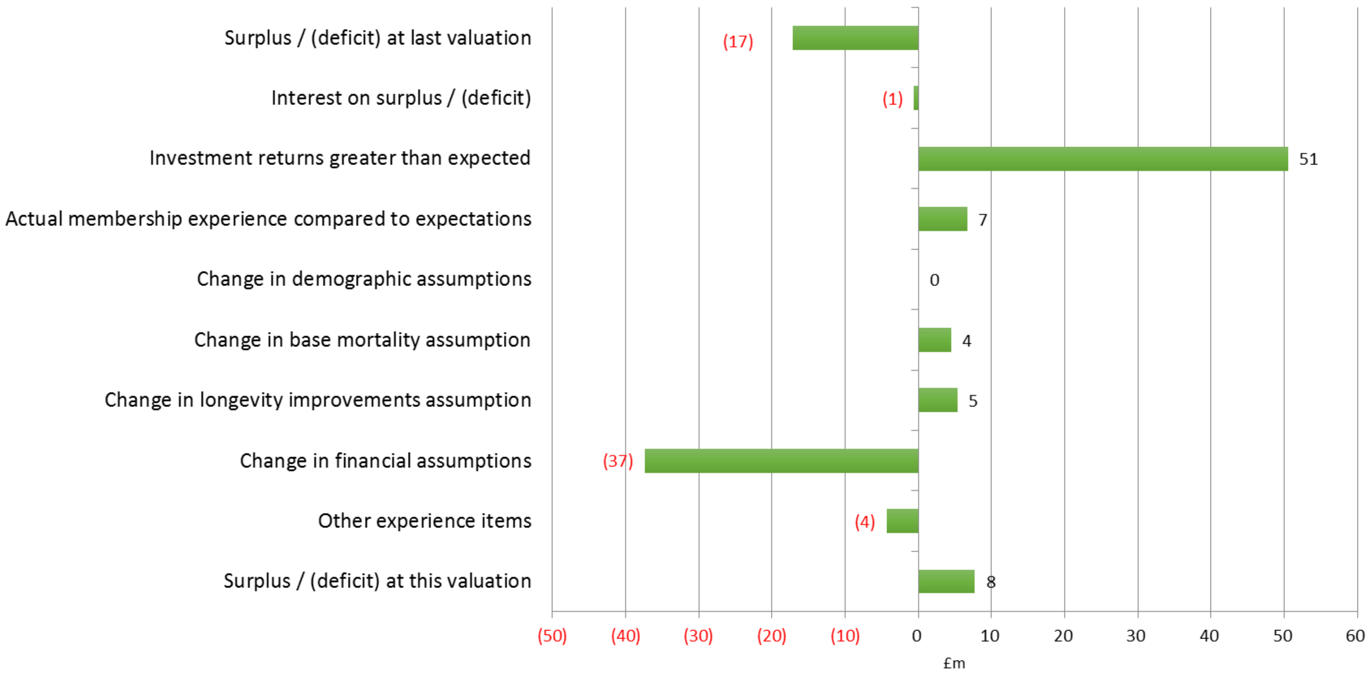
In assessing the extent to which the past service funding objective was met at the valuation date, we have used the actuarial assumptions described in the previous section of this report and the funding method also earlier described. The table below compares the value of the assets and liabilities at 31 March 2017. The 31 March 2014 results are also shown for reference.

Valuation Date	31 March 2014	31 March 2017
	(£m)	(£m)
Deferred Pensioners	39.4	42.8
Pensioners	114.1	120.1
Past Service Liabilities	153.5	162.9
Total Liabilities	**153.5**	**162.9**
Assets	**136.3**	**170.6**
Surplus / (Deficit)	**(17.1)**	**7.7**
Funding Level	**88.8%**	**104.7%**

The Actual Funding Level (AFL) has improved from 88.8% to 104.7% since the previous valuation at 31 March 2014. This corresponds to a surplus of £7.7m at 31 March 2017.

Summary of changes to the funding position

The chart below illustrates the factors that caused the changes in the funding position between 31 March 2014 and 31 March 2017:



Further comments on this chart are set out below:

- There is an interest loss of £1m. This is broadly three years of compound interest at 1.2% p.a. (the average assumed return over the period using the yield curve approach) applied to the previous valuation deficit of £17m.
- Investment returns being higher than expected since 2014 lead to a gain of £51m. This is roughly the difference between the actual three-year return (44.7%) and the expected three-year return (3.6%) applied to

the whole fund assets from the previous valuation of £136m, with a further allowance made for cashflows during the period.

- The change in longevity assumptions (baseline and improvements) has given rise to a gain of £9m. .
- The change in financial conditions since the previous valuation has led to a loss of £37m. This is due to a decrease in the real discount rate between 2014 and 2017. This can be approximately broken down as follows:
    - Changing the discount rate leads to a loss of £47m
    - Changing the benefit increase assumption leads to a gain of £10m.
- Membership experience over the 3 years has led to a gain of £7m. The most material item of membership experience have been lower than expected pension increases leading to a gain of £6m

Projection of the funding position

The progression of the funding position will depend on various factors including future asset performance, economic conditions and membership movements. If the financial and demographic assumptions we have made at this valuation are borne out in practice, and there are no changes to the valuation assumptions, we project that the funding level at the 2020 valuation date will be broadly unchanged.

Guarantor Contribution Rates

Deficit Recovery Contributions

The Funding Agreement sets out how payments from the Guarantor should be determined. As the Fund is in surplus as at 31 March 2017, no deficit contributions are required from the Scottish Government.

Expense Requirement

The Guarantor has a responsibility to pay towards the cost of administration expenses, which are currently estimated to be £70,000 p.a..

The Fund is now well ahead of its Target Funding Level. It therefore intends to shortly de-risk its investment strategy and invest 100% of its assets in index-linked gilts. As required by the Funding Agreement, the liabilities are valued using yield curves that make no allowance for investment returns. The proposed switch to a full gilts-based investment strategy means that in future expected returns should be broadly in line with those curves. To maintain prudence in future valuations, the Guarantor should also pay for investment expenses otherwise these would act to reduce the returns expected from the gilts-based strategy to below those implied by the yield curves. Given the surplus position at this valuation, we and the Administering Authority are comfortable for investment expenses to be met by the Fund over the next three years.

The total Expense Requirement is therefore £70,000 p.a. from 1 April 2018 to 31 March 2021.

Certified contributions

The Guarantor is being asked to pay total contributions of £70,000 p.a. to the Fund from 1 April 2018 to 31 March 2021. This contribution requirement is set out in the Rates and Adjustment Certificate in **Appendix D**.

The Actual Funding Level and Expense Requirement will be reassessed at the 2020 valuation of the Fund and contributions (either towards any Past Service Deficit or towards expenses) will be reviewed at that time.

Guaranteed Minimum Pension (GMP) consultation

The GMP is the minimum pension which a UK occupational pension scheme has to provide for those employees who were contracted out of the State Earnings Related Pension Scheme (SERPS) between 6 April 1978 and 5 April 1997. A UK Government consultation issued in November 2016 sought views on a long term solution to address the indexation and equalisation of GMPs for members reaching State Pension Age (SPA) on or after 6 December 2018.

The Government recently announced that the existing 'interim solution' should be extended by 2 years and 4 months to cover members who reach SPA before 6 April 2021 but is yet to make a decision on the longer term solution. It is possible that its final decision could lead to the Fund paying full pension increases on the GMP of the affected members. If this happens, we estimate that around £2m could be added to the Fund's liabilities.

The majority of members benefits increase in line with CPI. Only one element of pension, namely pre 1988 GMP, is fixed in nature (i.e. it does not increase in line with any inflation index). The liability in respect of pre 1988 GMP is equal to approximately 12% of the total liabilities.

5 Risk Assessment

The valuation results depend critically on the actuarial assumptions that are made about the future of the Fund. If all of the assumptions made at this valuation were exactly borne out in practice then the results presented in this document would represent the true cost of the Fund as it currently stands at 31 March 2017.

However, no one can predict the future with certainty and it is unlikely that future experience will exactly match the assumptions. The future therefore presents a variety of risks to the Fund and these should be considered as part of the valuation process. In particular:

- The main risks to the financial health of the Fund should be **identified**.
- Where possible, the financial significance of these risks should be **quantified**.
- Consideration should be given as to how these risks can then be **controlled** or **mitigated**.
- These risks should then be **monitored** to assess whether any mitigation is actually working.

This section investigates the potential implications of the actuarial assumptions not being borne out in practice.

Set out below is a brief assessment of the main risks and their effect on the valuation past service funding position results.

Sensitivity of past service funding position results to changes in assumptions

The table below gives an indication of the sensitivity of the funding position to small changes in two of the main financial assumptions used:

		Benefit Increases (p.a.)			
Discount Rates (p.a		+0.2%	Curve	-0.2%	
	-0.5%	4 102%	5 103%	6 103%	(Deficit) Funding Level
	Curve	7 104%	8 105%	8 105%	(Deficit) Funding Level
	+0.5%	9 106%	10 107%	11 107%	(Deficit) Funding Level

Please note, the Fund is primarily invested in index-linked gilts. The table above allows for movements in liabilities to be 75% matched by movements in assets. This approximate approach is for illustrative purposes only as the index linked gilts held do not match the liabilities exactly.

The table makes no allowance for the proposed change in asset allocation to full investment in gilts. Once this is in place, changes to the assumptions should have little impact on the funding level and surplus/deficit position, as movements in asset values should be broadly matched by corresponding movements to liability values.

The valuation results are also very sensitive to unexpected changes in future longevity. All else being equal, if longevity improves in the future at a faster pace than allowed for in the valuation assumptions, the funding level will decline and the required employer contribution rates may increase.

The proposed valuation assumption assumes that in the longer term mortality rates will improve at a rate of 1.75% each year. The more prudent assumptions shown for sensitivity analysis assumes that mortality rates will improve at a rate of 2.0% each year in the longer term.

	1.75% long term rate of improvement	2.00% long term rate of improvement
Surplus	8	6
Funding Level	105%	104%

Unless otherwise noted, the tables show the effect of changes to each assumption in isolation. In reality, it is perfectly possible for the experience of the Fund to deviate from more than one of our assumptions simultaneously and so the precise effect on the funding position is therefore more complex. Furthermore, the range of assumptions shown here is by no means exhaustive and should not be considered as the limits of how extreme experience could actually be.

Funding risks

The Guarantor is exposed to a number of risks. These include, but are not limited to:

- Market risks – these include investment returns being less than anticipated or liabilities increasing more than expected due to changes in market conditions underlying the financial assumptions (e.g. inflation above that assumed in **Section 3**). The proposed change to a full gilts-based investment strategy should help to minimise this risk.
- Demographic risks – these include anything that affects the timing or type of benefits (e.g. members living longer than anticipated).
- Regulatory risks – changes in the Regulations could materially affect the benefits that members become entitled to. It is difficult to predict the nature of any such changes but it is not inconceivable that they could have a retrospective effect on the past service position.
- Administration and Governance risks – failures in administration processes can lead to incorrect actuarial calculations. For example, where membership data is not up to date material inaccuracies in respect of the level of deficit and contributions may occur at future valuations

6 Related issues

The Fund's valuation operates within a broader framework, and this document should therefore be considered alongside the following:

- the operation of the Scottish Executive Funding Agreement, confirming the approach to determining contributions payable to the Fund by the Scottish Government.
- the Statement of Investment Principles (e.g. the discount rate must be consistent with the Fund's asset strategy);
- the general governance of the Fund, such as meetings of the Pensions Committee, decisions delegated to officers, the Fund's business plan, etc;
- the Fund's risk register.

Further recommendations

Valuation frequency

Under the provisions of the LGPS regulations, the next formal valuation of the Fund is due to be carried out as at 31 March 2020. The move to a gilts-based investment strategy should reduce the volatility of the funding level. We would be happy to provide funding updates on request if the Fund would like to test the impact of the new strategy.

Investment strategy and risk management

The Administering Authority in consultation with the Guarantor has recently reviewed the investment strategy and has agreed to adopt an index linked gilts strategy. We recommend that the Administering Authority continues to regularly review its investment strategy and ongoing risk management programme.

7 Reliances and limitations

Third parties

This document has been prepared for the sole use of City of Edinburgh Council in its role as Administering Authority of the Fund and not for any other third party. Hymans Robertson LLP makes no representation or warranties to any third party as to the accuracy or completeness of this report. This report will therefore not address the particular interests or concerns of any such third party.

As this report has not been prepared for a third party, no reliance by any third party will be placed on it. It follows that there is no duty or liability by Hymans Robertson LLP (or its members, partners, officers, employees and agents) to any party other than City of Edinburgh Council. Hymans Robertson LLP therefore disclaims all liability and responsibility arising from any reliance on or use of this report by any person having access to this report or by anyone who may be informed of the contents of the Report.

The Report must not be used for any commercial purposes unless Hymans Robertson LLP agrees in advance.

Component reports

As set out in **Section 1** and **Section 6**, the totality of our advice pertaining to the valuation is set out over a number of component communications and complies with the various professional and regulatory requirements related to public sector actuarial valuations in Scotland. The reliances, limitations and caveats within this report and each component report apply equally across the totality of our advice.

Model limitations

The models used to calculate the assets, liabilities, contribution rates and the level of indemnity make some necessary simplifying assumptions. I do not consider these simplifications to be material and I am satisfied that they are appropriate for the purposes described in this report.

Limited purpose

This document has been prepared to fulfil the statutory obligations of the Administering Authority to carry out a formal actuarial valuation. None of the figures should be used for accounting purposes (e.g. under FRS102 or IAS19) or for any other purpose.

Reliance on data

The results of the valuation are dependent on the quality of the data provided to us by the Administering Authority for the specific purpose of this valuation. We have previously issued a separate report confirming that the data provided is fit for the purposes of this valuation and have commented on the quality of the data provided. The data used in our calculations is as per our report dated 5 March 2018.

Actuarial standards

The following Technical Actuarial Standards[1] are applicable in relation to this report and have been complied with:

- TAS 100 – Principles for technical actuarial work;
- TAS 300 – Pensions.

No material deviations have been made from the above actuarial standards.

[1] Technical Actuarial Standards (TASs) are issued by the Financial Reporting Council (FRC) and set standards for certain items of actuarial work, including the information and advice contained in this report.

Compliance statement

The totality of our advice complies with the Regulations as they pertain to actuarial valuations.

Richard Warden

Fellow of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

12 March 2018

Laura McInroy

Fellow of the Institute and Faculty of Actuaries

Appendix A: Data

This section contains a summary of the membership, investment and accounting data provided by the Administering Authority for the purposes of this valuation (the corresponding membership and investment data from the previous valuation is also shown for reference). For further details of the data, and the checks and amendments performed in the course of this valuation, please refer to our separate data report.

Membership data – whole fund

Deferred pensioners

	31 March 2014		31 March 2017	
	Number	Deferred pension (£000)	Number	Deferred pension (£000)
Total deferred membership	598	1,353	471	1,110

Current pensioners, spouses and children

	31 March 2014		31 March 2017	
	Number	Pension (£000)	Number	Pension (£000)
Members	953	6,225	919	5,799
Dependants	314	805	289	956
Children	3	3	1	1
Total pensioner members	**1,270**	**7,033**	**1,209**	**6,755**

Note that the membership numbers in the table above refer to the number of records provided to us and so will include an element of double-counting in respect of any members who are in receipt (or potentially in receipt of) more than one benefit.

Membership Profile	Average Age (years)	
	2014	2017
Deferred Pensioners	53.5	54.7
Pensioners	71.6	71.9

The average ages are weighted by liability.

Assets at 31 March 2017

A summary of the Fund's assets provided by the Administering Authority as at 31 March 2017 and 31 March 2014 is as follows:

Asset class	31 March 2014 (Market Value) (£000)	Allocation %	31 March 2017 (Market Value) (£000)	Allocation %
UK equities	8,777	6%	0	0%
UK fixed interest gilts	17,336	13%	0	0%
UK index-linked gilts	69,498	51%	128,477	75%
Overseas equities	31,189	23%	29,037	17%
Property	6,960	5%	7,998	5%
Cash and net current assets	2,544	2%	5,132	3%
Total	**136,305**	**100%**	**170,644**	**100%**

Accounting data – revenue account for the three years to 31 March 2017

Consolidated accounts (£000)	Year to			Total
	31 March 2015	30 March 2016	31 March 2017	
Income				
Employer - normal contributions	771	675	675	2,121
Employer - additional contributions	0	0	0	0
Employer - early retirement and augmentation strain contributions	0	0	0	0
Employee - normal contributions	0	0	0	0
Employee - additional contributions	0	0	0	0
Transfers In Received (including group and individual)	0	0	0	0
Other Income	0	0	0	0
Total Income	**771**	**675**	**675**	**2,121**
Expenditure				
Gross Retirement Pensions	7,057	6,890	6,789	20,736
Lump Sum Retirement Benefits	372	472	563	1,407
Death in Service Lump sum	11	7	0	18
Death in Deferment Lump Sum	0	0	0	0
Death in Retirement Lump Sum	0	0	0	0
Gross Refund of Contributions	0	0	0	0
Transfers out (including bulk and individual)	93	290	120	503
Fees and Expenses	69	53	68	190
Total Expenditure	**7,602**	**7,712**	**7,540**	**22,854**
Net Cashflow	**-6,831**	**-7,037**	**-6,865**	**-20,733**
Assets at start of year	**136,305**	**154,720**	**150,275**	**136,305**
Net cashflow	**-6,831**	**-7,037**	**-6,865**	**-20,733**
Change in value	**25,246**	**2,592**	**27,234**	**55,072**
Assets at end of year	**154,720**	**150,275**	**170,644**	**170,644**
Approximate rate of return on assets	**19.0%**	**1.7%**	**18.5%**	**43.4%**

Note that the figures above are based on the Fund accounts provided to us for the purposes of this valuation, which were fully audited at the time of our valuation calculations.

Appendix B: Assumptions

Financial assumptions

Financial assumptions	31 March 2014	31 March 2017
Discount rate	Bank of England nominal yield curve	Bank of England nominal yield curve
Price inflation	Bank of England implied inflation (RPI) curve less 0.8% p.a.	Bank of England implied inflation (RPI) curve less 1.0% p.a.

Mortality assumptions

As the fund is a member of Club Vita, the baseline longevity assumptions are a bespoke set of Vita Curves that are tailored to fit the membership profile of the Fund. These curves are based on the data the Fund has provided us with for the purposes of this valuation. Full details of these are available on request.

We have also allowed for future improvements in mortality based on the CMI 2016 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.75% p.a..

Other demographic valuation assumptions

Family details	A varying proportion of members are assumed to be married (or have an adult dependant) at retirement or on earlier death. For example, at age 60 this is assumed to be 90% for males and 85% for females. Husbands are assumed to be 3 years older than wives.
Commutation	50% of future retirements elect to exchange pension for additional tax free cash up to HMRC limits for service to 1 April 2009 (equivalent 75% for service from 1 April 2009).

Sample rates of the incidence of death from deferred status are shown in the table below

Age	Death in Deferment Rates Incidence per 1000 members per annum	
	All Males	All Females
20	0.27	0.14
25	0.27	0.14
30	0.31	0.21
35	0.38	0.34
40	0.64	0.55
45	1.07	0.89
50	1.72	1.30
55	2.68	1.71
60	4.83	2.19
65	0.00	0.00

Appendix C: Events since valuation date

Post-valuation events

These valuation results are in effect a snapshot of the Fund as at 31 March 2017. Since that date, various events have had an effect on the financial position of the Fund. Whilst we have not explicitly altered the valuation results to allow for these events, a short discussion of these "post-valuation events" can still be beneficial in understanding the variability of pension funding.

In the period from the valuation date to end February 2018, asset returns have been better than expected and there has been a small increase in long term interest rates which places a lower value on the past service liabilities. Overall, the funding position at end February 2018 is likely to have improved since 31 March 2017.

It should be noted that the above is for information only: the figures in this report have all been prepared using membership data, audited asset information and market-based assumptions all as at 31 March 2017. Had the funding position improved or worsened, we would not have proposed amending the contribution rate shown in the Rates and Adjustments Certificate.

Appendix D: Rates and adjustments certificate

In accordance with regulation 60(4) of the Regulations we have made an assessment of the contributions that should be paid into the Fund by the Guarantor for the period 1 April 2018 to 31 March 2021 in order to maintain the solvency of the Fund.

The method and assumptions used to calculate the contributions set out in the Rates and Adjustments certificate are detailed in our report on the actuarial valuation dated 12 March 2018.

Regulation 60(8) requires a statement of the assumptions on which the certificate is given regarding the number of members, and the associated of liabilities arising, who will become entitled to payment of pensions under the regulations of the LGPS. These assumptions can be found in Appendix B of the 31 March 2017 formal valuation report dated 12 March 2018. These assumptions cover members who become entitled to payment of pension via normal retirement and ill health retirement.

The required minimum contribution rates are set out below.

Period	Guarantor's Minimum Contribution Rate
1 April 2018 to 31 March 2019	£70,000
1 April 2019 to 31 March 2020	£70,000
1 April 2020 to 31 March 2021	£70,000

Signature:		
Date:	12 March 2018	12 March 2018
Name:	Richard Warden	Laura McInroy
Qualification:	Fellow of the Institute and Faculty of Actuaries	Fellow of the Institute and Faculty of Actuaries
Firm:	Hymans Robertson LLP	Hymans Robertson LLP
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Pensions Committee

2.00pm, Monday, 26 March 2018

Funding Strategy Statement

Item number	5.9
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

As required under the Local Government Pension Scheme (Scotland) Regulations, the Lothian Pension Funds' Funding Strategy Statement has been reviewed as part of the actuarial valuation process to ensure that it remains appropriate. In revising the Funding Strategy Statement, due consideration has been given to:

- Actuarial valuation results;
- Consultation feedback from Fund employers;
- Revised guidance from CIPFA; and
- Changes to the Local Government Pension Scheme.

Report

Report

1. Recommendations

Committee is requested to:

1.1 Note the responses received as part of the consultation process;

1.2 Approve the revised Funding Strategy Statement; and

1.3 Note that new Local Government Pension Scheme Regulations are expected to be introduced shortly and consideration will be given to a further review of the Funding Strategy Statement to incorporate any changes required as a result.

2. Background

2.1 The Funding Strategy Statement (FSS) is a policy document which summarises the approach to funding pension liabilities of Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund. Relevant policies on:

- Employer admission to the Fund;
- Bulk transfers;
- Employers leaving the Fund and
- Charging

are appended to the FSS for completeness.

2.2 The FSS was last reviewed and updated in November 2015 following the employer appeals process introduced following the 2014 actuarial valuation.

2.3 An initial consultation on draft changes to the FSS was carried out in July 2017 with an update provided to Committee in September 2017. This initial consultation was carried out earlier than in previous years in order to provide employers with advance notice of proposed changes.

2.4 The draft revised FSS is attached as Appendix 1 to this report

3. Main report

Actuarial Valuation of the Pension Funds

3.1 As separately reported to Committee on this agenda, the Fund Actuary carried out a valuation of the Funds as at 31 March 2017. These valuations are required under regulation 60 of the Local Government Pension Scheme (Scotland) Regulations

2014 and the Actuary has prepared the reports in line with required Technical Actuarial Standards.

3.2 The valuation reports contain rates and adjustment certificates setting out employer contribution rates for the 3 years from 1 April 2018. Such certificates must be in place before the first anniversary of the valuation date i.e. by 31 March 2018. In setting contribution rates, the Actuary must have regard to the Funding Strategy, and the Actuary will certify these rates following Committee approval of the FSS.

CIPFA Guidance

3.3 The Scheme regulations require that in formulating the FSS, Funds must have regard to relevant CIPFA Guidance. The draft FSS has been amended to reflect the current CIPFA guidance ("Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme 2016'). The changes include provisions of the subsequent valuation of all Scottish Local Government Pension Scheme Funds under Section 13 of the Public Service Pensions Act 2013 regarding solvency.

Local Government Pension Scheme (Scotland) Regulations 2015

3.4 Since the FSS was last fully reviewed, a new Local Government Pension Scheme was introduced from 1 April 2015. Therefore, regulatory references in the FSS have been amended.

Introduction of new medium-risk investment strategy

3.5 At the 2014 valuation the Fund introduced a second investment strategy (the 'Lower Risk Strategy') for employers close to exit, ie those employers with:

- less than 5 active members, and/or
- a future working lifetime of active members of less than 6 years.

3.6 For such employers, the funding strategy is based on a more prudent gilts basis, akin to that used in the cessation valuation. In addition, employer contributions were based on their liabilities, rather than being part of a Pool. In effect, this strategy aimed to spread the deficit payment payable on cessation over the future working lifetime of the active members. It also aims to reduce the risk of employers being unable to pay large deficits when the last active member leaves.

3.7 The contribution rates introduced following this change were a significant increase from the amounts previously paid by employers, and resulted in a time-consuming appeals process. With hindsight, a smoother transition between the two strategies would have been implemented.

3.8 To address these issues, as previously advised in the July 2017 consultation exercise, from 1 April 2018 an additional funding and contribution strategy will apply for those employers which:

- are closed to new entrants, and
- have 5 or more active members.

3.9 For such employers, investment allocation will be halfway between the Primary and the Lower Risk Strategies (50% each). As with employers who are part of the Lower Risk Strategy, contributions for employers part of the Medium Risk strategy will be based on their own liabilities rather than being part of a Pool. This has meant an increase to contributions; however, the introduction of this strategy is intended to smooth the path to exit and reduce the risk of large deficits when the employer eventually leaves the Fund.

3.10 Following feedback from employers moving to the Medium-Risk strategy, the Fund has, in consultation with the Actuary, extended the phasing in of new contribution rates in certain circumstances.

Employer commitment to contribution rates

3.11 As noted above, changes to the FSS following the 2014 valuation led to a time-consuming appeals process. This process allowed employers to appeal the original minimum contribution rates on affordability grounds, and in several circumstances revised rates were calculated, with the future service rate on the gilts basis being the minimum stipulated contribution.

3.12 However, it is not considered to be in the best interests of either the individual employers or the Fund, for employers to continue to accrue unaffordable pension liabilities whilst not making contributions towards their deficit. As such, the draft FSS requires employers to provide written confirmation that minimum contribution rates set by the Actuary are not unaffordable. Where such confirmation cannot be provided, the admission agreement will be terminated, with three months' notice being provided by the Fund. Following calculation of a cessation valuation, the Fund may then agree repayment with the employer in line with principles previously agreed by Committee in November 2015.

3.13 Regulation 62(4) of the Local Government Pension Scheme (Scotland) Regulations 2014 also provides that, where in the opinion of the Administering Authority there are circumstances which make it likely that a Scheme employer (including an admission body) will become an exiting employer, the Administering Authority may obtain an updated rates and adjustments certificate from the Actuary with a view to providing that assets equivalent to the exit payment that will be due from the Scheme employer are provided to the fund by the likely exit date or, where the Scheme employer is unable to meet that liability by that date, over such period of time thereafter as the administering authority considers reasonable.

3.14 At the time of writing, four employers have indicated that the minimum contribution rates are unaffordable and more details are provided on the Committee's B agenda.

Strain on Fund Costs

3.15 Fund officers have received a request from an employer whose valuation results showed a significant surplus at 31 March 2017. The employer has asked if any strain on fund costs payable on the early retirement of members at a cessation event could be offset against their surplus. Strain on fund costs are normally payable as a one-off payment at the time of the member's retirement. Section 5.6 of the draft FSS has been amended to allow for an alternative arrangement to apply depending on the employer's circumstances.

Review of other policies appended to the FSS.

3.16 The Charging Policy has been amended to include reference to recharges of unfunded pensions. In particular; to highlight that should an employer who has previously made such an award cease to exist, then these payments would stop. This change is in line with a previous report to Pensions Committee.

Consultation with employers

3.17 As previously reported to Committee, an initial consultation exercise was carried out in July 2017. The intention of such an early consultation was to provide employers with greater notice of proposed changes and to give time for any feedback received to be incorporated into the final document.

3.18 A draft version of the FSS was then issued to employers for further consultation in November 2017. Feedback received from employers, together with the Fund's response is summarised and attached as Appendix 2 to this report.

Amendments to LGPS Regulations

3.19 As previously advised to Committee, the Scottish Government recently issued a consultation on consolidated changes to the Local Government Pension Scheme. One of the proposed changes was a provision to postpone the calculation of a cessation valuation and also to allow any surplus arising on cessation to be refunded to the employer. Currently, any surplus would be retained in the Fund. The new regulations are not yet effective and the final wording is not yet available.

3.20 As yet, the effective date of the new Regulations is still to be confirmed. Once final Regulations are in place, consideration will be given to a further review of the FSS to incorporate any changes required as a result.

4. Measures of success

4.1 The funding strategy should ensure that the Fund has sufficient assets to meet pension obligations in the long term.

5. Financial impact

5.1 The funding strategy should ensure that the Fund has sufficient assets in the long term to meet its liabilities.

5.2 The funding strategy and the results of the actuarial valuation have significant financial impact on the Fund's employers. The contribution stability mechanism was introduced to provide certainty of pension contributions to certain Fund employers for future years, together with appropriate assurance of funding level to the Fund.

6. Risk, policy, compliance and governance impact

6.1 An extract from the Lothian Pension Fund risk register is included in the FSS. The change in funding strategy for small employers close to exit should improve employers' awareness of cessation valuations and reduce the risk that such employers are unable to meet deficit payments with the resulting liability being spread over all other employers within the Fund.

7. Equalities impact

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

8. Sustainability impact

8.1 There are no sustainability impact implications as a result of this report.

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

9.2 The revised FSS was drafted in consultation with the Fund Actuary, Hymans Robertson. As noted above, an initial consultation exercise was carried out in July 2017, and a copy of the draft revised FSS was issued to employers for further consultation in November 2017. A summary of the feedback received is attached as Appendix 2 to this report.

10. Background reading/external references

10.1 None.

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11. Appendices

Appendix 1: Revised Funding Strategy Statement

Appendix 2: Feedback from consultation

FUNDING STRATEGY

STATEMENT

MARCH 2018

Contents

1. Introduction

This is the Funding Strategy Statement (FSS) of Lothian Pension Fund ("the Fund"). It is prepared and maintained by the City of Edinburgh Council, the Administering Authority for the Fund, in consultation with the Fund's Actuary and following a period of consultation with participating employers.

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues.

This FSS is produced in accordance with the Chartered Institute of Public Finance & Accountancy (CIPFA) revised statutory guidance "Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme (LGPS) 2016", which affirms the FSS as being a key part of a pension fund's risk management framework.

This statement was agreed by the Pensions Committee on 26 March 2018 and is effective from 1 April 2018. It replaces all previous Funding Strategy Statements and policies on funding.

1.1 Maintenance

The Administering Authority will review the FSS every three years in conjunction with actuarial valuations or more frequently if considered appropriate

1.2 Availability

This document is available on the Fund's website (www.lpf.org.uk). Printed copies are available on request.

2. Purpose of the Funding Strategy Statement

CIPFA's "Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme 2016" states that the purpose of the FSS "is best defined by reference to the discussion paper issued by the Office of the Deputy Prime Minister (ODPM) on 23 July 2003, 'Local Government Pension Scheme – Strategy Proposals: Stocktake Discussion Paper – Funding Strategy Statement Proposals', namely:

- to establish "a clear and transparent fund-specific strategy that will identify how employers' pension liabilities are best met going forward;
- supports the desirability of maintaining as nearly constant a primary contribution rate as possible, ….; and
- takes a prudent longer-term view of funding those liabilities."

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

The FSS shall also ensure that the regulatory requirements to set contributions to ensure the solvency and long-term cost efficiency of the fund, as defined by the Public Service Pensions Act 2013, are met.

The statement and appendices set out how the Administering Authority balances the potentially conflicting aims of affordability of contributions, transparency of process, stability of employers' contributions, and prudence in the funding basis. Specific clarity is provided as to the Fund's policies in respect of:

- employers being admitted to the Fund;
- employers leaving the Fund (cessations);
- bulk transfers; and
- the charging for services and recovery of costs incurred.

2.1 Regulatory Framework

Pension benefits accrued by members of Lothian Pension Fund are determined by statute.

The contributions paid by the members of the Fund are fixed in the Scheme Regulations. Employers pay the balance of the cost of delivering the benefits, however, in line with the requirements of the Public Service Pensions Act 2013, the Scheme Regulations incorporate a cost sharing mechanism to ensure sustainability of the Scheme over the long term.

The FSS focuses on the pace at which employers pay for the benefits i.e. the approach used to determine contribution rates. It forms part of a framework that includes:

- the Local Government Pension Scheme) (Scotland) Regulations 2014 (as amended), the Local Government Pension Scheme (Governance) (Scotland)

Regulations 2015 and the LGPS (Management and Investment of Funds) (Scotland) Regulations 2010;
- the Pensions Committee, the Pensions Audit Sub-Committee and the Pension Board;
- the Rates and Adjustments Certificate, which can be found appended to the Fund Actuary's valuation report;
- actuarial factors for valuing early retirement costs and the cost of buying extra service; and
- the Fund's Annual Report, including the Annual Governance Statement, the Governance Compliance Statement and the Statement of Investment Principles.

This is the framework within which the Fund's Actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund.

3. Aims and Purpose of the Fund

3.1 Aims of the Fund

The aims of the Fund are to:

- manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due;
- seek returns on investment within reasonable risk parameters; and
- enable primary contribution rates to be kept as nearly constant as possible and (subject to the administering authority not taking undue risks) at reasonable cost to scheduled and admitted bodies, whilst achieving and maintaining fund solvency and long-term cost efficiency. This should be assessed taking appropriate cognisance of the risk profile of the fund and employers and the risk appetite of the administering authority and employers alike.

3.2 Purpose of the Fund

The Fund provides benefits to members and their dependants. The purpose of the Fund is to:

- receive monies in respect of contributions, transfer payments and investment income and recover costs and charges, pay pension benefits, transfer values and administration costs, charges and expenses; and
- make investments to meet the future costs of pension promises made to members of the Scheme.

4. Responsibilities of the Key Parties

The sound and effective management of the Fund can only be achieved if all interested parties exercise their statutory responsibilities conscientiously. Although a number of these parties, including investment managers and external auditors, have a responsibility to the Fund, the following may be considered of particular relevance to the funding strategy:

4.1 The Administering Authority should:

- operate the Fund as per the Regulations;
- collect and account for employer and employee contributions, investment income and other amounts due to the Fund as stipulated in the Scheme regulations;
- invest surplus monies in accordance with the regulations;
- ensure that sufficient cash is available to meet liabilities as and when they fall due;
- pay relevant benefits from the Fund as set out in the Scheme regulations;
- manage the actuarial valuation process in consultation with the Fund's Actuary, including providing all required data and employer covenant analysis;
- prepare and maintain a Funding Strategy Statement and Statement; of Investment Principles after proper consultation with interested parties;
- monitor all aspects of the Fund's performance and funding, and amend the Funding Strategy Statement/Statement of Investment Principles accordingly;
- take measures as set out in the Scheme regulations to safeguard the Fund against the consequences of employer default;
- effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and scheme employer;
- manage any cessation valuation in consultation with the Fund's Actuary;
- prepare and maintain admission, cessation, bulk-transfer and charging policies. The admission, cessation and charging policies are included in this document,
- enable the Pension Board to review the valuation process as set out in their Constitution; and
- fulfil all other duties as specified in Lothian Pension Fund's Pensions Administration Strategy – available in the 'Publications' section of the Fund's website www.lpf.org.uk

4.2 The Individual Employers should:

- calculate an employee's contribution rate and deduct the correct contributions from members' salaries;
- pay employee and employer contributions to the Administering Authority on a timely basis and provide appropriate supporting documentation in a format and timescale specified by the Fund;
- develop and maintain a policy where discretion can be exercised within the regulatory framework (e.g. granting enhanced benefits) bearing in mind costs;
- make additional contributions, in accordance with agreed arrangements, for example, augmentation of scheme benefits and early retirement strain costs;

- notify the Administering Authority promptly of organisation changes for example, changes in ownership or structure, TUPE transfers which could affect future funding;
- notify the Administering Authority of a possible ending of its admission agreement/participation in the Fund within the terms of that agreement or otherwise as required by the Regulations (typically a 3 month notice period is required), including closed employers where the last employee member is leaving (whether due to retirement, death or otherwise leaving employment);
- pay any exit payments due on ceasing participation in the Fund in line with provisions set out in the Fund's Policy on employers leaving the Fund (see Appendix C);
- meet costs as specified in the Charging Policy (see Appendix D); and
- fulfil all other duties as specified in the Fund's Pensions Administration Strategy. This includes provision of all data required for effective administration and record-keeping, and payment of any charges levied by the Fund following poor performance by the employer.

4.3 The Fund Actuary should:

- prepare actuarial valuations to assess the solvency of the Fund and the required employers' contribution rates;
- engage with the Administering Authority in consultation processes;
- prepare advice and calculations in connection with bulk transfers and the funding aspects of individual benefit related matters such as pension strain costs, ill-health retirement costs, compensatory added years costs, etc.;
- provide advice and valuations on the on the exit of employers from the Fund;
- provide advice to the Administering Authority as required on bonds or other forms of security against the financial effect on the fund of employer default;
- assist the Administering Authority in assessing whether employer contributions need to be revised between valuations as required by the regulations; and
- ensure that the Administering Authority is aware of any professional guidance or other professional requirements that may be of relevance to his or her role in advising the Fund.

5. General Funding and Solvency Issues

5.1 Funding Principles

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

5.2 Solvency

The notes to the Public Service Pensions Act 2013 state that solvency means that the rate of employer contributions should be set at “such level as to ensure that the scheme’s liabilities can be met as they arise”.

It is not regarded that this means that the pension fund should be 100% funded at all times. Rather, and for the purposes of Section 13 of the Public Service Pensions Act 2013, the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency if the rates of employer contributions are set to target a funding level (assets divided by liabilities) for the whole fund of 100% over appropriate time periods and using appropriate actuarial assumptions.

If the conditions above are met, then it is expected that the Fund will be able to pay scheme benefits as they fall due.

The Fund’s Actuary is required to report on the solvency of the Funds and recommend future employer contribution rates every three years. In assessing the solvency and employer contribution rates, the Actuary must make a number of financial and demographic assumptions (see below). The solvency of the Funds and the contribution rates can be very sensitive to these assumptions.

In calculating solvency, the Actuary values the benefits using the assumptions described below. Assets are taken into account at their market value.

The Regulations specify the principles which must be used in the funding strategies. However, it is the responsibility of the Administering Authority, acting on the advice of the Fund’s Actuary, to determine the precise approach and the financial and demographic assumptions to be used in the actuarial valuation.

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

The Fund carries out regular employer covenant reviews to gather a range of key financial and non-financial information. This includes a request for details of funding sources and for annual financial statements to be provided. In addition, membership numbers are regularly reviewed to monitor membership maturity. The results of the covenant review are used to rank employers on risk level, with details being provided to the Fund’s Actuary to inform the actuarial valuation.

As required under Section 13(4)(c) of the Public Service Pensions Act, The Scottish Public Pensions Agency has appointed the Government Actuary's Department to report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure the solvency of the Fund and the long-term cost efficiency of the Scottish Local Government Pension Scheme, so far as relating to the Fund. Such reports must be made following each triennial valuation of the Fund.

When developing this Funding Strategy, the Administering Authority has had regard to the review under Section 13(4)(c).

5.3 Long term cost efficiency

The notes to the Public Service Pensions Act 2013 state "Long-term cost-efficiency implies that the rate must not be set at a level that gives rise to additional costs. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the time".

The rate of employer contributions shall be deemed to have been set at an appropriate level to ensure long-term cost efficiency if the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the fund.

In assessing whether the above condition is met, the review under Section 13(4)(c) may have regard to the following considerations:

- the implied average deficit recovery period
- the investment return required to achieve full funding over different periods, e.g. the recovery period
- if there is no deficit, the extent to which contributions payable are likely to lead to a deficit arising in the future
- the extent to which the required investment return is less than the administering authority's view of the expected future return being targeted by a fund's investment strategy, taking into account changes in maturity/strategy as appropriate.

5.4 Financial Assumptions and Link to Investment Strategies

The key financial assumption in calculating the solvency and contribution rates is the rate of return which will be achieved on the Funds' investments. The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns (resulting from the investment strategy). To the extent that investment returns may be lower than expected, then higher contributions may be required from employers, and vice versa. Hence, the funding and investment strategy are inextricably linked.

The expected return is based on the yield on UK government bonds (gilts) at the time of the actuarial valuation. If appropriate, allowance is made for the fact that the investment strategy includes assets other than gilts which are expected, over the long term, to deliver a higher return for the Fund.

The discount rate(s) adopted in the actuarial valuation is derived by considering the expected rate of investment return which is anticipated to be achieved by the underlying investment strategy.

The Funds invest in assets other than gilts in order to reduce the cost to the employers in the long term, subject to the alignment to the expected duration and admission basis of the individual employer's membership. However, the investments are not guaranteed to deliver returns in excess of gilts. This means that the funding level can be volatile, particularly in the short term. In order to minimise the degree of short-term change in employer contribution rates, expected investment returns are considered over the long term.

The Pensions Committee is responsible for setting investment strategies after taking professional investment advice.

A formal review of the Funds' investment strategies is undertaken at least every three years to ensure appropriate alignment with liabilities. This is typically after the results of the triennial Actuarial Valuation are known and the Pensions Committee is responsible for agreeing that the strategies are appropriate. Implementation of the investment strategies is delegated to the Executive Director of Resources of the City of Edinburgh Council, under the advice of the Investment Strategy Panel.

The Panel comprises the Chief Executive Officer and Chief Investment Officer of Lothian Pension Fund together with a minimum of two external, independent expert advisers. The Panel meets quarterly to monitor the risk, return and implementation of investment strategy, and to discuss current issues, including asset allocation. This involves an appraisal of the current investment market opportunities and risks and the distribution of the Funds' investments across different assets, countries, sectors and companies to ensure that overall risk is being managed appropriately.

Further information on the investment strategies can be found in the Funds' Statement of Investment Principles which is available on the Fund's website (www.lpf.org.uk).

5.5 Demographic Assumptions

The Actuary makes a number of demographic assumptions including mortality, salary growth, rates of retirement, commutation experience and withdrawal. They are intended to be best estimates of the future experience of the Funds.

The assumptions take into account the past experience of the employer and Funds, other Local Government Pension Schemes and/or the general population, as considered appropriate by the Actuary.

5.6 Contributions

Employee contributions are determined by the Local Government Pension Scheme (Scotland) Regulations 2014. A member's contribution rate is calculated by the employer on an annual basis, dependent on their actual pensionable pay at 31 March each year and allowing for any election made under Regulation 10 (50:50 option).

Employer contributions are calculated by the Fund Actuary. They are made up of two elements:

A the primary rate of the employers' contribution. This is the contribution rate required to meet the cost of the future accrual of benefits expressed as a percentage of pensionable pay, ignoring any past service surplus or deficit but allowing for any employer specific circumstances, such as the membership profile of that employer, the funding strategy adopted for that employer, the actuarial method chosen and/or the employer's covenant, and,

B the secondary rate of the employers' contribution. This is an adjustment to the primary rate to arrive at the rate each employer is required to pay. If there is a surplus, there may be a contribution reduction, if there is a deficit there may be a contribution increase. For all employers, contributions to cover any deficit are expressed as a fixed monetary sum, rather than as a percentage of payroll. The period over which any funding deficit or surplus is spread for each Fund is covered further in Sections 6, 7 and 8 below. Any deficit contributions should be paid in equal monthly instalments along with the primary rate contributions, or by prior arrangement as a one off lump sum at the start of the year.

For any employer, the rate they are required to pay is the sum of the primary and secondary rates.

The rates for all employers are shown in the Fund's Rates and Adjustments Certificate, which forms part of the formal Actuarial Valuation Report. The contributions stated are minimum amounts – employers can pay more than this. The Actuary will take account of any higher amounts paid at subsequent valuations.

All employers are required to pay the estimated additional cost (strain cost) of **non-ill health early retirements**, to allow for the fact that the pension is paid earlier and for longer. This is calculated at the time of the early retirement. The Fund's general policy is that strain costs are payable as a one-off payment at the time of the early retirement, however at the Fund's discretion, alternative arrangements may be permitted if the early retirement occurs at the time of cessation, depending on the employer's circumstances.

If an employer allows members to elect to use the 'Voluntary Scheme Pays' option, then any costs arising from this due to member longevity will be borne by the employer and factored into future contribution rates.

The Administering Authority monitors the actual contributions received to ensure they are in line with those expected. As set out in the Fund's Pensions Administration Strategy, employers are expected to provide requisite detailed information on a monthly basis to assist this monitoring exercise and to substantiate the payments made.

6. Funding – Scottish Homes Pension Fund

Scottish Government acts as guarantor to the Scottish Homes Pension Fund. A bespoke funding strategy has been developed for the Scottish Homes Pension Fund. This has been agreed by the Administering Authority, the Fund's Actuary and the Scottish Government (previously known as the Scottish Executive).

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

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

7. Funding – Lothian Buses Pension Fund

The Lothian Buses Pension Fund closed to new members in 2008 and the liabilities are expected to mature over time.

The objectives of the funding strategy include:

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

When determining employer contributions at the triennial valuation the Administering Authority may (after consultation with the Fund Actuary) take into account any events that arise after the valuation date, but before the formal valuation report is signed off (which must occur within one year of the valuation date), that materially affect the employer contributions. In doing so, the Fund will aim to achieve the objectives of the funding strategy.

Changes in employer contributions may be phased over time in order to minimise the degree of short-term change. The Administering Authority in consultation with the Fund's Actuary decides how any reductions or increases to contribution rates are introduced.

8. Funding – Lothian Pension Fund

8.1 Objectives of the Lothian Pension Fund's Funding Strategy

The objectives of the funding strategy include:

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

8.2 Investment Strategy

The Fund has put in place three investment strategies for differing employer risk profiles.

Primary Strategy

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

This strategy applies to the following types of employers:

- Large employers with enduring membership which are open to new entrants (including but not limited to Councils and other statutory bodies);
- Transferee Admitted Bodies;
- Employers which are part of the small employer 'pool' and
- Employers admitted to the Fund following a transfer of staff from another Fund employer and the ceding employer has agreed the employer can be treated as Transferee Admitted Bodies for funding purposes.

Other than employers which are part of the small employer 'pool', Employers invested in the Primary Strategy will have individual contribution rates certified by the Actuary.

Lower Risk Strategy

This strategy adopts a lower-risk approach for employers which have a short expected duration in the Fund and invests in index-linked government bonds to reduce the degree of short-term change in funding level and employer contribution rates in the period prior to the employer leaving the Fund and hence manage risks for both the individual employer and for the Fund as a whole.

This strategy was first introduced with effect from 1 April 2015.

This strategy applies to the following types of employers:

- Employers who have left the Fund (excluding bodies which may be aligned to another Fund employer);
- Employers which are closed to new entrants and:
  - Have fewer than five active members and/or
  - Average membership age of 55 or higher.

Such employers will have individual contribution rates certified by the Actuary.

Medium Risk Strategy

This strategy adopts a balanced investment strategy reflecting the maturing membership and liability profile of the relevant employers. It is intended to act as a transition between the Primary Strategy and the Lower Risk Strategy, for those employers which are closed to new entrants. Accordingly, investments will be targeted to represent 50% allocation from both the Primary Strategy and the Lower Risk Strategy. This will serve to reduce the degree of change in employer contribution rates which would result from moving immediately from the Primary Strategy to the Lower Risk Strategy. This strategy was first introduced with effect from 1 April 2018.

This strategy applies to the following types of employers:

- Employers which are closed to new entrants but do not meet the criteria for the Lower Risk Strategy.

Such employers will have individual contribution rates certified by the Actuary

Allocation to strategies

Relevant employers will move between strategies on 1 April 2018 as appropriate following the end of the 2017 valuation.

An employer will change to an alternative Strategy with immediate effect between valuations in the following situations:

- An employer part of the small employer pool closing to new entrants will move to the Medium Risk or Lower Risk Strategy as appropriate;
- An employer which is part of the Medium Risk Strategy which falls below five active members will move to the Lower Risk Strategy.

In these circumstances, the Actuary will provide revised employer contribution rates.

Where an employer has closed to new entrants, it will not be able to reverse this decision and offer membership to new staff without the agreement of the Administering Authority and where applicable, the body acting as guarantor.

The Fund may consider a request for an employer to be assigned to an alternative investment strategy to that which strict application of the criteria would indicate, but only in circumstances where a higher risk strategy is supported by an explicit guarantor and/or where the Fund would not consider such to represent a scenario of greater risk exposure to other employer(s). The Fund may also consider a request for a riskier investment strategy should provision of satisfactory security over assets be offered.

It is not practical for the Fund to offer individual employers full flexibility on asset allocation.

8.3 Employer Asset Tracking

The Lothian Pension Fund is a multi-employer fund. Previously, individual employer asset shares have been calculated triennially at formal valuations by the Fund's Actuary using an analysis of surplus technique and tracked between valuations using a cash flow or roll forward approach. However, in order to enhance the transparency, accuracy and auditability of individual employer asset allocations and reduce any cross-subsidy between participating employers, from 1 April 2014 the Fund introduced an employer asset tracking system based on cash flows. This is a form of unitisation of investments, where each investment or disinvestment of monies involves the purchase or selling of units in the fund. By sub-dividing the assets into units, the fund can more easily and accurately track each individual employer's assets. Changes in the value of the underlying assets are reflected by changes in unit prices.

Such unitisation therefore provides an efficient way of accurately apportioning assets to individual employers by allowing for employer cash flows and investment returns achieved by the Fund. In addition, this provides a mechanism for facilitating and managing a range of investment strategies within the single Fund to meet the needs of employers with different maturity profiles, funding levels or investment objectives.

8.4 Grouping

Changes in employer contributions may be phased over time in order to minimise the degree of short-term change and enhance affordability. The Administering Authority, in consultation with the Fund's Actuary decides how any reductions or increases to contribution rates are introduced, taking into account specific employer circumstances.

The **large employers** in the Fund are required to fund the benefits of their own employees; the Actuary calculates a different contribution rate specific to each large employer.

Individual contribution rates will also apply to:

- Transferee Admission Bodies;
- employers who have closed membership of the LGPS to new entrants;
- other small employers who do not qualify for inclusion in the pool due to the funding level criteria (see below); and
- those employers admitted to the Fund owing to the transfer of members from another Fund employer and the ceding employer has agreed to the treatment of the employer as a Transferee Admission Body for funding purposes (unless,

by exception, the ceding employer and Administering Authority are content with the body being included within the smaller employer "pool", as described below).

Other **smaller employers** who are grouped together for the purposes of calculating contribution rates at the actuarial valuation. This grouping provides some protection against changes in the contribution rate of a small employer from one actuarial valuation to the next.

Criteria are set for the purpose of determining which employers should be part of the Pool in order to manage the risk for both the individual employer and for the Fund as a whole. The Administering Authority has ultimate discretion in determining whether or not an employer joins and remains in the Pool and may remove an employer from the Pool if its experience or characteristics are extreme or untypical compared to other employers in the Pool. To be included, an employer should:

- have fewer than 100 total members and/or;
- an average full time equivalent annual salary of less than £40,000;
- have a funding level of at least 80% at each of the current and previous actuarial valuations;
- be open to new entrants, including not being "deemed closed". Any employer who does not admit any new entrants within a reasonable period is deemed to be closed to new entrants. For the purposes of this statement, a reasonable period is an inter-valuation period (i.e. three years between formal valuations of the Fund). Any employer who elects to close to new entrants will be excluded from the Pool. Any employer classed as 'deemed closed' which takes on new staff who join the Scheme will revert to the Open Rate with immediate effect;
- have its membership of the Pool supported by any guarantor or aligned body.

The Pool criteria and individual employer's participation in the Pool will be reviewed at each valuation. For example, if a small employer's funding level has recovered, it will re-join the Pool and pay the appropriate Pool contribution rate at the next valuation.

8.5 Contribution Stability

The policy of the Fund is to operate a Contribution Stability Mechanism on an ongoing basis, subject to regular reviews, in order to provide certainty of pension contributions to Fund employers for future years, together with ensuring appropriate assurance of funding level to the Fund. Contribution stability will not be offered to all employers – each employer's particular circumstances will be considered, in particular the strength of the covenant offered and the extent of membership commitment to the Fund. Employers are not obliged to participate in the Contribution Stability Mechanism, but if they wish to opt out, they must make an election at the outset. This election will cover the entire duration of the current Contribution Stability Mechanism (6 years from the 2014 actuarial valuation) as well as future reviews of the Contribution Stability Mechanism. Any decision to allow an employer to join the Contribution Stability Mechanism at a later date will be at the discretion of the Administering Authority.

An employer which chooses not to participate will instead pay the theoretical contribution rate as set by the Fund Actuary at the actuarial valuation.

Employers which are open to new entrants and have contribution rates calculated based on their individual circumstances will be offered contribution stability subject to

- satisfactory assessment of the employer covenant, and;
- agreement by their guarantor to inclusion of the employer in the contribution stability mechanism (where appropriate).

An employer's participation in the Contribution Stability Mechanism is expected to extend to the full duration of the mechanism. However, contribution stability will be subject to ongoing review by the Fund which reserves the right to remove an employer from the Contribution Stability Mechanism should particular circumstances deem it prudent to do so, for example assessment of employer covenant, financial or demographic experience. In addition, if an employer closes to new entrants they will be removed from the Contribution Stability Mechanism and a recalculation of their contribution rate may be required.

Contribution stability will not be afforded to the following employers:

- Employers which are closed to new entrants;
- Transferee Admission Bodies; and
- Community Admission Bodies which are part of the Pool.

Full information on the Contribution Stability Mechanism is available on the Fund's website.

The Fund has, in conjunction with the Actuary reviewed the Contribution Stability Mechanism introduced at the 2014 valuation. This review concluded that the Contribution Stability Mechanism remains appropriate for long-term secure employers at the 2017 actuarial valuation, however the valuation should set contributions only for the following three years (from 1 April 2018). However, to reflect financial prevailing circumstances at the 2017 actuarial valuation, contribution rates for stabilised employers from 1 April 2018 will either:

- remain frozen (if rates on the Contribution Stability Mechanism were due to reduce); or
- increase by a maximum of 0.5% per annum.

The Actuary recommended that a full review of the Contribution Stability Mechanism be undertaken before the next triennial valuation in 2020. Pensions Committee approved the recommendations made by the Actuary.

8.6 Deficit/Surplus Spreading

In deciding the period over which any funding deficit or surplus is spread, the Administering Authority considers a number of factors including the objective of minimising the degree of short term change in employer contribution rates and employers' ability to meet their commitments to the Fund.

The deficit recovery periods used for different employers range from 20 years for Councils, to the remaining contract period for Transferee Admission Bodies which can in some cases be a matter of months. The differences in deficit recovery periods reflect the financial strength of the employers and the perceived long-term commitment to the Fund.

The following table shows the employers in the Fund for which are required to fund the benefits of their own employees, setting out the key characteristics of each type of employer which influence the period over which any surplus/deficit has been spread.

Where an employer can offer security over assets or otherwise improve their covenant, the Fund may, at its discretion, allow a longer recovery period to be used.

	Employer	Deficit Recovery Period (Years)
Councils/Large Scheduled bodies	City of Edinburgh Council	20
	Midlothian Council	
	West Lothian Council	
	East Lothian Council	
	Scottish Fire & Rescue Service (Civilians)	
	Scottish Police Authority	
	Lothian Valuation Joint Board	
	Scottish Water	
	Lothian Buses	FWL [1]
Universities / Colleges	Heriot-Watt University	15
	Newbattle Abbey College	
	Queen Margaret University College	
	Napier University	
	Edinburgh College	
	West Lothian College	
	Scottish Rural University College	FWL [1]
	University of Edinburgh	
Other Large employers	Audit Scotland	15
	Barony Housing Association	
	Convention of Scottish Local Authorities	
	Visit Scotland	
	West Lothian Leisure	FWL[1]
	Edinburgh Leisure	
	EDI	
	CHAS	
	The Improvement Service	
	SESTRAN	
Transferee Admission Bodies		Shorter of FWL [1] or contract period
Other employers (including Small employer 'Pool')		FWL[1]

[1] Future Working Lifetime of current active members or duration in Fund if shorter

8.7 Admission Bodies – Affordability constraints

As noted in section 5.6 above, the Actuary certifies minimum contributions which each employer is required to pay. In circumstances where an employer's membership of the Fund is not mandated by Regulations and that employer is unable to meet the minimum certified contributions, then its membership will be terminated, with notice period of three months being applied by the Fund.

At each valuation, therefore, every employer will require to confirm its commitment to meet the certified minimum contributions, otherwise, following the notice period as specified above, the Administering Authority will terminate the admission agreement, and Appendix C: "Policy on employers leaving the Fund" will apply. Specifically, the Fund will arrange for a cessation valuation to be carried out to assess the level of the employer's liabilities. The Fund will then engage with the employer on repayment of any cessation debt.

8.8 Post Valuation Adjustments

When determining future employer contributions at the triennial actuarial valuation the Administering Authority may (after consultation with the Fund Actuary) take into account any events that arise after the valuation date, but before the formal valuation report is signed off (which must occur within one year of the valuation date), that materially affect the employer contributions referred to above. In doing so, the Fund will aim to minimise the degree of short-term change in employer contribution rates while still ensuring the long-term solvency of the overall Fund.

The contribution rates are subject to review and change if there are changes in employer circumstances between actuarial valuations, for example, if an employer has closed to new members or has left the Fund. In the latter case, any residual liability may impact upon the rate(s) payable by employer(s) remaining in the Fund. In all instances, any such changes would be determined by the Administering Authority and require certification by the Fund Actuary.

8.9 Employers Joining the Fund

Appendix A sets out in full the Fund's policy on employers joining the Fund.

Bodies applying to join the Fund will be provided with a copy of this Statement and will be required to provide a written undertaking that they understand and are aware of the long-term financial implications of participation in the Fund.

8.10 Employers Leaving the Fund

Appendix C sets out in full the Fund's policy on employers leaving the Fund in any of the following circumstances:

- When the employing authority is wound up or liquidated;
- When the last active member leaves or retires from an employer;

- When the admission agreement is otherwise terminated by either the employing authority or the admission authority, subject to the notice period specified in the admission agreement;
- In the case of Transferee Admission Bodies, when the contract comes to an end and is not renewed and;
- In the case of scheduled bodies, when the body no longer has an active member contributing to the Fund or through changes in over-riding legislation or Government policy can no longer contribute to the Local Government Pension Scheme.

Where an employer has an active admission agreement, but no active members and no new members will join in the future, then the admission agreement will be terminated and actions detailed in Appendix C will apply, other than where specific provision exists in the admission agreement for such circumstances.

8.11 Bulk Transfers

The treatment of bulk transfers of pension rights to and from the Fund are detailed in Appendix B.

9. Key Risks and Controls

The Administering Authority has an active risk-management programme in place. The risk register is reviewed periodically with a quarterly summary provided to the Pensions Committee. The following extract from the risk register, with Impact and Likelihood for each risk scored on a scale of 0-10, highlights those risks which can be considered of particular relevance to the funding strategy:

Risk	Existing controls	Impact	Likelihood	Current Risk
Adverse Investment performance leading to pressure on employer contributions	• Regular actuarial valuations & review of funding strategy, including longevity assessment. • Regular asset liability studies. • Frequent performance assessment by Investment Strategy Panel. • Bespoke investment strategy offered to employers.	5	4	20
The collapse of an Employer body member, leading to pressure on other employers	• Improved and enhanced Admissions Policy including use of guarantees. • Regular contact with employers. • Education to improve understanding, including grant funding implications. • Employer covenants review. Membership and employer monitoring • Funding Strategy now consistent with cessation policy • Funding agreements in place for payment of cessation debt	4	8	32
Employers make HR decisions without considering the impact on the pension fund	• Monitoring via actuarial valuation. • Employer training programme. • Communications - employer bulletin and employer events programme • Individual employer contribution rates. • Pensions Administration Strategy. • Funding Strategy Statement. • Staff Training. • Membership monitoring • Take note/action when last active member leaves or retires.	4	4	16
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions	• Regular actuarial valuations and review of funding strategy, including longevity assessment. • Pooling for small employers to reduce volatility. • Regular contact with employers. • Contribution stability in place • Monitoring of Transfer-Out volumes and processes. • Scheme cost monitoring by the Scheme Advisory Board • Scrutiny through data quality team.	5	7	35

Appendix A: Admission Policy

1. Background

The Local Government Pension Scheme (LGPS) (Scotland) Regulations contain powers for the City of Edinburgh Council (CEC) to admit bodies into the Lothian Pension Fund. Those bodies must meet certain conditions, generally relating to their purpose and aims, contained in the regulations before being considered for admission.

This document sets out the policy of CEC as Administering Authority of Lothian Pension Fund ('the Fund') in applying discretion to admit, on application, a new body into the fund for the purposes of allowing employees of that body access to the LGPS.

This policy will be reviewed as and when considered necessary.

2. General application of discretion to admit new bodies

The Pensions Committee of the City of Edinburgh Council (CEC), as the executive body responsible for the administering authority function, delegates power to approve or reject applications to the Executive Director of Resources.

The Executive Director of Resources will consider all applications from bodies who meet the conditions of the scheme regulations. In making his decision, due weight will be given to the merit of the body's financial covenant.

Approved applications will be subject to the conclusion of an admission agreement containing the appropriate matters prescribed in scheme regulations. Appropriate legal advice will be obtained in drafting and concluding admission agreements.

The body will be provided with a copy of the current Funding Strategy Statement of the Fund and will be required to provide a written undertaking that they understand and are aware of the long-term financial implications of participation in the Fund.

A bi-annual report will be submitted to the Pensions Committee providing details of the delegated decisions made during the year.

3. Policy in relation to Bodies admitted following the transfer of services from a Scheme Employer (TABs)

Such organisations will be admitted, subject to the conclusion of an admission agreement between CEC, the scheme employer (where different) and the TAB. The Scheme employer will also be required to act as a guarantor and undertake to meet any amounts due to the Fund in respect of any funding or contribution shortfall either during or at the cessation of the contract.

4. Policy in relation to other admission bodies

The applying organisation must provide documentary evidence of their:

- aims and objectives;
- articles of association;
- latest annual accounts; and
- future income streams including the source and timing.

The organisation will be expected to find a guarantor who will undertake to meet any amounts due to the Fund in respect of any funding or contribution shortfall either during or cessation of the admission agreement. The body must supply documentary evidence of the guarantee obtained and, where considered necessary by CEC, of the financial security of the guarantor.

Appendix B - Bulk Transfer Policy

1. Introduction

This is the policy of Lothian Pension Fund ("the Fund") as regards the treatment of bulk transfers of pension rights to and from the Fund.

These procedures and policies apply to employers participating in the Main Fund and the Lothian Buses Pension Fund**.**

1.1 Regulatory Framework

The Local Government Pension Scheme (Scotland) Regulations 2014 outline the general framework for employees and employers participating in the Local Government Pension Scheme in Scotland.

1.2 Reviews of Policy

This policy will be reviewed at least every three years following triennial valuations or following changes in the Regulations pertaining to employees transferring rights.

It should be noted that this statement is not exhaustive and individual circumstances may be taken into consideration where appropriate.

2. Principles

2.1 Overriding Principles

The purpose of bulk transfer negotiations is to determine the amount of service credits to be awarded and transfer payment to be paid when a number of members transfer their benefits from one pension scheme or Fund to another.

On transfers out from the scheme, it is the Fund's general policy that the bulk transfer amount should not leave the Fund (and the specific employer concerned) with insufficient assets to meet the remaining members' liabilities. Further, where possible, all bulk transfers should be "cost neutral" for the ceding employers, i.e. there should be no financial impact on them, positive or negative, based on the ongoing valuation basis.

On transfers in from another scheme, it is the Fund's general policy that bulk transfers be treated in the same manner as a transfer out.

However, it should be noted that if a deficit arises as a result of a bulk transfer, either into the Fund or out of the Fund, the employer may, at the discretion of the Administering Authority, be required to repay this deficit as a lump sum or, depending on their financial circumstances, through their ongoing contribution rates.

On transfers from one Fund employer to another existing Fund employer, assets equal to 100% of the transferring liabilities will be notionally transferred, unless otherwise agreed.

On transfer from one Fund employer to a new Fund employer, the following principles will apply:

- A fully funded transfer, on the ongoing valuation basis, will be notionally transferred to the new employer, if the new employer is a TAB, unless otherwise agreed; and
- A share of deficit transfer, on the ongoing valuation basis, will be notionally transferred to the new employer for all other types of employer, unless otherwise agreed.

2.2 Interaction with Funding Policy

It is the Fund's policy that each employer is responsible for the funding of all Fund benefits of its own members, including current and previous employees. Whilst employer contributions may be pooled in the interests of stability and administrative ease for the purpose of triennial funding valuations the individual funding position for each employer is tracked by the Actuary at each triennial valuation.

Any transfer of pension rights may have an effect on the valuation position of the employer and an individual contribution rate may be calculated depending on the effect of the transfer.

2.3 Principles for Determining Payment

The Fund will determine the transfer payment and service credits having taken actuarial advice.

The assumptions proposed / accepted by the Actuary are to be, at a minimum, as strong as those set as at the latest formal valuation of the Fund updated for financial conditions on the date of transfer.

For transfers out of the scheme, the transfer amount will be set equal to the value of benefits accrued to the transfer date for transferring members based on the agreed transfer basis, adjusted to take account of any underfunding in the transferring employer's share of the Fund such that the maximum transfer value is not greater than the reserves held for the transferring members. This approach is known as a 'share of fund' or 'share of deficit' approach.

If, as a result of the transfer out, the employing authority within LPF no longer has any active membership, then a cessation valuation may be triggered. If this is the case, the transfer value may be adjusted such that the reserves of the employer, following transfer, are equal to the value of the remaining deferred pensioner and pensioner benefits within the scheme on the appropriate cessation basis as outlined in the Fund's cessation policy.

For transfers in from a funded scheme, the actuary will be instructed to agree terms where the minimum transfer amount from the ceding scheme should be cost neutral to that scheme. This approach is consistent to the calculation of the transfer amount if there was a transfer out of LPF. If the transfer is from an unfunded scheme, the actuary will be instructed to ensure the transfer value is equal to the value of transferring benefits based on the ongoing valuation basis of LPF based on financial conditions at the date of transfer.

There is normally a lag between the date of the actual transfer of staff and the date of payment. During this period, on transfers out, the agreed transfer value will be adjusted by a factor determined by an estimate of the movement in the investments as determined by the asset allocation of the Fund (or sub-Fund if appropriate) and the respective market indices.

This method of rolling up the transfer payment is to be recommended for incoming bulk transfers as well.

3. Process

3.1 Responsibilities of ceding/receiving employers

An employer which is aware of a transfer from or into the Fund is required to:

- advise the Fund, in writing, of the transfer. This communication should indicate where members are transferring to/from and how many members will potentially transfer;
- provide information and data as requested by City of Edinburgh Council and the actuary to the Fund which is relevant, including in particular any changes to the membership which could affect the liabilities (e.g. salary increases and early retirements), contact details for the ceding/receiving scheme, etc.; and
- assist in the administration of option forms to transferring members as and when required.

3.2 Responsibilities of Administering Authority

The Administering Authority will gather information as required, including, but not limited to, the following:

- details of the transfer – where are members transferring to/from, how many members are involved and (where a transfer out to a non-LGPS scheme) if the receiving scheme is broadly comparable to the LGPS;
- complete membership data for the transferring members;
- commission the Fund actuary to carry out bulk transfer negotiations where necessary;

- where applicable, liaise with the employer and ensure they are aware of their responsibilities, in particular for any residual deficit or risk associated with the transfer; and
- ensure that payments or receipts of transfer value payments are carried out on the agreed dates.

3.3 Responsibilities of the Actuary

Following commission of bulk transfer negotiations by the Administering Authority, the Fund Actuary will:

- on notification of the transfer, ensure that the data and information required is collated;
- propose / agree assumptions and transfer values based on the policies set out by Lothian Pension Fund;
- propose / agree service credits in line with relevant legislation and policies; and
- negotiate and agree the final transfer payment date and amount.

Appendix C: Policy on employers leaving the Fund

1. Introduction

This is the policy of Lothian Pension Fund ('the Fund') as regards the treatment of employers of the Fund.

This policy replaces all previous policies on employer termination and is effective from 1 April 2015.

1.1 Scope of Policy

This policy covers employers leaving the Fund in any of the following circumstances:

- when the employing authority is wound up or liquidated;
- when the last active member leaves or retires from an employer;
- when the admission agreement is otherwise terminated by either the employing authority or the admission authority, subject to the notice period specified in the admission agreement;
- in the case of Transferee Admission Bodies, when the contract comes to an end and is not renewed; and
- in the case of scheduled bodies, when the body no longer has an active member contributing to the Fund or through changes in over-riding legislation or Government policy determines that members can no longer contribute to the Local Government Pension Scheme;

1.2 Reviews of Policy

This policy will be reviewed at least every three years following triennial valuations or following changes in the Scheme Regulations relevant to employers leaving the Fund.

2. Principles

2.1 Overriding Principles

If an employer leaves the Fund, or their admission agreement is otherwise terminated, the Administering Authority will instruct the Fund's Actuary to carry out a valuation of that employer's liabilities (a 'cessation valuation').

Payment of any deficit does not guarantee that the assets in the fund will be sufficient for the liabilities in the future: the actual cost of benefits will only be known after the last dependant dies and there is a risk that the amount estimated in the cessation valuation does not cover the actual cost of the liabilities. In this situation, the Fund would seek recourse from the body which acted as guarantor to the employer, or alternatively the body which the employer was aligned.

The basis used to carry out such a valuation will depend on the circumstances of the change. The Fund's general policy is that the valuation will be carried out on a more prudent basis than that used in the ongoing actuarial valuation. However the Fund may take into account the covenant strength of any successor body and/or guarantor which may be in place after the cessation date.

The employer, successor body and/or guarantor may be required to pay additional contribution(s) or capital payments to the Fund.

In normal circumstances, the Actuary will use the following assumptions for the cessation valuation:

- A discount rate equivalent to the gilt yield at the date of the cessation, with no allowance for outperformance of investments;
- An increase in the liabilities by 5% reflecting anticipated additional future improvements to life expectancies (over and above the ongoing valuation assumption); and
- Other assumptions would be consistent with the most recent actuarial valuation.

However, where the employer leaving the Fund is a Transferee Admission Body or if an employer was admitted owing to the transfer from another Fund employer (and the ceding employer has agreed to the treatment of the employer as a Transferee Admission body for funding purposes), the ongoing basis will be used. On joining the Fund, Transferee Admission Bodies are set up on a fully funded basis with contribution rates calculated based on the duration of the contract in order to reduce the likelihood of a deficit arising on leaving.

If an employer becomes insolvent and it, or its guarantor, is unable to meet any deficit, additional contributions will be required from each remaining employer in the Fund, in proportion to their liabilities. This means that the majority of any deficit will fall on the large employers. However, where it has been established that there is a specific alignment to one or more other employers, then the pension liability will be assigned or apportioned accordingly to those other employer(s).

In the event of a Transferee Admission Body leaving the Fund and being unable to pay additional contributions to the Fund, the employer granting the contract will be liable for the additional contributions or capital payments.

The purpose of a cessation valuation is to determine the level of any surplus or deficit in an employer's share of the Fund as at the date the employer leaves the Fund. Unless the cost of doing so is deemed to outweigh the likely recovery to the Fund, the Fund will pursue an outgoing body (including the liquidator, receiver, administrator or successor body if appropriate) for any deficit. The Fund will also pursue guarantor, for payment where appropriate.

It is the Fund's policy that the determination of any surplus or deficit on termination should aim to minimise, as far as is practicable, the risk that the remaining, unconnected employers in the Fund have to make contributions in future towards meeting the past service liabilities of current and former employees of employers leaving the Fund.

2.2 Principles for Determining Payment of Cessation Debt

The Administering Authority will determine the deficit/surplus attributable to the employer on cessation having taken actuarial advice.

If the employer is in surplus, there is currently no mechanism by which this surplus can be repaid by the Fund. If an employer is aware that it will be leaving the Fund for any reason in the near future, it should alert the Administering Authority as soon as it is aware and request a valuation as required under the Scheme regulations. If this valuation indicates that a surplus position is likely, then the Actuary will be able to advise the Administering Authority whether a contribution reduction (before the employer ceases) is appropriate. The Administering Authority will monitor potentially affected employers in order to reduce the risk that an irrecoverable surplus is left in the Fund. In particular, the Authority will carry out periodic reviews of Transferee Admission Bodies whose contract is due to end before the next triennial valuation.

If it is determined that there is a deficit and the employer will be required to make a payment to the Fund, the administering authority will advise the employer of the amount required. The Fund's general policy is for any deficit on cessation to be recovered through a single lump sum payment to the Fund. In exceptional circumstances, and where it considers that this does not pose a material risk to the solvency of the Fund, the Fund may consider:

- allowing payment of cessation debt over longer terms rather than insisting on payment as a one-off payment or over shorter terms previously agreed;
- agreeing repayment of debt less than the cessation debt in order to avoid employer insolvency, with an appropriate agreement which allows the Fund to revisit the repayment of the remaining debt at a future date (i.e. the debt would be a contingent liability and hence not recognised on an employer's balance sheet); and
- seeking, where appropriate, suitable "anti-embarrassment" provisions in legal agreement covering future increase in employer asset values.

The Fund may take into account the covenant strength of any successor body and/or guarantor which may be in place after the cessation date. In this instance, interest at a rate advised by the Actuary will be applied to determine the appropriate payments to be made.

Adopting such principles would protect the interests of the Fund as a whole.

Appendix D Charging Policy

This appendix sets out Lothian Pension Fund's policy on meeting the cost of actuarial fees and other service costs which are recharged to employers. It covers the main circumstances where fees are payable, but is not exhaustive.

The Fund will obtain the consent of the employer or member before carrying out any work which is likely to lead to fees being recharged.

1. Costs recharged to Scheme members

The costs of general pension administration are not recharged to members of the pension fund. However costs associated with complex pieces of work, as well as costs of providing certain other confirmation may be recharged. This includes (but is not limited to) the following:

- costs associated with providing valuations under the Family Law (Scotland) Act 1985;
- costs of implementing pension sharing orders;
- costs of providing further cash equivalent transfer values where this information has already been provided once in the last twelve months; and
- costs of appointments with the Fund's independent medical advisers where appointments have been repeatedly missed without good reason, or where habitual requests for assessment are received without new medical evidence.

Details of the costs payable can be found on the Fund's website (www.lpf.org.uk). These costs will increase annually each April by CPI over the 12 months to the previous September.

2. Costs recharged to Scheme employers

Employers should always contact the Fund in the first instance to establish whether fees will be recharged for any administration process or obtaining professional advice, and to obtain an estimate of likely fees.

Actuarial charges will be met by Lothian Pension Fund where the work is common to all or most employers, or where the work is required by the Scheme regulations and the employer has no choice whether the work is carried out.

However, where work is carried out or advice obtained at the request of a single or small number of employers, is not required by other employers, and is not a regulatory requirement, then the charges for that work or advice are generally recharged to the employer(s) concerned.

The schedule below sets out these activities for which fees will be charged to the Fund and those that will be recharged to the commissioning employer.

3. Schedule

3.1 Actuarial Fees

Activities for which Lothian Pension Fund should be charged:

- all matters relating to the triennial actuarial valuation, except additional work done at the direct request of an individual employer;
- interim actuarial valuations if and when the Administering Authority require such valuations;
- actuarial advice regarding questions concerning the interpretation of Scheme Regulations and matters pertaining to the administration of Fund benefits;
- preparation for and attendance at the Fund meetings; and
- any other matters which affect, or are likely to affect all or a significant number of Fund employers.

Activities for which actuarial fees will be recharged to an employer:

- extra, non-standard triennial actuarial valuation work done for and at the direct request of an individual employer;
- a common actuarial service used by most employers is the provision of figures for IAS19/FRS17/FRS102 accounting disclosure purposes. As this information is for the benefit of individual employers and not the Fund itself, the relevant costs are recharged to the individual employers;
- interim valuations where these are not a requirement for all employers but are either: -
  - required by an employer’s admission agreement or;
  - not required but specifically requested by the employer concerned;
- calculations etc. in respect of the admission of a new Fund employer;
- Best Value and other outsourcing calculations and consequent interim valuations;
- where an employer has been admitted to the Fund and is required to provide a bond or indemnity to meet any shortfall in funding in the event of the employer ceasing to participate in the Pension Fund, the cost of assessment and subsequent annual reassessment of the value of the bond or indemnity;
- assessing whether a potential/actual contractor’s pension arrangement is “broadly comparable” to the Local Government Pension Scheme;
- any other interim valuations for an employer that is required through some action, or failure to act, by that employer;
- bulk transfer work in respect of transfers out of or into the Fund;
- cessation valuations; and
- any other charges specific to one employer, or specific to such a small number of employers that it would be unreasonable to spread the cost between the membership as a whole. Where a number of employers are involved, the charges will be proportioned in light of the circumstances of the case.

3.2 Other charges

In addition to recharging actuarial fees as specified above, certain requests which result in:

- additional administrative work and advice over and above the norm;
- complex calculations;
- specific work for high earners; and
- the requirement for the Fund to seek advice or commission work from other providers e.g. lawyers will be charged to employers on a full cost recovery basis where this work is specific to one employer or specific to such a small number of employers that it would be unreasonable to spread the cost across all employers. Where more than one employer is involved, charges will be proportioned depending on the circumstances of the case.

Activities for which fees will be recharged to an employer:

- disclosure of information relating to Senior Officers and Councillors for inclusion in Local Authority Accounts:
    - provision of Cash Equivalent Transfer Value calculations and appropriate pension benefit calculations;
    - charges applied per case;
- setting up an Admission Agreement with the Fund for new employers joining the Fund;
    - costs to cover legal fees incurred by the Fund in drafting and finalising the Admission Agreement;
    - See note 1 below;
- attendance at meetings and associated work in connection with Employer projects involving transfers of staff (e.g. outsourcing, mergers etc);
    - a charge will be made where the Fund considers the work undertaken to be in excess of normal advice to employers;
    - costs will be based on Fund Officers time plus VAT; and
- interest payable on a cessation valuation where the Fund allows payment to be spread over and agreed period; and interest will be charged at a rate advised by the Fund Actuary

Regulatory recharges

Where an employer has chosen to award compensation in the form of additional membership under Part III of the Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998, for ease of administration the Fund will pay the compensation pension to the member along with the funded pension. The compensation pension will be recharged to the employer on a monthly basis. However, should the awarding employer cease to exist, the compensation pension will cease. The funded pension would be unaffected.

Notes:

1. Any additional costs arising if specialist actuarial, legal etc advice is requested will be charged in full in addition to the figures quoted above.

2. The Fund will act in accordance with relevant procurement guidance in obtaining external professional services.

2017 Actuarial valuation and revision of Funding Strategy Statement

Feedback from consultation

Introduction

The latest actuarial valuation of the Lothian Pension Funds (Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund) was carried out as at 31 March 2017. As part of the valuation process, the Funds' Funding Strategy Statement (FSS) was reviewed and revised.

As required by the Scheme Regulations, the Fund consulted with stakeholders on proposed changes. An initial consultation on the principles for change took place in July 2017, and a draft FSS was issued to employers for further consultation in November 2017.

In December 2017 and January 2018, Fund officers also held further meetings with employers to discuss valuation results and the impact of the changes to the FSS.

This document summarises feedback received from employers including the issues discussed at meetings with employers.

Background

The FSS is a key policy document which sets out the Funds' approach to funding pension liabilities. It includes information on funding and contribution strategies for different types of employers, deficit recovery periods as well as relevant responsibilities of the Fund, employers and the Fund Actuary. Key policies (Admission Policy, Bulk Transfer Policy, Policy on Employers leaving the Fund and Charging Policy) are included as appendices.

The Fund issued an initial consultation on changes to the FSS in July 2017. This provided employers with early notice of changes and an opportunity to comment. Proposed changes included:

- Introduction of a new medium-risk investment strategy
- Requirement for employers to confirm commitment to contribution rates

A draft Funding Strategy Statement was then issued to employers in November 2017 for a further period of consultation. In addition, Fund Officers also held individual meetings with 19 employers to discuss their valuation results.

This document summarises feedback received from employers including the issues discussed at meetings with employers.

Key issues raised by employers

Investment strategies

General

The Funding Strategy Statement now requires all employers to confirm that proposed contributions are not unaffordable. Employers have been advised that if they cannot provide this confirmation, the Fund will terminate the admission agreement with three months' notice. A cessation valuation would then be carried out and repayment agreed with the employer in line with principles previously agreed by Pensions Committee. This includes spreading cessation payments over a longer period of time. Several agreements have been concluded with exiting employers and during the consultation period, the Fund received positive feedback from advisers acting for employers praising the Fund's 'innovative approach'.

Medium-risk strategy

As noted above, the Fund will introduce a third investment strategy from 1 April 2018 which will act as a transition between the Primary and Lower-risk strategies and will apply to employers which are closed to new entrants but do not meet the criteria for the Lower-risk strategy.

This change was highlighted to employers at the Lothian Pension Fund Finance Briefing in July 2017, and in the consultation document issued in July 2017. However, some employers have expressed concerns that the increase in contribution rates resulting from this change are unaffordable. One employer commented that whilst they had accepted they would fall into the Medium risk category, they had not appreciated the financial impact that this would cause.

Lower risk investment strategy

This strategy is invested wholly in Lower risk assets (index-linked government bonds). This is in line with the assumptions used in the cessation valuation carried out when an employer leaves the Fund, and is therefore intended to reduce the volatility of the employer liabilities on cessation and target full funding. This strategy was introduced following the 2014 Actuarial Valuation and led to significant increases in contributions for some employers. Several employers in this group have contacted the Fund to highlight that draft contribution rates calculated at the 2017 valuation are unaffordable.

Response: *To alleviate affordability concerns for employers moved to the Medium-risk strategy, contribution rates have been phased in over the three-year valuation period.*

Lothian
PENSION FUND

The Fund has also highlighted options which could be available to improve their covenant which would allow contribution rates to be reviewed:

- *Obtain a guarantor;*
- *Offer the Fund security over assets.*

Whilst these options may not be applicable to all employers, several employers have been able to obtain a guarantor which has enabled the Actuary to review the originally calculated rates.

In addition, following feedback from employers, the Fund has, in consultation with the Actuary extended the phasing in of new contribution rates in certain circumstances.

Actuarial Assumptions

Assumptions used in the valuation are agreed by the Fund following discussions with the Fund Actuary.

<u>Salary increases</u>
As in 2014, several employers have queried the salary growth assumption used (4.1%), asserting that this is far higher than increases awarded by Fund employers.

Response: *As part of the valuation process, the Fund discussed the salary increase assumption with the Actuary. Modelling on the impact of various options was carried out and the assumption was reduced to 4.1% from the 5.0% used in the 2014 valuation, However, around the same time, announcements were made by both the UK and Scottish Governments regarding future relaxation on public sector pay caps. In addition, it was reiterated to employers that the salary assumption is a long-term assumption, and only one of several assumptions used in the process. As such, the impact on liabilities is limited.*

Employers were also reminded that whilst an individual employer can choose to review and amend the salary assumption used in annual accounting reports (FRS102/IAS19), the assumption used in the triennial valuation applies to all employers in the Fund and individual employers do not have scope to change this. In addition, the introduction of the new Local Government Pension Scheme from 1 April 2015 was highlighted: as benefits are now calculated on a Career Average Revalued Earnings basis, rather than Final Salary, in time the impact of salary increases will diminish. Employer results schedules now show the split of final salary and Career Average liabilities to illustrate this change.

<u>Discount rate</u>
Several employers (particularly those within the Lower risk strategy), have queried their results – asking why a deficit remains despite paying increased contributions following the 2014 valuation.

Response: *Although the Lower-risk strategy has reduced the volatility of funding levels, repayment of the deficit was (depending on the employer's circumstances), unlikely over a three year period. In addition; following the appeals process put in place following the 2014 valuation, some employers part of the Lower-risk strategy have not made any contributions towards their deficit in the last three years and as such, have seen little or no change in funding levels. This latter point was one of the key considerations in introducing the requirement for employers to confirm that contribution rates are not unaffordable. The Fund considers that it is not in the interests of the employer, or the Fund as a whole, for the employer to continue to accrue unaffordable pension deficits.*

Contribution Stability Mechanism

The contribution stability mechanism was introduced with effect from 1 April 2015 (ie following the 2014 Actuarial Valuation). This applies to secure employers which are open to new entrants and are expected to have a long duration in the Fund – typically Councils and other large employers. The contribution stability mechanism was introduced for 6 years (ie from 1 April 2015) to give certainty to employers and aid in budgetary planning. At that time rates were frozen at the 2014/15 rate. The Fund retained the right to review or withdraw the Contribution Stability Mechanism as protection against extreme adverse financial experience.

As part of the preparatory work for the 2017 Actuarial Valuation, it was concluded that the Contribution Stability Mechanism was suitable for use for the 2017 valuation. However, it was recommended that contribution rates be provided for only 3 years with a full review of the Contribution Stability Mechanism carried out prior to the 2020 Actuarial Valuation.

Employers which are part of the Contribution Stability Mechanism have, in the main seen very little change to their contribution rates. The majority have seen an increase of 0.5% per year for the next three years (the specified maximum increase agreed when the Contribution Stability Mechanism was introduced). Some employers have seen rates frozen.

However, one of the employers was disappointed that further certainty could not be provided and that any increase was required.

Response: *This was noted and the Fund has committed to review the Contribution Stability Mechanism prior to 2020. It is highlighted that the review to be carried out by the Government Actuary's Department under Section 13 of the Public Sector Pensions Act will highlight the need for solvency and prudent deficit recovery plans*.

Pensions Committee

2.00pm, Monday, 26 March 2018

Pension Fund Cost Benchmarking

Item number	5.10
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

The purpose of this report is to inform Committee of conclusions of the benchmarking of investment costs for Lothian Pension Fund and pensions administration costs for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund ("the Funds").

The report on investment costs relies on data and analysis provided by CEM Benchmarking Inc. Its database comprises 33 LGPS funds (£168 billion), and a wider global universe of 331 funds (£6.2 trillion including half of the world's top 300 funds). Actual cost of 0.41% was below the benchmark cost of 0.48%. The majority of actual costs relate to external management. The 0.07% difference amounts to approximately £4.3m per year. The main contributing factor to these cost savings is the fact that the Fund manages a relatively high percentage of assets on an internal basis, compared to the benchmark peer group.

Pension administration cost per member of £24.37 for the three Funds is within the wide range of cost of local authority funds, c£13 to £33, albeit higher than the total average of £20.18. CIPFA Benchmarking Club also allows for a narrower range of "comparator" funds to be selected on the basis of fund size. The average cost per member of funds of comparable scale to the combined three Funds is £21.12.

However informative, care should be taken not to derive definitive conclusions on the basis of benchmarking information due to potential flaws and/or assumptions included in the underlying data.

Report

Pension Fund Cost Benchmarking

1. Recommendations

Committee is requested to:

1.1 Note the report; and

1.2 Note that the CEM Investment Cost Effectiveness Analysis (to 31 March 2017) and the CIPFA Pensions Administration Benchmarking 2017 reports (both the "Final Report" and the "Comparator Report") have been provided, on a confidential basis, to the Convener of the Pensions Committee and Convener of the Pensions Audit Sub-Committee.

2. Background

2.1 The annual report 2016/17 identifies £31.9 million of expenses for the Funds, with investment costs representing the largest proportion of the total, as expected.

2.2 Benchmarking can be a helpful tool to identify areas for review to deliver improved value for money. It is intended that participation in the benchmarking of service provision should facilitate:

- Comparison between the costs and performance;
- Provision of evidence to support decisions on budget relating to the sustainability and capability of the investment and administrative teams to enhance customer satisfaction;
- Sharing of information and ideas with peer(s);
- Review of performance trends over time.

2.3 In an effort to better understand its investment expense base, Lothian Pension Fund has contributed to CEM's database for the past five years.

2.3.1 The CEM 2017 global database comprises 331 funds representing £6.2 trillion in assets, including 248 North American funds with assets of £3.4 trillion and 74 European funds with assets of £2.1 trillion.

2.3.2 The global database also includes 33 LGPS funds with total assets of £168bn.

2.3.3 The funds range in size from £0.1 billion to £736 billion.

2.3.4 The peer group for calculating the Fund's benchmark costs contains 21 funds (including 11 LGPS funds). The peer group funds have been selected on the basis of fund size. The median fund size within the peer group is

£6.8bn, with half the funds in the range of £6.5bn to £7.8bn. This compares with Lothian Pension Fund's assets of £6.6bn at 31 March 2017.

2.3.5 Care should be taken in deriving conclusions from the headline data. CEM itself states that "being high or low cost is neither good nor bad". What matters is whether a pension fund is receiving sufficient value for the costs incurred. This is reflected in the long term returns of pension funds, net of costs.

2.4 Chartered Institute of Public Finance and Accountancy (CIPFA) pensions administration benchmarking club has been used for a number of years to assess the costs of administration of the Lothian Pension Fund, Lothian Buses Pension Fund and the Scottish Homes Pension Fund. The outputs and analyses have served to supplement internal performance management information.

3. Main report

Investment Cost Benchmarking Analysis

3.1 The benchmarking provided by CEM aims to provide comparable data, but they are unable to capture all investment costs from all funds. Private asset performance fees (excluded in previous years) are now included, although transaction costs remain excluded. The total actual costs reported by CEM therefore differ from those reported in Lothian Pension Fund's annual report.

3.2 CEM calculates a benchmark cost for Lothian Pension Fund, which reflects the Fund's asset class mix, based on the asset class costs of the peer group funds.

3.3 The Fund's actual cost figure to 31 March 2017 of approximately 0.41% was below the benchmark cost of 0.48%. The 0.07% difference amounts to approximately £4.3m per year. Previous year CEM cost analyses were calculated on a calendar year basis and are shown below:

- 31 December 2015: 0.36% versus the benchmark cost of 0.45%
- 31 December 2014: 0.39% versus the benchmark cost of 0.50%

3.4 CEM concludes that the primary reason for costs being low compared with the benchmark is 'implementation style' – a relatively high percentage of assets are internally managed. External active management fees are significantly more expensive than internal management.

3.5 CEM analysis also shows that Lothian Pension Fund costs of 0.41%, are significantly lower than the median costs of the global peer group (0.64%) and CEM's LGPS dataset of 33 funds (0.54%).

3.6 The annual report 2016/17 for the pension fund identifies £27.7m of investment management expenses (2015/16: £34.5m), £23.4 million (84%) of which are external management fees (2015/16: £29.5m). All other expenses, the largest of which are internal asset management costs, transaction costs, property operational costs and custody fees, amounted to £4.3m (2015/16: £5m). External management fees represent 0.39% of average assets, while all other expenses represent 0.07%

of average assets. The direct costs attributable to internal asset management are approximately 0.02% of average assets.

CIPFA Pensions Administration Benchmarking Club

3.7 The CIPFA Pensions Administration Benchmarking Club aims to collect the transactional volumes and processing costs for administering members' LGPS benefits (i.e. excluding investment) using standard definitions. "Employing authority work" and any work associated with the administration of non-LGPS pensions are excluded.

3.8 Local authority pension funds subscribe to the CIPFA Benchmarking Club on a voluntary basis. The relative value to be gained from benchmarking analyses is therefore dependant on the scale of take-up of the service.

3.9 CIPFA has stated that, in order to protect its commercial interests, its benchmarking reports "cannot be put in the public domain. It is for internal uses only within the authority....and for contacting and communicating with other members of the club". Accordingly, the full report and also the comparator report, the latter being a selected subset of Funds of comparable scale, have been provided, on a confidential basis, to the Convener of the Pensions Committee and Convener of the Pensions Audit Sub-Committee.

3.10 Recognising this important proviso, restricted summary findings on costs and other observations on differences in the make-up of the Fund are as follows:

- LPF cost per member of £24.37 is within the range of the local authority funds, c£13 to £33. However, the cost is higher than the average of all funds of £20.18. The average of funds of comparable scale is £21.12.
- Active members represent a higher percentage of overall membership for LPF (40.3%) than the group average (33.9%). The proportion of Pensioners to total membership (29.5%) is again higher (than group of 24.1%), with the consequence being that the proportion of deferred members (22.6%) is lower than that of the typical fund (31.7%). As deferred members are less demanding on administration services, these factors would tend to increase pension administration and payroll workload and therefore cost.
- Also of note is that in terms of the proportion of staff holding relevant pension administration qualifications, LPF is significantly in excess (more than double) that of the average.

3.11 It is emphasised that it would be incorrect to derive definitive conclusions on the basis of apportioned costs. This is an inherent issue given the scale of central support costs which are typically apportioned to the pension fund by the host Councils, the extent of co-provision of employer services and also the bases of overhead apportionment to the pension administration function, as distinct from other activities within the Fund Accounts.

Performance Benchmarking

3.12 CEM highlights that investment costs should be taken in the context of a fund's long-term net returns.

3.13 CEM have compared Lothian Pension Fund's net value added (investment performance in excess of a fund's benchmark) over three-, four- and five-year time horizons against the net value added performance of CEM's global universe and LGPS universe.

3.14 The analysis indicates Lothian Pension Fund's net value added performance has been very strong over these periods - in the top 5%-10% percentile for the global universe and in the top 5% percentile for the LGPS universe.

3.15 The Fund's strong performance relative to peers is attributable to the strong performance of the Fund relative to its benchmark in the years to 31 March 2015 and 2016. This was driven by the performance of the Fund's internally managed equity portfolios, which aim to deliver stronger returns when equity markets are weaker/ less buoyant.

3.16 Pension administration performance appears to be generally in line with industry standards.

CIPFA Pension Panel – Letter to Chief Finance Officers, all Local Authority Funds, September 2017

3.17 Mike Ellsmore, Chair, CIPFA Pension Panel, wrote to the Chief Finance Officers of all UK administering authorities in September 2017. He expressed the opinion that "During this period of prolonged austerity there is continuous pressure to drive down costs and local government pension schemes have not been able to avoid this pressure. The CIPFA Pension Panel has become increasingly concerned that in some instances this may now be impacting on the effective administration of the scheme". This letter is shown in full at Appendix 1.

4. Measures of success

4.1 Benchmarking of costs provides management information, which serves to inform the service planning and budgetary process of the three pension funds.

5. Financial impact

5.1 There are no financial implications arising directly from this report. Out of the Funds' total costs of £31.9 million for 2016/17, investment costs amounted to £29.7 million and pension administration costs amounted to £2.1 million. Continuous improvement initiatives will be met from the approved budget 2017/18.

6. Risk, policy, compliance and governance impact

6.1 The provision of summarised conclusions of benchmarking is intended to enhance the governance of the three Lothian Pension Funds.

7. Equalities impact

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

8. Sustainability impact

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

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1 None

Stephen S. Moir

Executive Director of Resources

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11. Appendices

Appendix 1 – Letter from Chair of CIPFA Pensions Panel

Appendix 1

Dear Colleague,

LGPS Resource Requirements

During this period of prolonged austerity there is continuous pressure to drive down costs and local government pension schemes have not been able to avoid this pressure. The CIPFA Pension Panel has become increasingly concerned that in some instances this may now be impacting on the effective administration of the scheme. The Panel acknowledges that a number of Funds and Pools have worked hard to protect schemes during this difficult period.

I am therefore taking the opportunity to write on behalf of the CIPFA Pensions Panel to remind all Section 151 Officers of their responsibilities regarding the resourcing requirement for Local Government Pension Scheme (LGPS) Funds. The pension liability is the biggest single risk on the balance sheet of most local authorities, and the responsibility for this risk lies with individual employers in respect of both the historic and current costs.

You will no doubt be aware of the current asset pooling initiatives which are placing significant demands on existing pension staff and the Panel is concerned that this is having a negative impact on the level of resources available to deliver the statutory functions of pension funds. The LGPS is already facing a number of challenges including managing an ever increasing number of employing bodies in the scheme and also the ongoing implementation of the 2014 CARE Scheme. Following the 2016 Triennial Valuation the four actuarial firms identified major concerns with the quality of data being submitted by funds and this has been followed up recently by The Pensions Regulator who has noted the issues around data quality and will be focusing upon this area in the coming year.

We are all aware of the challenges around resources during this period of austerity and pension funds as with all other services should be as efficient as possible. However, the current pressures and increased complexity facing the LGPS require an increase in resources to ensure that the huge challenge of establishing asset pools as well as the increasing administrative requirements do not create an unmanageable risk.

In 2014 CIPFA issued a supplement to its Role of the CFO Publication covering the Role of the CFO in the Local Government Pension Scheme setting out the requirements and standards expected of the CFO. CIPFA also collaborated with AON Hewitt to produce **Guidance on Investment Pooling Governance Principles for Administering Authorities.** The fiduciary responsibility for a pension fund will not change following asset pooling and all stakeholders should ensure that in addition to the work going on to establish asset pools it is equally important that the funds put in place sound governance arrangements to manage the relationship with these pools.

The level of scrutiny on LGPS Funds has never been higher both from internal sources such as Local Pension Boards but particularly from external sources such as The Pensions Regulator, Pensions Ombudsmen and the national press. It is therefore essential that funds have the necessary capacity to meet these challenges otherwise there is a significant risk of censure and the subsequent reputational damage at local and national level. CIPFA would expect funds to be taking the necessary advice and comparing its costs and service delivery (through benchmarking and other analysis) to ensure they are in line with the rest of the LGPS and achieving the standards expected by their members.

CIPFA's Pension Panel aims to support all those involved in delivery of the LGPS and has produced a range of Guidance to assist practitioners and will continue to do so. The Panel is always keen to hear the views of its members with regard to pensions and works closely with Treasurer Societies as required.

Kind Regards,

Mike Ellsmore

Mike Ellsmore
Chair CIPFA Pensions Panel

CIPFA The Chartered Institute of Public Finance & Accountancy

Pensions Committee

2.00pm, Monday, 26 March 2018

Employers Participating in Lothian Pension Fund

Item number	5.11
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

The purpose of this report is to provide an update on current matters affecting employers participating in the Fund and in particular to highlight:

- The steady number of employers leaving the Fund and efforts made to recover exit payments; and
- Other relevant issues including bulk transfers of employers.

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Report

Employers Participating in Lothian Pension Fund

1. Recommendations

Committee is requested to:

1.1 Note the changes to the employers participating in Lothian Pension Fund.

2. 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.

3. Main report

Employers leaving the Fund

3.1 The Fund has continued discussions with Age Scotland, a former Fund employer with regards to repayment of cessation debt. An update is included in agenda item B1.1.

3.2 The Fund has continued discussions with Edinburgh Rape Crisis Centre regarding repayment of cessation debt following the retirement of the last active member in August 2016. An update is provided in agenda item B1.1.

3.3 As previously reported to Committee, Streetwork left the Fund in August 2017 following the retiral of the last active member. Further information is included in agenda item B1.1.

3.4 Victim Support Scotland chose to leave the Fund with effect from 1 September 2017. Further information is included in agenda item B1.1.

3.5 Pilton Youth and Children’s Project chose to leave the Fund with effect from 1 November 2017. Further information is included in agenda item B1.1.

3.6 As previously reported to Committee, Queensferry Churches Care Community Project chose to leave the Fund with effect from 1 November 2017. An update is included in agenda item B1.1.

3.7 As previously reported to Committee, two admitted bodies, Four Square and Keymoves merged. As a result, Keymoves is being wound up and left the Fund in July 2017. Further information is included in item agenda B1.1.

Other Changes

3.8 As reported to Committee in March 2017, Citadel Youth Centre has advised that it is changing status to become a Scottish Charitable Incorporated Organisation. 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. Confirmation of the change from the Office of the Scottish Charity Regulator has now been received and it is expected that the revised admission agreement will be signed imminently.

3.9 As previously reported to Committee, employees of the City of Edinburgh Council, East Lothian Council and West Lothian Council involved in the creation of a Single Fraud Service transferred to the Civil Service Pension Scheme in 2014. Although the transfer of pension arrangements for the relevant West Lothian Council member has been completed, no further updates have been provided in relation to the rest of the members. The Fund continues to pursue the matter via the Fund Actuary who has been working with the Government Actuary's Department who are working on this transfer for the Civil Service Pension Scheme.

3.10 As previously advised to Committee, following changes made by the City of Edinburgh Council, to arrangements for city development, EDI is expected to leave the Fund during 2018. Fund officers have been in discussion with the Actuary, EDI Group and the City of Edinburgh Council regarding pension liabilities on exit. The City of Edinburgh Council (as guarantor) have agreed that the cessation valuation will be carried out on the ongoing basis.

3.11 The City of Edinburgh Council entered into a contract with Mite PFI Ltd to provide cleaning and janitorial services in schools. Mitie PFI Ltd were admitted to the Fund in 2008, by way of a tri-partite admission agreement between the Fund, the City of Edinburgh Council and Mitie PFI Ltd. Mitie have now advised the Fund that they intend to transfer all employees, currently employed by a number of Mitie companies, to a single employing entity. This means that staff currently covered by the admission agreement will be employed by Mitie Limited with effect from 1 April 2018. Given the change in employment relationship, a new admission agreement is required. This will include the requirement for Mitie Limited to take responsibility for previously accrued liabilities.

4. 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.

5. 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.

6. 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.

7. Equalities impact

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

8. Sustainability impact

8.1 There is no sustainability impact arising from this report.

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

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.

10. Background reading/external references

10.1 None.

Stephen S. Moir

Executive Director of Resources

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11. Appendices

None

Pensions Committee

2.00pm, Monday, 26 March 2018

2016-2018 Service Plan Update

Item number	5.12
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for 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 and Transparent;
- Working Together; and
- Forward Thinking.

Overall progress is being made against the service plan objectives with all but two of performance indicators meeting the target so far for 2017/18. An underspend is projected for the financial year.

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Report

2016-2018 Service Plan Update

1. Recommendations

Committee is requested to:

1.1 Note the progress of the Fund against the 2016-2018 Service Plan;

1.2 Note the UK Government's announcement on Guaranteed Minimum Pension (GMP) indexation; and

1.3 Note the guidance from Scottish Public Pensions Agency in respect of GMP related overpayments.

2. Background

2.1 The purpose of this report is to provide an update on the 2016–2018 Service Plan, performance indicators and the key actions to enable the Fund to meet its four key objectives:

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

3. Main report

3.1 Progress is being made against the service plan. Progress of particular note since the last update to Committee is shown below. The following areas are covered elsewhere on the agenda:

- Audit reports and plans;
- Review of Funding Strategy Statement;
- 2017 Actuarial Valuations;
- Developments of the Fund's Governance arrangements.

Guaranteed Minimum Pension (GMP) indexation

3.2 On 22 January 2018, the UK Government announced the outcome of its previous statutory consultation in relation to increases to Guaranteed Minimum Pensions (GMPs) for the Public Service Schemes, including the LGPS. Its decision is an extension of the current GMP increase policy, under which members reaching State Pension Age (SPA) between 6 April 2016 and 5 April 2021 will have full GMP increases provided by their scheme (currently this policy applies only to members reaching State Pension Age between 6 April 2016 and 5 December 2018).

3.3 Further consideration will be given in relation to members whose State Pension Age falls after 5 April 2021.

3.4 Costs for the entire LGPS have been estimated as being of the order of 0.5% of accrued liabilities (approximately £1 billion) if full indexation were to be provided to all members reaching SPA after 5 April 2016. The cost of this latest extension of GMP increases is not material in the context of the liabilities of the Funds (less than 0.1%).

GMP related overpayments – guidance from Scottish Public Pensions Agency (SPPA)

3.5 On 8 February 2018, SPPA published "Circular No.1/2018", the purpose of which is to:

a. "Confirm how GMP related overpayments which arise from the current reconciliation exercise should be managed going forward; and
b. Provide information that the Accountable Officer may wish to take into account when deciding on how accrued GMP related overpayments are managed."

3.6 "Scottish Ministers have decided that as in 2008/2009 any LGPS pension in payment affected by the exercise should not be reduced going forward. Instead the identified GMP related overpayment should be converted as before into an Increased Pension Entitlement (IPE) allowing the pension to continue at its existing level."

3.7 "The responsibility for deciding what action should be taken on the accrued overpayments arising …... rests with the scheme's Accountable Officer (AO)". Based "on advice issued by the Local Government Association (LGA) to its administering authorities earlier in June 2017", SPPA has detailed a number of factors and potential legal precedents which may be considered.

3.8 SPPA has also confirmed that "There may also be a small number of cases where the incorrect GMP data has led to an underpayment of pension. In these cases, the affected pension will be corrected going forward with any arrears being paid to the pensioner".

3.9 SPPA Circular No.1/2018 is shown in full at Appendix 2.

Staffing

3.10 As was reported to the Pensions Committee in December 2017, the remaining Fund staff's transfer of employment to LPFE Limited was delayed in October 2017 due to operational issues. These issues have now been completed and the phase 2 transfer was completed on the 31 January. The team is now together under the same employer again providing more opportunities to develop services for members and employers.

3.11 An appointment for temporary (12 months) Human Resources manager has been made and the post holder is now in place.

3.12 After the resignation of the Fund's Bond Manager early in 2017, an offer for the role has been accepted and the role will be filled in April 2018.

Local Authority Pension Fund Forum (LAPFF) update

3.13 Committee will recall that the Fund proposed the following amendments to the LAPFF constitution at the 2017 AGM:

- The introduction of a maximum tenure for members on the Executive.
- The removal of the current two-tier membership of the Executive, which distinguishes between 'trustees' and 'officers'.
- The appointment to the secretarial role of an individual who is independent from the Research and Engagement partner.

3.14 The proposed amendments were not agreed but they did receive 42%, 36% and 42% of members' votes respectively.

3.15 In February 2018, draft amendments to the constitution have been circulated to funds for comment ahead of the AGM on 28 March 2018. The main changes proposed in the draft concern the inclusion of the English & Welsh LGPS investment pools as members of LAPFF.

3.16 While the draft has also removed the requirement for the Research and Engagement partner to undertake the secretarial function, it falls short of requiring the secretary to be independent. There are no amendments introducing a maximum tenure for members on the Executive or to remove the distinction between trustees and officers on the Executive. The draft constitution also introduces a requirement 'to wait for a period of three years before being permitted to re-present an amendment to the Constitution, if it has been defeated at any particular annual meeting.'

3.17 The Fund has responded to the draft re-iterating the principles it proposed in 2017. Further, it is proposed to introduce a requirement to consult on, and respond to, AGM resolutions supported by more than 20% of members, in-line with the FRC's draft Corporate Governance Code. An update will be provided to Committee following the LAPFF AGM.

3.18 Committee has previously agreed for Councillor Rankin to be nominated to the LAPFF Executive. With the changes to the constitution and local elections in England and Wales in May, elections to the LAPFF Executive have been postponed until June 2018.

Freedom of Information (FOI) requests

3.19 The Fund receives regular FOI requests and in 2017 responded to 19 that covered topics such as private market investments, shareholdings, travel, IT and shareholder voting. We also received one subject data request from a member requesting a copy of the information the Fund held on them. These requests are resource intensive and where possible we refer queries to the website for publicly available information.

Performance Indicators

3.20 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 65% of staff had completed their pro-rata training target up to 31 December 2017. The Fund is comfortable that the target should be achieved by the end of the year.
- The proportion of annual benefit statements issues was 99.9%, missing the 100% target. 26 statements were not issued due to missing information from employers and, of these, all but 2 have now been issued. We are working with the relevant employers to correct the remaining errors.

3.21 Overall employer performance under the Pensions Administration Strategy for the first three quarters of 2017/18 is shown below, with 2016/17 shown for comparison purposes.

Employer performance		April to Dec 2017			2016/17		
Case type	Target (working days)	Number received	Number within target	% within target	Number received	Number within target	% within target
New Starts	**20**	4824	4462	**93%**	4763	4074	**86%**
Leavers	**20**	1577	732	**46%**	3435	1434	**42%**
Retirements	**20**	766	298	**39%**	1244	440	**35%**
Death in Service	**10**	19	9	**47%**	29	21	**72%**

Overall, this shows a continuation of poor employer performance for the first three quarters of this year particularly for retirements and leavers. The Fund has contacted employers requesting outstanding leaver information. Once provided, it is likely this will not be in target and affect performance in the final quarter.

The receipt of new start information through the secure data transmission portal is generally good. The Fund received a large increase in volume in Q3 but the majority of cases were received within target.

3.22 The Fund's annual Customer Service Excellence (CSE) assessment was scheduled to take place on 1 March 2018 but has been postponed due to the weather disruption. A new assessor will be visiting the Fund in April and will cover key customer service provisions such as complaints, listening to customers and responding to feedback.

3.23 The rolling 12 month survey results for overall customer satisfaction (including active, new members, retired and email survey results) to the end of December was 92.5% ahead of target 89%. In January, the Fund conducted the annual employer survey and received helpful feedback on our performance. 41 responses were received. Key results were as follows:

- 100% of respondents were satisfied with the overall service provided by the fund (96% in 2016/17);
- the monthly employer bulletin continues to be well received with 98% (97% in 2016/17) satisfaction and the preferred method of communications for most;
- 89% agreed the website was useful (89% in 2016/17);
- satisfaction of pensionsWEB (the employer portal) increased from 87% to 91%.

The positive results from the employer survey will be included in the overall customer satisfaction next quarter.

Membership and Cashflow monitoring

3.24 The Fund continues to monitor movements in membership numbers to assess potential implications upon cashflow. Early retirement initiatives could trigger significant and immediate outflows due to the payment of tax free lump sums and pensions and reductions in contributions received. However, payment of strain costs by the employer help to mitigate current cashflow pressures.

3.25 The table below details the cashflows as at the end of December 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	2017/18 YTD	2017/18 Projected
Income	**£'000**	**£'000**
Contributions from Employers	104,066	142,000
Contributions from Employees	32,195	42,100
Transfers from Other Schemes	2,896	4,700
	139,157	**188,800**
Expenditure		
Pension Payments	(111,545)	(149,000)
Lump Sum Retirement Payments	(32,514)	(54,000)
Refunds to Members Leaving Service	(512)	(630)
Transfers to Other Schemes	(8,923)	(11,000)
Administrative expenses	(1,700)	(2,221)
	(155,294)	**(216,851)**
Net Additions/(Deductions) From Dealings with Members	**(16,137)**	**(28,051)**

Lothian Buses Pension Fund	2017/18 YTD	2017/18 Projected
Income	**£'000**	**£'000**
Contributions from Employers	5,662	7,320
Contributions from Employees	1,488	1,860
Transfers from Other Schemes	13	13
	7,163	**9,193**
Expenditure		
Pension Payments	(6,541)	(8,740)
Lump Sum Retirement Payments	(2,102)	(3,000)
Refunds to Members Leaving Service	(3)	(18)
Transfers to Other Schemes	(539)	(750)
Administrative expenses	(65)	(85)
	(9,250)	**(12,593)**
Net Additions/(Deductions) From Dealings with Members	**(2,087)**	**(3,400)**

Scottish Homes Pension Fund	2017/18 YTD	2017/18 Projected
Income	**£'000**	**£'000**
Contributions from Employers	**675**	**675**
Expenditure		
Pension Payments	(4,996)	(6,700)
Lump Sum Retirement Payments	(525)	(910)
Transfers to Other Schemes	(47)	(75)
Administrative expenses	(45)	(60)
	(5,613)	**(7,745)**
Net Additions/(Deductions) From Dealings with Members	**(4,938)**	**(7,070)**

3.26 It is expected that active members as a proportion of the whole Lothian and Lothian Buses Pension Funds will continue to decrease during the year, causing a fall in contributions and increase in pension and lump sum payments. Lothian Buses fall in active membership is likely to be at a higher rate than Lothian due to being closed to new members.

3.27 All three Funds' expenditure cashflows are anticipated to continue to exceed cashflow income.

3.28 In 2016/17 Lothian Pension Fund had a negative cash flow position, whereby pension payments exceed total contributions received. This is a trend that is likely to continue for the foreseeable future. Increased investment income has been targeted in recent years for this scenario, which is expected to exceed net cashflow for the long term. The Fund has revised its forecasted negative cashflow figure (decreased by £3m), reflecting higher than previously expected income.

4. Measures of success

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

5. Financial impact

5.1 A summary of the projected and year-to-date financial outturn compared to the approved budget for 2017/18 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	3,009	2,707	(302)	2,257	1,976	(281)
Transport & Premises	242	242	-	182	175	(7)
Supplies & Services	1,232	1,021	(211)	924	749	(175)

Investment Managers Fees	5,200	5,200	-	3,900	3,612	(288)
Other Third Party Payments	1,392	1,055	(337)	1,044	608	(436)
Central Support Costs	286	250	(36)	215	167	(48)
Depreciation	82	82	-	61	61	-
Direct Expenditure (Invoiced)	**11,443**	**10,557**	**(886)**	**8,583**	**7,348**	**(1,235)**
Income	(727)	(900)	(173)	(545)	(744)	(199)
Net Expenditure (Invoiced)	**10,716**	**9,657**	**(1,059)**	**8,038**	**6,604**	**(1,434)**
Indicative Expenditure (Uninvoiced)	**17,100**	**17,100**	**-**	**12,825**	**12,825**	**-**
Total Cost to the Funds	**27,816**	**26,757**	**(1,059)**	**20,863**	**19,429**	**(1,434)**

5.2 The financial outturn includes year to date budget, actual expenditure and variance as at the end of December 2017. Year to date actual expenditure includes provision for services incurred but for which no invoice has yet been received. Uninvoiced expenditure (i.e. investment management costs deducted from capital) is assumed to be in-line with the budget.

5.3 The projection shows an underspend of approximately £1,059k. The key variances against budget are:

- Employees **- £302k underspend**. This is mainly due to unfilled posts across the division during the period from April to December 2017. Within the Investment team there is a vacant Portfolio Manager post, following a resignation earlier in 2017, and two new Investment Analysts posts. These posts will not be filled until after the financial year end.
- Supplies and Services **- £211k underspend**. Miscellaneous underspends during the year including £110k underspend in investment/collaboration legal expenses.
- Other Third Party Payments **- £337k underspend**. This is primarily due to delays in splitting out research costs from brokers' fees. The Fund will be invoiced directly for all research cost from 1st January 2018 when MiFID regulations came into force requiring the splitting of costs.
- Income **- £173k above budget.** Stock lending commission income has been higher than originally projected. The Fund's custodian had highlighted that securities lending could become less profitable with tighter regulations coming into fruition but this has yet to impact income.

5.4 An outline business case on the Fund's ongoing collaboration work with other LGPS administering authorities was approved by Committee in March 2017. The requisite adjustments to the service plan budget are shown below:

Category	Approved Budget £'000	Business Case adjustments £'000	Description
Employees	3,009	201	Increased staffing resources including a Service Development Manager and an additional Investment Analyst and Administrator
Supplies & Services	1,232	222	Includes costs associated with the procurement of an Investment Front Office System and the transfer of remaining staff into LPFE Ltd.
Other Third Party Payments	1,392	152	Includes £110k of one off revenue costs for services/advisers for due diligence on the legal collaboration structure.
Income	(727)	(583)	Increased revenue from the expansion of services to other Funds.

5.5 The above changes have not yet been integrated into the budget. The following progress has been made during the year with actual year to date spending being below £20k –

- **Employees** – An Investment Administrator has been recruited and a temporary HR Manager. An appointment has also been made for a Bond Manager. Recruitment of other permanent staff will commence after the end of the financial year.
- **Supplies and Services** – a new staff payroll and time recording system has been implemented. Procurement for an Investment Front Office System is underway.

5.6 **Income** –Northern Ireland Local Government Officers Superannuation Committee and Scottish Borders Pension Fund are working with the Fund on collaborative infrastructure investments. Income has been received from the completion of co-investments with these funds as well as the existing relationship with Falkirk Pension Fund. Further income from further new partnerships may result, as covered earlier in this paper.

6. 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.

7. Equalities impact

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

8. Sustainability impact

8.1 There are no sustainability implications as a result of this report.

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1 LPF Service Plan 2016-2018

Stephen S. Moir

Executive Director of Resources

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11. Appendices

Appendix 1 – Service Plan Performance Indicators

Appendix 2 - SPPA Circular No.1/2018

Appendix 1

Service Plan Performance Indicators – Targets & Actual Performance

	Q1 April to June	Q2 July to Sept	Q3 Oct to Dec	Target	Status
Customer First					
Maintain Customer Service Excellence Standard	Annual assessment will be carried out on 1 March 2018			Retain CSE Award	Not yet known
Overall satisfaction of employers, active members and pensions measured by surveys	Rolling 12-month performance is 92.5% to end December 2017			89%	
Proportion of active members receiving a benefit statement and time of year statement is issued	99.9% issued by 31 August 2017			100%	
Forward Thinking					
Performance and Risk of Lothian Pension Fund	Actual 13.0%pa, Benchmark 11.8%pa. Exceeding benchmark with lower risk.			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	95.1%	94.8%	96.2%	Greater than 90%	
Honest & Transparent					
Audit of annual report	Achieved			Unqualified opinion	
Percentage of employer contributions paid within 19 days of month end	99.74%	99.60%	99.85%	99.00%	
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	0.45%	1.24%	2.6%	4%	
Annual staff survey question to determine satisfaction with present job	Staff survey will be undertaken later in the year			77%	Not yet known
Percentage of staff that have completed two days training per year.	35.63%	46.26%	65.45%	100%	

SCOTTISH PUBLIC PENSIONS AGENCY

LOCAL GOVERNMENT PENSION SCHEME (SCOTLAND)
CIRCULAR SPN/LG No. 1/2018

WHO SHOULD READ:	**Secretary General, Convention of Scottish Local Authorities** **Chief Executive, Scottish Local Authorities** **Chief Executive, Water Authorities** **Principal Reporter, Scottish Children's Reporter Administration** **Chief Executive, Scottish Environment Protection Agency** **Director General, Strathclyde Passenger Transport Executive** **Clerk, Strathclyde Passenger Transport Authority** **Chief Executive/Director, VisitScotland**
ACTION:	**This circular should be brought to the attention of Pension Managers, Superannuation Sections and LGPS Employer Payroll Departments. You may also wish to draw it to the attention of the Directors of Finance and Administration**
SUBJECT:	

About Circular No.1/2018:

The purpose of this circular is to:

- **Confirm how Guaranteed Minimum Pension (GMP) related overpayments which arise from the current reconciliation exercise should be managed going forward and**

- **provide information that the Accountable Officer may wish to take into account when deciding on how accrued GMP related overpayments are managed.**

Background

SPPA wrote on 11 February 2016 setting out the process schemes should follow on undertaking its GMP reconciliation exercise. This set out the recommendations on the tolerances to be used, the cases to be included in the exercise and that action on arising overpayments would be considered once the scale was known. The recommendations were issued to all public service schemes with the aim that a consistent approach would be applied. Fund authorities will be aware that HMRC's timetable for completing the reconciliation exercise by December 2018.

Since then SPPA has recently confirmed the current position of each Funds' reconciliation exercise and understands that at the moment no overpayments have been formerly identified as part of this exercise.

Overpayment action

As you are aware a similar problem was identified in 2008/9 whereby erroneous GMP data lead to incorrect annual indexation being applied and a number of individuals being overpaid pension. At that time it was agreed that overpayments accrued up to the point of identification should be written off across all public service schemes. However, going forward and unique to Scotland, the pensions for affected members of the LGPS, Police and Firefighter schemes were allowed to remain at their original level with the overpaid element being converted to a scheme entitlement known as an Increased Pension Entitlement (IPE).

The responsibility for deciding what action should be taken on the accrued overpayments arising from the current reconciliation exercise rests with the scheme's Accountable Officer (AO). This circular sets out what the AO may wish to consider when deciding on the recoverability of any overpayments that arise from the reconciliation exercise. The circular also confirms how GMP related overpayments should be managed going forward.

Overpayments going forward

Although as far as SPPA is aware overpayments have still to be formally identified from the reconciliation exercise, in line with other public service schemes it estimates that there will be a number of GMP related overpayments in the LGPS. In anticipation of that occurring Scottish Ministers have decided that as in 2008/2009 any LGPS pension in payment affected by this exercise should not be reduced going forward. Instead the identified GMP related overpayment should be converted as before into an IPE allowing the pension to continue at its existing level.

SPPA has confirmed with HMRC that the award of an IPE in these circumstances would be treated as an authorised payment and further work will now be undertaken to draft and consult on the regulations necessary to introduce an IPE to cover overpayments for this reconciliation exercise. The Regulations used to introduce the IPE in 2008/9 were limited to the overpayments that were identified as part of that earlier exercise.

In the meantime an IPE should be awarded administratively pending the finalisation and coming into force of the Regulations. Schemes should keep a note of each IPE awarded and the amount involved as SPPA will need to reconcile the number and level of awards made. Again as in 2008/09 a similar approach is being taken for affected pensioners in the Police and Firefighters schemes.

Accrued overpayments

As mentioned above a decision on how any accrued GMP related overpayments should be managed is the responsibility of the scheme AO in line with any guidance relating to the management of public service pension overpayments. The following information is intended to help inform the AO when considering what action is appropriate on the accrued overpayments.

The complexity and general legal construction surrounding the Pension Increase and GMPs is recognised and accepted and on that basis it would be highly unlikely that affected pensioners would have been aware that they were being overpaid. Therefore the AO may wish to take into account the areas mentioned below, alongside their existing guidance when making any decision to recover overpayments. This is based on advice issued by the LGA to its administrative authorities earlier in June 2017.

Is the size of the overpayment relevant?

In its determination in the case of *Capita ATL Pension Trustees Ltd v Gellately* [2011] EWHC 485 (Ch) the High Court found that "In view of the small scale of the problem, the distress that any attempt to recover the sums would inevitably cause, and the likelihood that the exercise would anyway not be cost-effective" it was not necessary for the Trustees to take any steps to recoup the overpayments." In this case, the amounts of the overpayments to three widows were relatively small (no more than £10,200 in total).

Can 'Estoppel' be used to prevent the recovery of an overpayment?

The starting point used to be that if an overpayment had been made under a mistake of law it was generally not recoverable but if the employer could establish that the mistake was a mistake of fact, the money was potentially recoverable. The Law Commissions in England, Wales and Scotland recommended that the distinction between mistakes of law and mistakes of fact should be removed. The House of Lords has already decided cases on this basis (see *Kleinwort Benson v Lincoln City Council and others* 1998 4 All ER 513). So, whether an overpayment results from a mistake of fact or law, it would seem that, potentially, it could now be recoverable unless estoppel applies (although, in the absence of an employee's consent to repayment, legal advice should be sought before instigating any formal recovery action).

The recipient may lodge the defence of *estoppel by representation* if they can show that:

- the administering authority made a representation of fact that led the recipient to believe that they were entitled to treat the money as their own;
- the recipient has changed their position, in good faith, in reliance of that representation; and
- the overpayment was not caused by the fault of the recipient.

The recipient may lodge the defence of *Estoppel by convention* if they can show that:

- even if the administering authority had not made a representation of fact that led the recipient to believe that they were entitled to treat the money as their own, the administering authority and the recipient had acted on an assumed state of facts or law, the assumption being shared by both parties or assumed by one and acquiesced to by the other (as demonstrated in subsequent mutual dealings between both parties)

However, estoppel is an inflexible, all or nothing defence. A successful plea of estoppel acts as a total bar to recovery. This can lead to unjust enrichment so that the recipient can keep all of the money even if it exceeds the detriment they suffered. In recognition of this, the courts have developed the more flexible 'change of position' defence (see below).

Although the Scottish Government Finance Manual (SGFM) guidance on overpayments does not directly apply to local government the following is provided for information and allows consideration of how overpayments in the other affected schemes will be considered.

In principle public sector organisations should always pursue recovery of overpayments, irrespective of how they came to be made. In practice, however, there will be both practical and legal limits to how cases should be handled. Each case should therefore be dealt with on its merits. When deciding on appropriate action, taking legal advice, organisations should consider:

- whether the recipient accepted the money in good or bad faith;
- the cost-effectiveness of recovery action;
- any relevant personal circumstances of the payee, including defences against recovery;
- the length of time since the payment in question was made; and
- the need to deal equitably with overpayments to a group of people in similar circumstances.

As a general rule, public sector organisations should only take a decision not to seek recovery of an overpayment on the basis of a cost benefit analysis of the options but the SGFM goes on to set out examples where a defence against recovery can be made which include:

- the length of time that had elapsed since the overpayment was made see Prescription and Limitation (Scotland) Act 1973 below.

- **hardship**. As a matter of policy public sector organisations may waive recovery of overpayments if it would cause hardship, but hardship must not be confused with inconvenience. To be required to pay back money to which there was no entitlement does not in itself represent hardship, especially if the overpayment was discovered quickly. To be acceptable, a plea of hardship should be supported by reasonable evidence that the recovery action proposed would be detrimental to the welfare of the recipient or his / her family.

- **change of position**. It could be argued that the recipient of an overpayment may in good faith have relied on it to change their lifestyle. It might then be inequitable to seek to recover the full amount of the overpayment. The paying organisation's reaction should depend on the facts of the case. The onus is on the recipient to show that it would be unfair to repay the money

Prescription and Limitation (Scotland) Act 1973 ("the 1973 Act")

Claims for overpayments must be made within 5 year "prescriptive period"

Claims for recovery of overpayments of pension made by either an error of fact or law must be made (i) within 5 years of the date when the overpayment was made; or (ii) within 5 years from the date the overpayment with reasonable diligence could have been ascertained.

A claim must be made by commencement of court proceedings. **(N.B. A simple request for the money is not enough.)** If such a claim is not made within the 5 year period, the right to recover is extinguished (section 6 of the 1973 Act). The 5 year period is known as "the 5 year prescriptive period".

Each overpayment creates a separate right of recovery

Each overpayment of pension gives rise to a separate right of recovery, with each right of recovery subject to the 5 year prescriptive period. This means that if there has been a series of overpayments going back 10 years, only those overpayments made within the last five years from today are recoverable. In practice, however, time would have to be factored in for the raising of court action. This means if court action is still to be raised, only overpayments made within five years of the raising of the court action would be recoverable.

The five year time limit is subject, of course, to the proviso that the 5 year prescriptive period can run from a date later than the date the overpayment was made if the overpayment could not until later with reasonable diligence have been ascertained. Accordingly if the overpayments dating back 10 years could only have come to light 3 years ago, they would all still be recoverable. In fact there would still be another two years to run during which time they would all still be recoverable.

In a simple example schemes will have paid full indexation where a GMP was <u>not</u> held despite having scheme history (i.e. of contracted out employment for the period April 1978 to April 1997 during which GMP accrued) that should have alerted the scheme that a GMP was potentially due where a member has reached state pension age. The split indexation between the scheme and DWP only commences when the member claims their state pension but it may be argued that it would have been reasonable for schemes to make enquiries in these cases. Hence at the point of the member reaching state pension age with reasonable diligence it may have been realistic for a scheme to recognise the indexation being applied could be wrong and enquiries should have been made. So in this example the prescriptive period would have commenced when the member reached state pension age.

Alternatively where the scheme held a GMP but the amount was incorrect it would have been relying on HMRC to provide the correct GMP record. So an error will only come to light once the reconciliation exercise has completed and the correct GMP rate has been established. In these cases it could be argued that the scheme would have undertaken reasonable diligence by applying the incorrect GMP data and would not have been aware that it was incorrect until the reconciliation. In this example the prescriptive period would commence when the scheme became aware of the error following reconciliation.

This is just a brief explanation of how the 1973 Act may be applied. Schemes should seek their own legal advice before reaching a decision on when the prescriptive period commences.

Tax

Where a pension is overpaid, from what date should the pension be corrected?

Pension schemes are obliged to correct any error they discover within a reasonable period of time. To do otherwise would render payments unauthorised under regulation 14 of the Registered Pension Scheme (Authorised Payments) Regulations 2009 [SI 2009/1171].

HMRC have provided a clear steer with regards to timing, in so much that "*When a scheme discovers an overpayment it immediately becomes unauthorised and is subject to an unauthorised tax charge*".

However paragraph 5 of regulation 14 confirms that a pension is an authorised payment if the scheme rules are being amended to allow for such payments to be made indicating that the continued payment of the existing rate of pension would be treated as an authorised payment by the planned introduction of the IPE.

Would sums written off be unauthorised payments?

We understand that any overpayment that is not recovered will not be unauthorised if it falls within regulations 13 or 14 of the Registered Pension Schemes (Authorised Payments) Regulations 2009 [SI 2009/1171].

Regulation 13 says that a payment made in error will be an authorised payment if the:

- payment was genuinely intended to represent the pension payable to the person,
- administering authority believed the recipient was entitled to the payment, and
- administering authority believed the recipient was entitled to the amount of pension that was paid in error.

In addition to the above, there is a further exemption where the overpayment is a 'genuine error' as described in PTM146300 and the aggregate overpayment (paid after 5th April 2006) is less than £250. In such circumstances, if the overpayment is not recovered it remains an unauthorised payment but it does not have to be reported to HMRC and HMRC will not seek to collect tax charges on it.

In the meantime, SPPA has provided a short update and Q&A on its website.

Kimberly Linge
Policy Manager, LGPS
8 February 2018

Contact Information:

Should you have any enquiries about this circular, or require further information, please contact Kimberly Linge, Policy Manager, LGPS.

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Pensions Committee

2.00pm, Monday, 26 March 2018

2018-20 Service Plan and Budget

Item number	5.13
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

The Service Plan provides details of the pension fund's priorities over the coming years. It also sets budget and performance targets for the service.

EDINBVRGH
THE CITY OF EDINBURGH COUNCIL

Report

2018-20 Service Plan and Budget

1. Recommendations

Committee is requested to:

1.1 Approves the two-year Service Plan for 2018-20;

1.2 Approves the budget for 2018-19; and

1.3 Notes the indicative budget for 2019-20.

2. Background

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

3. Main report

3.1 The draft Service Plan for 2018-20 is provided as Appendix 1.

3.2 The challenges and opportunities facing the pension funds over the coming years, and hence the themes in the Service Plan, remain similar to those considered for the 2016-18 Service Plan, namely increased external scrutiny, increasing changes in employer participation in the Fund and opportunities afforded by collaboration. The Pensions Committee regularly considers these issues.

3.3 The draft Service Plan includes a 'Purpose' and 'Ambitions' to define priorities more clearly for the next two years. The Fund's values remain unchanged as follows:

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

3.4 Notable initiatives are:

- Using the pension administration software system to drive further efficiencies and improvements in service, including the flow of data from employers;
- Embed the funds' current investment collaboration initiatives and explore opportunities for collaboration on pensions administration;
- Improve sustainability of the team, including succession planning.

3.5 Notable changes in the plan are:

- Significant expansion of the performance indicators for pensions administration;
- A new section on Risk Assurance, with a high-level summary of the controls and assurance in place to mitigate risks.

3.6 The proposed budget for 2018/19 is included in the Appendix, together with an indicative budget for 2019/20. The main points to note are summarised below at "Financial Impact".

4. Measures of success

4.1 The funds key measures of success are:

- Meeting key performance indicators; and
- Achieving key actions set out in the Service Plan.

5. Financial impact

5.1 The proposed budget for invoiced costs represents a £474k increase to the comparable 2017/18 budget, including that agreed as part of collaboration business case. The key changes comprise the following:

	Increase/ (Decrease) £'000
Employee Costs – Additional posts have been added, including a temporary HR Manager and additional accounting and legal resources. An increase in employer pension contribution and staff salaries has also contributed to the increase.	304
Supplies & Services – additional expenditure in a front-office trading system which will be used to support internal investment management, risk controls and collaboration.	131
Central Support Costs – Cost savings reflect the current service level agreement in place for 2017/18.	(43)

5.2 Please note there are two significant areas, external investment manager fees and collaboration income where the budget has not changed from 2017/18.

- External Investment Manager fees – following the completion of the 2017 actuarial valuations, the Fund will be reviewing investment strategy which could impact investment manager arrangements. The proposed budget continues to include £10 million contingency to be utilised in the specific event of significant departures from the internal investment team compelling the outsourcing of the investment management function.
- Collaboration income –. The income shown in the budget is the annual income indicated in the business case provided to Committee in March 2017. As reported elsewhere on the agenda, discussions continue with potential partners over the timing, form and structure of services. Further the Fund will be working with Falkirk Pension Fund on the review of investment strategy over coming months which should provide greater certainty of collaborative initiatives.

5.3 Updates on collaboration and revised financial projections will be provided to Committee later in 2018.

5.4 Further, the Fund has not included investment performance fees which 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 accounting treatment of investment managers (some reporting performance on an accruals basis, others on a cash basis) make it extremely difficult to accurately forecast costs. In recent years, the Funds' accounts have highlighted the fluctuation in the performance related element of its investments, with 2016/17's figures reported as £4.3m compared to £12.1m in 2015/16. 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 2015/16's figure was also inflated by a change in accounting treatment by a manager recognising performance fees, correctly, on an accruals basis rather than a cash basis.

6. Risk, policy, compliance and governance impact

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

7. Equalities impact

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

8. Sustainability impact

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

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

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

- Input from staff;
- Customer insight including surveys and meetings;
- Feedback from the Fund's Customer Service Excellence and Pensions Administration Standards Association assessments.

10. Background reading/external references

10.1 None

Stephen S. Moir

Executive Director of Resources

Contact: Name, Clare Scott, Chief Executive Officer, Lothian Pension Fund

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11. Appendices

Appendix 1 – Draft Lothian Pension Fund Service Plan 2018-2020

Appendix 1

Lothian
PENSION FUND

Service Plan 2018 - 2020

Accredited Member
Pensions Administration Standards Association
assess | aspire | achieve

CUSTOMER SERVICE EXCELLENCE
CSE

Our purpose

To provide a highly professional and responsive service to members and employers

Introduction

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

Lothian Pension Fund is the second largest Local Government Pension Fund in Scotland with assets of approximately £6.8 billion, 90 employers with active members and over 76,000 members.

The Lothian Buses Pension Fund holds assets of £0.5 billion and 3,800 members, while Scottish Homes Pension Fund investments amount to £0.17 billion with 1,700 members.

How the Funds are run

All pension matters are delegated to the Pensions Committee of the Council and its members act as 'quasi trustees'. The day to day running of the Fund is delegated to a specialist team who undertake pension administration, accounting and investment functions, managing the majority of the Fund's assets internally. The team is employed by an arms-length company which is owned by the Council and is supervised by a board of directors chaired by the Council's Executive Director of Resources.

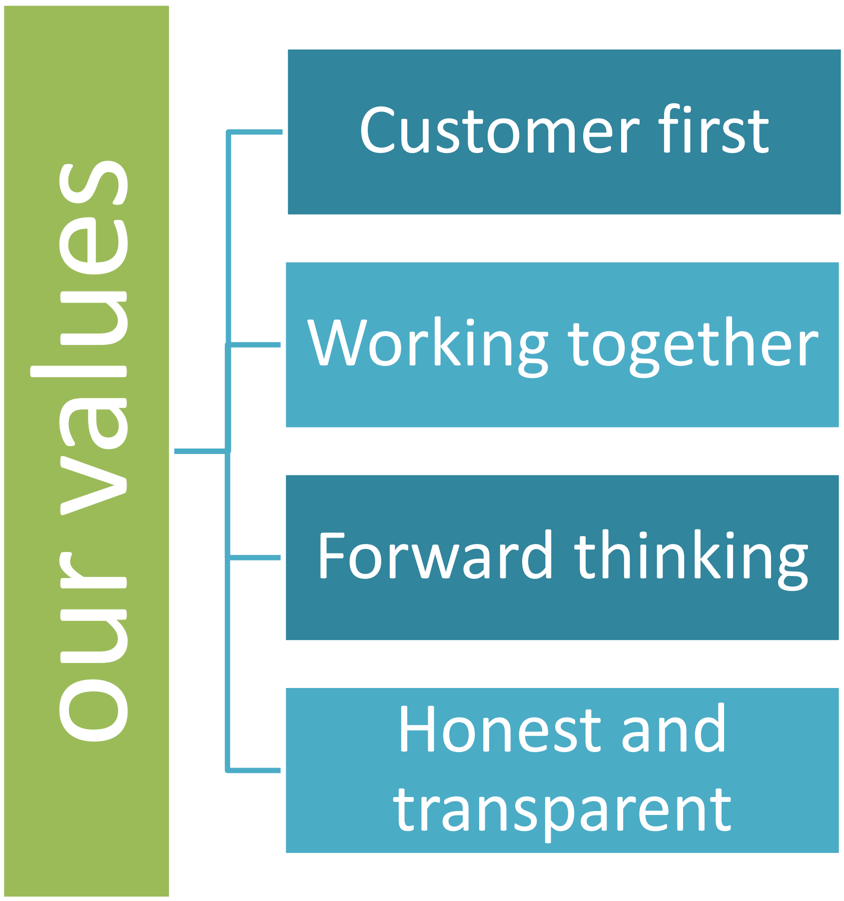
A Pension Board, made up of 5 employer and 5 union member representatives, assists the Pensions Committee in securing compliance with legislation and other requirements of the Pensions Regulator.

Investment strategy guidance to the Committee is provided by an Investment Strategy Panel, working in collaboration with Falkirk Pensions Fund. The Investment Strategy Panel includes senior officers and external investment advisers. The Pensions Committee of each Council agree their own investment strategy but delegate the implementation of strategy, including selection of investment managers, to officers. The Investment Strategy Panel advises the Finance Directors of each administrating authority (the City of Edinburgh Council and Falkirk Council) on implementation of investment strategy. The assets of Lothian Pension Fund and Falkirk Council Pension Fund remain separate.

The Fund maintains a comprehensive website for easy access to all relevant pension information and this is found at www.lpf.org.uk. This includes the Annual Report & Accounts of the three pension funds, Statement of Investment Principles, Funding Strategy Statement and Pensions Administration Strategy and Pensions Discretions Policy.

Our Ambitions and Our Values

- To provide an excellent service to our members and employers
- To provide funding and investment strategies for employers to manage affordability and mitigate risk
- To be a partner of choice for other local government pension funds to improve efficiency and sustainability



Service plan priorities

Customer first	Provide an excellent service to members
	❖ **Implement new technology, improving service and maximising efficiencies.** ❖ **Continue to improve the flow of data from employers and the quality of member data.** ❖ **Broaden our performance indicators and targets for pensions administration to improve service.**
	1. Implementation of new pension administration systems. 2. Explore automation of pension administration work to improve productivity, efficiency and customer experience. 3. Review Pensions Administration Strategy. 4. Introduce broader pension administration performance measures. 5. Continue to improve member communications through a new website, provision of improved material. 6. Communicate new flexibilities introduced by the 2018 regulation changes. 7. Complete reconciliation of members' Guaranteed Minimum Pensions with HMRC information. 8. Continue to use the Customer Service Excellence and Pension Administration Standards Association criteria to enhance our service.

Forward thinking

Collaboration

- To be the partner of choice for other Scottish LGPS funds.
- Inform and influence decisions on the LGPS at national level.
- Review opportunities to work with English & Welsh LGPS investment pools.
- Extend collaboration services to provide access to LPF's in-house investment portfolios.
- Explore options for collaboration in pensions administration and Joint Investment Strategy Panel.
- Develop communications strategy around our collaborations.

1. Deliver extended collaborative services to Falkirk Pension Fund and beyond.
2. Work with the Joint Investment Strategy Panel to review the Investment Strategies of the Lothian and Falkirk Pension Funds.
3. Continue to support collaboration efforts, with appropriate accounting and financial reporting.
4. Implementation of Front Office Investment System, maximising efficiencies and controls.
5. Strengthen resources to support increasing collaborative opportunities and regulatory developments.

Working together

Develop team-based culture of excellence

- **Develop and embed culture of excellence following transfer of staff to LPFE Limited.**
- **Celebrate and reward team and individual successes, incentivising excellent performance.**
- **Improve sustainability of the team, building support, developing capabilities and succession planning.**
- **Put in place a business support function.**

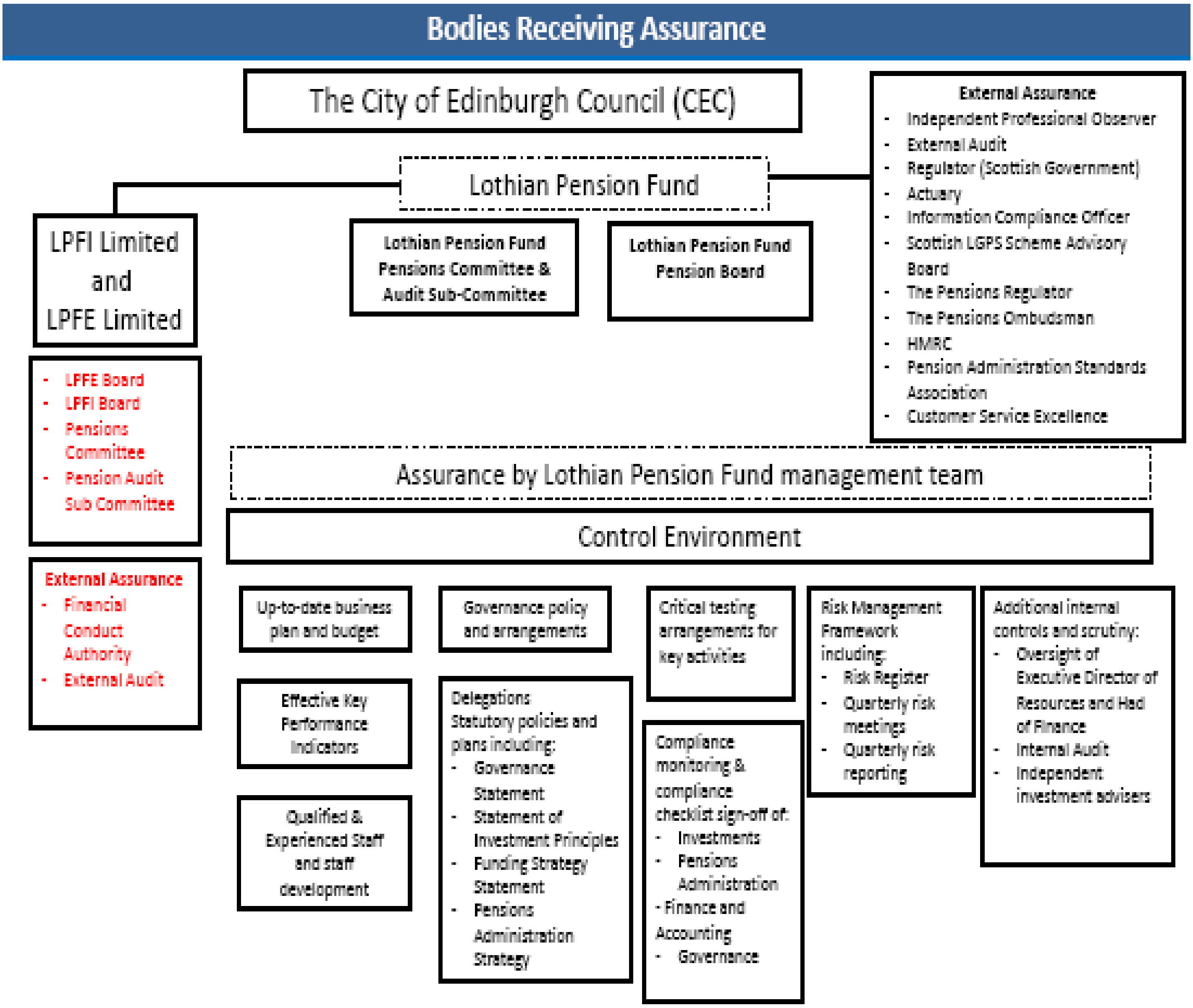
1. Create flexible, supportive and empowering working environment focused on productivity and high quality output.
2. Introduce new performance review process for staff and managers.
3. Deliver high professional standard of internal service delivery to support staff, external parties and business in all areas.
4. Develop and enhance procedures manuals.

Honest and transparent	## Effective Governance ❖ **Focus on our accountability to members and employers, whilst continuing to report to the general public.** ❖ **Knowledgeable and resourced governance.** ❖ **Greater transparency on pensions administration performance.** ❖ **Develop support services, including those received from Council departments.**
	1. Ensure processes, systems and communications comply with new data protection and financial services legislation. 2. Ensure successful consolidation of Lothian Pension Fund and Lothian Buses Pension Fund. 3. Enhance reporting facilities of the employer unitisation of Lothian Pension Fund. 4. Complete review of admission agreements. 5. Ongoing employer covenant analysis and develop process for ongoing management and monitoring of employer funding (cessation) agreements. 6. Develop governance processes and procedures for the Fund's arm's length companies. 7. Focus on Investment Management Fee transparency. 8. Improve communication of efforts around responsible investment and analysis of environmental, social and governance issues. 9. Maintain a leading approach to risk management.

Risk Assurance

The Fund operates a bespoke assurance framework designed to ensure it meets its objectives, is adequately resourced, managed to high professional standards, meets legislative requirements and has high customer satisfaction.

The framework is illustrated below:



An extensive risk register is maintained covering a wide range of issues across investments and benefit operations. The register is subject to internal review each quarter and a summary is reported to Pensions Committee and Pensions Audit Sub-Committee. On an annual basis the Pensions Audit Sub-Committee reviews the register.

Performance Indicators

	2016/ 2017	2017/ 2018	2018/ 2019	2019/ 2020
	Target (Actual or Actual Year-to-Date)		Target	Target
Maintain Customer Service Excellence Standard (CSE) (Annual assessment)	Retain (Retained)	Retain (Assessment March 2018)	Retain	Retain
Maintain Pensions Administration Standards Association (**PASA**) accreditation (achieved in 2017 with biannual assessment)			Retain	-
Overall satisfaction of employers, active members and pensioners measured by surveys	88% (90%)	89% (92.5%*)	90%	91%
Proportion of members receiving a benefit statement and by August	100% (99.6%)	100% (99.9%)	100%	100%
Investment performance and Risk of Lothian Pension Fund	Meet benchmark over rolling 5 year periods with lower risk with risk/return measures including performance in rising and falling markets			
	(Met)	(Met)		
Audit of annual report	Unqualified opinion			
	Unqualified opinion	Unqualified opinion		
Percentage by value of pension contributions received within 19 days of the end of the month to which they relate	99% (98.6%)	99% (99.7%*)	99%	99%
Data quality - compliance with best practice as defined by The Pensions Regulator	Fully compliant			
	Fully compliant	Fully compliant		
Monthly pension payroll paid on time	Yes (Yes)	Yes (Yes)*	Yes	Yes
Level of sickness absence	4.0% (0.9%)	4.0% (1.3%)*	4.0%	4.0%
Proportion of staff engaged			Greater than 70%	Greater than 80%
All staff complete at least two days training per year	Yes (Met)	Yes (on track*)	Yes	Yes
Proportion of critical pensions administration work completed within standards – individual performance within this indicator are shown below	Greater than 90% (93%)	Greater than 90% (96%*)	Greater than 91%	Greater than 92%
❖ Provide new members with scheme information within 20 working days of getting details from employer	-	-	100%	100%

	2016/ 2017	2017/ 2018	2018/ 2019	2019/ 2020
❖ Provide transfer-in quote within 10 working days of receiving the Cash Equivalent Transfer Value (CETV) from member's previous pension provider	-	-	95%	96%
❖ Notify members holding more than 3 months, but less than 2 years' service, of their options at leaving. As there is a one month and a day lying period, the target is within 10 days of the end of the lying period or after the employer providing full leaving information if later	-	-	80%	85%
❖ Pay a refund of contributions within 7 working days of receiving the completed declaration and bank detail form	-	-	90%	91%
❖ Notify early leavers entitled to deferred benefits of their rights and options within 10 days of being informed of end of pensionable service	-	-	90%	91%
❖ Provide a maximum of one guaranteed Cash Equivalent Transfer Value (CETV) within 10 working days of receiving a request	-	-	90%	91%
❖ Payment of CETV within 20 working days of receiving all completed transfer out forms	-	-	95%	96%
❖ Pay lump sum retirement grant within 7 working days of receiving all the information we need from the member	-	-	95%	96%
❖ Estimate requested by employer of retirement benefits within 10 working days	-	-	90%	91%
❖ Pay any lump sum death grant within 7 working days of receipt of the appropriate documentation	-	-	95%	96%
❖ Notification of dependant benefits within 5 working days of receiving all necessary paperwork	-	-	95%	96%
❖ Acknowledge the death of a member to next of kin within 5 working days	-	-	95%	96%
❖ Respond in writing within 20 working days to formal complaints that have escalated from frontline resolution, or recorded directly as an investigation	-	-	95%	96%
**Proportion of non-key procedures completed within standard including Additional Regular Contributions, responding to member communications, updating nominations and maintaining the member database.	65% (64%)	65% (79.4%)	75%	76%

* *Performance for financial year to January 2018,* *** *previously an internal performance indicator*

Our Budget

The budget for 2018-2019 and indicative figures for 2019-2020 are as follows:

	Projected 2017/18 £000	Budget 2017/18 £000	Movement £000	Budget 2018/19 £000	Movement £000	Indicative Budget 2019/20 £000
Employees	2,707	3,210	304	3,514	38	3,552
Property Costs	201	201	1	202	1	203
Plant and Transport	41	41	7	48	-	48
Supplies and Services	1,021	1,594	131	1,725	(95)	1,630
Third Party Payments	1,055	1,404	35	1,439	(25)	1,414
Investment Managers Fees*	22,300	22,300	0	22,300	-	22,300
Support Costs	250	286	(43)	243	-	243
Capital Funding	82	82	39	121	(8)	113
Gross Expenditure	**27,657**	**29,118**	**474**	**29,592**	**(89)**	**29,503**
Income - Stock Lending	(770)	(550)	-	(550)	-	(550)
- Collaboration	(287)	(740)	-	(740)	-	(740)
- Other	(25)	(20)	-	(20)	-	(20)
Total Income	**(1,082)**	**(1,310)**	**-**	**(1,310)**	**-**	**(1,310)**
Net Expenditure	**26,575**	**27,808**	**474**	**28,282**	**(89)**	**28,193**

* External Investment Management Fees include uninvoiced investment expenditure.

Pension Administration	**2,076**	**2,213**	**33**	**2,246**	**(1)**	**2,245**
Investment Management	**24,499**	**25,595**	**441**	**26,036**	**(88)**	**25,948**

Investment Managers Fee Contingency	**-**	**10,000**	**-**	**10,000**	**-**	**10,000**

<u>Capital Expenditure</u>

Loan Facility - LPFE	358	358	(358)	-	-	-
- LPFI	250	250	(250)	-	-	-
LPFI Share Capital	60	150	(60)	90	(90)	-
Total Capital Expenditure	**668**	**758**	**(668)**	**90**	**(90)**	**-**

Pensions Committee Report

2.00pm, Monday, 26 March 2018

Procurement Governance and Contract in respect of Integrated Pensions Administration & Payroll Software System (Ref: CT0400)

Item number	5.14
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

This report considers the governance of the procurement of service providers for the three pension funds.

It also advises of the approval of the award of contract for the delivery of the 'Integrated Pension Administration and Payroll Software System' (ref: CT0400). This has been actioned, in accordance with the Council's urgency provisions, by the Executive Director of Resources, in consultation with the Convenor of Pensions Committee and Finance and Resources Committee.

EDINBVRGH
THE CITY OF EDINBURGH COUNCIL

Pensions Committee Report

Procurement Governance and Contract in respect of Integrated Pensions Administration & Payroll Software System (Ref: CT0400)

1. Recommendations

Committee is requested to:

1.1 Note that a proposal will be made to the City of Edinburgh Council that minor clarifications to governance documentation to ensure that all pension matters (including contracts) shall be exclusively in the remit of the Pensions Committee;

1.2 Note the decision of the Executive Director of Resources, in consultation with the Convenor of Pensions Committee and Finance and Resources Committee and in accordance with Council's urgency provisions, to the award of contract to Aquila Group Holdings Limited ("Aquila Heywood"), subject to agreement regarding mutually acceptable Terms and Conditions, for the provision of the Integrated Pensions Administration and Payroll Software System;

1.3 Note that the proposed contract is for an initial 10 years period commencing in March 2018 with an option to extend for up to 2 further periods of 2 years each; and

1.4 Refer this report to the Finance and Resources Committee.

2. Background

2.1 In order to administer the Local Government Pension Scheme (LGPS) in Scotland, Lothian Pension Fund (LPF) requires a stand-alone Information Technology (IT) software system for the purposes of administering its pension and payroll business. The system will provide benefit entitlement calculations and payments in compliance with relevant LGPS Regulations.

2.2 This is an ongoing legislative requirement of City of Edinburgh Council as an administering authority of the LGPS.

2.3 The proposed procurement would replace a total of three existing contracts:

2.3.1 Pension administration software, including integrated pensioner payroll (Software Licence Agreements CL/433);

2.3.2 Member Self Service (Web-Based) for Pension Administration System (Contract Ref: 3825/PB);

2.3.3 Employer (On-line) Portal for Pension Administration System (Contract Ref: 3715/PB);

thereby providing a more efficient, fully integrated solution.

2.4 The incumbent supplier for the core software is Aquila Heywood and it has responsibility for delivering the first two of these contracts. This procurement exercise offered an ideal opportunity to combine all three services for delivery of a more integrated, efficient and cost-effective service.

2.5 LGPS administering authorities in Scotland were consulted at the procurement planning stage to gauge their interest, on a purely non-committal basis, in potentially utilising the proposed service at some point in the future. A total of seven such authorities expressed interest and these were each named in the published Invitation to Tender (ITT) documents. Should any of these chose to do so, they will be responsible for entering into their own contractual arrangement with Aquila Heywood at that time.

3. Main report

Committee Approval of Provider Appointments

3.1 The Terms of Reference (ToR) for the Pensions Committee are sufficiently broad to capture all business relating to the pensions funds. However, they do not expressly refer or cross-refer to all aspects dealt with elsewhere in the document (including contracts). While there is express carve out from the ToR of the Council's Finance and Resources Committee for matters delegated to another Committee, customary practice has been for contract approval to be sought from the Finance and Resources Committee.

3.2 Further, the Scheme of Delegation read together with the current Contract Standing Orders (CSO) determines how officers are to proceed in carrying out contract and procurement processes. They include an express carve-out to allow for (rather than require) relevant pensions contracts to approved by the Pensions Committee.

3.3 Following discussion with Committee Services, it is proposed to make minor clarifications to the governance documentation to ensure all pension matters (including contracts) should be exclusively in the remit of the Pensions Committee. It is anticipated that this would be the expectation of the Pensions Committee and its other external and internal oversight bodies and regulators. The next review of the ToR is expected to be considered by Council in June 2018.

Integrated Pension Administration and Payroll Software System

3.4 This is a somewhat specialised requirement and supply market analysis confirms that there are relatively few potential suppliers in the UK market, which currently have the necessary technical depth of knowledge and experience of legislation affecting LGPS administration.

3.5 Following publication of a Prior Information Notice, a series of supplier engagement meetings were held with organisations which expressed interest. Information and feedback gleaned from these meetings helped inform the final Specification requirements which were subsequently developed. An open procurement competition was then undertaken to source an appropriate contractor.

3.6 In addition to the required OJEU notification, an Invitation to Tender was published on Public Contracts Scotland, giving potential bidders 30 days in which to prepare and submit their tender bids. In addition to submitting their formal written tender bid, all tenderers were required to deliver a presentation in order to demonstrate the functionality and effectiveness of their proposed software solution.

3.7 A total of four organisations submitted tender bids. Technical evaluation of the bids was conducted on the 'Most Economically Advantageous Tender' (MEAT) basis, using a quality / price ratio of 70:30. To further ensure the quality of the recommended tender bid, a pre-set quality threshold of 65% of the maximum available marks was enforced.

3.8 The following table gives a summary of the scores awarded to each of the bids received in respect of both Quality and Price:

Organisation	Weighted Quality Score (maximum 70)	Weighted Price Score (maximum 30)	Overall Total Tender Score (maximum 100)
Aquila Group Holdings Limited	65.662	30.000	95.662
Tenderer 2	68.522	26.861	95.383
Tenderer 3	47.968	12.163	60.131
Tenderer 4	44.164	*	**

* Note that Tenderer 4's response to the scored Quality questions failed to pass the pre-set quality threshold of 65% of the 'pre-weighted' marks available and so their tender pricing proposal was not scored.

3.9 A further summary of the tendering / tender evaluation processes is included in the Appendix.

4. Measures of success

4.1 Compliant and efficient procurement processes to achieve the necessary services for the pension fund and achieve best value.

4.2 Ultimately, the success of the contract delivery will be judged by the effectiveness and efficiency of the service provided. To facilitate the effective management of the service, a series of seven Key Performance Indicators (KPIs) have been included in the Specification Requirements and these will assist with the monitoring and measurement of performance on an on-going basis.

5. Financial impact

Procurement Governance

5.1 There are no direct financial implications as a result of this report. However, Committee should be aware that providers are able to challenge a procurement process which has not been undertaken appropriately and there are significant financial consequences of successful challenges.

Integrated Pension Administration and Payroll Software System

5.2 At the procurement planning stage, analysis of the current three contracts which have delivered the services over the past four full years (2012 – 2016) shows average spend during that period of £322,422 per annum.

5.3 The total bid price of £2,949,429.60 tendered by Aquila Heywood for the maximum 14 years period of the contract (including extensions) equates to an average of £210,654 per annum. This represents an average saving of £111,768 per annum (almost 34.7%) over the full fourteen years term. It should be noted that a greater proportion of these savings shall accrue in the later years of the contract.

5.4 Advice must be sought from Commercial and Procurement Services prior to committing the Council to any contract variation or extension, including any proposed price changes.

5.5 The costs associated with procuring this contract are estimated, by the Chief Procurement Officer, at between £20,001 and £35,000. This is in accordance with the application of cost bandings, as shown below:

	Estimated Staff Cost
ROUTE ONE Relatively low value, risk and a non- repetitive nature	Up to £10,000
ROUTE TWO Moderate value and risk	£10,001 - £20,000
ROUTE THREE High value/high risk/strategic procurements	£20,001 - £35,000

6. Risk, policy, compliance and governance impact

Procurement Governance

6.1 There are risks of providers challenging the award of a contract where a procurement process has not followed due process.

Integrated Pension Administration and Payroll Software System

6.2 The impact of potential “User Acceptance Testing” failure at implementation phase was considered at procurement planning stage. In order to offset the considerable additional expense which would be incurred should it prove necessary to extend the current contract arrangements in this circumstance, tenderers were required to include a Service Credit offer as part of their tender bid submissions. Service Credit offers were evaluated and scored as part of the overall evaluation process.

6.3 The tender bid received from Aquila Heywood included detailed information to suggest that they have the necessary technical ability, together with comprehensive proposals to ensure appropriate data security protocols and data sharing arrangements, good customer service, and management of the service delivery.

6.4 A validation of the financial standing (“Financial Probity Evaluation”) of Aquila Heywood was conducted and confirmed that it comfortably meets the minimum criteria stipulated in the Invitation to Tender documents and is therefore considered to be financially sound.

7. Equalities impact

7.1 There are no direct equality and rights impacts arising from this report.

7.2 Aquila Heywood has given assurances that it does not intend to employ workers (including any agency or sub-contractor workers) on zero hours contracts. Additionally, it has given assurances that it intends to pay all workers the Living Wage.

8. Sustainability impact

8.1 There are no direct impacts on carbon, adaptation to climate change or sustainable development arising directly from this report.

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1 None.

Stephen S. Moir

Executive Director of Resources

Contact: Clare Scott, Executive Officer, Lothian Pension Fund

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11. Appendices

Appendix 1 - Integrated Pension Administration and Payroll Software System – Summary of Tendering and Evaluation Processes

Integrated Pension Administration and Payroll Software System – Summary of Tendering and Evaluation Processes

<table>
<tr><th>Contract</th><th colspan="2">Integrated Pension Administration and Payroll Software System</th></tr>
<tr><td>Contract period (including any extensions)</td><td colspan="2">March 2018 to March 2032 (provisional) (including up to 2 extension periods of 2 years each – a total of up to 4 years).</td></tr>
<tr><td>Estimated contract value</td><td colspan="2">£2,947,429.60 (including possible extensions).</td></tr>
<tr><td>Procurement route chosen</td><td colspan="2">Open Tendering procedure</td></tr>
<tr><td>Tenders returned</td><td colspan="2">4</td></tr>
<tr><td>Recommended supplier</td><td colspan="2">Aquila Group Holdings Limited</td></tr>
<tr><td>Price / Quality Split</td><td colspan="2">Quality 70%, Price 30%.</td></tr>
<tr><td rowspan="7">Evaluation criteria and weightings and reasons for this approach</td><td>Criteria</td><td>Weighting</td></tr>
<tr><td>Technical Functionality</td><td>22.5%</td></tr>
<tr><td>Pension Administration Functionality</td><td>32.0%</td></tr>
<tr><td>Pension Payroll and Immediate / Irregular Payment Functionality</td><td>17.5%</td></tr>
<tr><td>Digital Services</td><td>18.0%</td></tr>
<tr><td>Development and Implementation Plans</td><td>10.0%</td></tr>
<tr><td colspan="2">The quality, accuracy and reliability of the service delivery was recognised as being more important than the cost because of the critical nature of the service itself.</td></tr>
<tr><td>Evaluation Team</td><td colspan="2">Three officers from Lothian Pension Fund, with advice and guidance from Chief Procurement Officer</td></tr>
</table>