Pensions Committee

2.00pm, Wednesday, 26 June 2019

LPF Unaudited Annual Report (and Financial Statements) 2019

Item number	**5.3**
Executive/routine	
Wards	**All**
Council Commitments	Delivering a Council that works for all

1. Recommendations

The Pensions Committee (**Committee)** is requested to:

1.1 **note** the unaudited Annual Report (and Financial Statements) for the year ended 31 March 2019 for Lothian Pension Fund and Scottish Homes Pension Fund; and

1.2 **refer,** for the purposes of noting**,** the unaudited Annual Report 2019 to the next meeting of the City of Edinburgh Council.

Stephen S. Moir

Executive Director of Resources

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EDINBVRGH
THE CITY OF EDINBURGH COUNCIL

Report

LPF Unaudited Annual Report (and Financial Statements) 2019

2. Executive Summary

2.1 The purpose of this report is to present the unaudited Annual Report (and Financial Statements) for the year ended 31 March 2019 for Lothian Pension Fund and Scottish Homes Pension Fund.

2.2 A copy of the unaudited Pension Funds' Annual Report 2019 is attached as Appendix 1.

2.3 The financial statements of Lothian Pension Fund reflect the consolidation of the former Lothian Buses Pension Fund.

2.4 With positive investment returns achieved over the financial year, the Accounts show that the Lothian Pension Fund net asset valuation increased from £7,174m (as adjusted to include the former sub-fund of Lothian Buses Pension Fund) to £7,819m and, given its mature membership profile, Scottish Homes Pension Fund increased very marginally from £164m to £165m.

3. Background

Statutory provisions and accounting guidance

Local Government (Scotland) Act 1973

3.1 Section 95 of the Local Government (Scotland) Act 1973 states that "every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the authority has responsibility for the administration of those affairs". The Head of Finance serves as the Section 95 Officer for all of the City of Edinburgh Council's accounting arrangements, including those of the Pension Funds, however, this Section 95 responsibility has been delegated to the Chief Finance Officer, Lothian Pension Fund.

3.2 The Act stipulates that unaudited financial statements must be presented to the Council and the Controller of Audit within three months of the financial year end, that is 30 June. It is within the Pensions Committee's remit to consider the unaudited Annual Report for the pension funds. Reflecting Audit Scotland guidance, the Annual Report should be referred to full Council for the purpose of noting. The next Council meeting is on 27 June 2019.

Accounting and other guidance

3.3 The content of the "Pension fund annual report" is governed by Local Government Pension Scheme (Scotland) Regulations 2018, Regulation 55. This regulation states:

> **"**(1) An administering authority must, in relation to each year beginning on 1st April 2015 and each subsequent year, prepare a document ("the pension fund annual report") which contains—
>
> > (a) a report about the management and financial performance during the year of each of the pension funds maintained by the authority;
> >
> > (b) a report explaining the authority's investment policy for each of those funds and reviewing the performance during the year of the investments of each fund;
> >
> > (c) a report of the arrangements made during the year for the administration of each of those funds;
> >
> > (d) for each of those funds, a statement by the actuary who carried out the most recent valuation of the assets and liabilities of the fund in accordance with regulation 60 (actuarial valuations of pension funds), of the level of funding disclosed by that valuation;
> >
> > (e) the current version of the statement under regulation 53 (governance compliance statement);
> >
> > (f) for each of the funds, the fund account and net asset statement with supporting notes and disclosures prepared in accordance with proper practices;
> >
> > (g) an annual report dealing with—
> >
> > > (i) the extent to which the authority and the Scheme employers in relation to which it is the administering authority have achieved any levels of performance set out in a pension administration strategy in accordance with regulation 57 (pension administration strategy); and
> > >
> > > (ii) such other matters arising from a pension administration strategy as it considers appropriate;
> >
> > (h) the current version of the statement referred to in regulation 56 (funding strategy statement);

(i) the current version of the statement under regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (statement of investment principles);

(j) the current version of the statement under regulation 59 (statements of policy concerning communications with members and Scheme employers); and

(k) any other material which the authority considers appropriate."

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

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

3.6 In May 2018, CIPFA published "Proposals for LGPS Fund Reporting in a 'Pooled World'". "This …. sets out proposals for revised reporting for LGPS pension funds to meet a number of objectives", including "to further enhance reporting of costs reflecting the introduction of the LGPS SAB Code of Transparency for asset managers, and initiatives underway by the Financial Conduct Authority (FCA) and Department for Work and Pensions (DWP) which aim to create more transparent and granular reporting standards for both providers and trustees …. This paper has been issued by CIPFA as good practice which is to be incorporated into 2018/19 Annual Report guidance for local government pension funds….".

3.7 Most recently, in March 2019, CIPFA published "preparing the annual report - Guidance for Local Government Pension Scheme Funds (LGPS) 2019 Edition". The purpose of this guidance is to assist local government pension funds with the

preparation and publication of the annual report required by Regulation 55 of The Local Government Pension Scheme (Scotland) Regulations 2018.

3.8 The financial statements of Lothian Pension Fund and Scottish Homes Pension Fund continue to include full transparency of all investment management fees.

3.9 With the, FCA regulated, investment services company, LPFI Limited, commencing trading on 28 February 2017, consolidated financial statements have again been prepared for Lothian Pension Fund for the year ended 31 March 2019. These consolidated financial statements combine those of the Fund (the parent entity) and its controlled entities (the investment staffing company, LPFE Limited, and now also LPFI Limited) as defined in International Accounting Standard (IAS) 27.

4. Main report

LPF Unaudited Annual Report 2019

4.1 A copy of the unaudited Annual Report (and Financial Statements) for the year to 31 March 2019 for Lothian Pension fund and Scottish Homes Pension Fund is attached as Appendix 1.

4.2 In considering the unaudited Pensions Funds' Annual Report, Committee should note the following:

Financial summary

4.2.1 With positive investment returns achieved over the financial year, the Accounts show that the Lothian Pension Fund net asset valuation increased from £7,174m (as adjusted to include the former sub-fund of Lothian Buses Pension Fund) to £7,819m and, given its mature membership profile, Scottish Homes Pension Fund increased very marginally from £164m to £165m.

Consolidation of the former Lothian Buses Pension Fund

4.2.2 Section 2.5 of the Code states that 'The combination of two or more local authorities into one new authority, or the transfer of functions from the responsibility of one authority to another, shall be accounted for under the principles that apply to group reconstructions and shall be accounted for as either a transfer by absorption or a transfer by merger.' 'Transfers by merger are rare transactions but may occur when legal transfers take place and management of the local government entity consider that in substance for a true and fair presentation of the local government entity the financial statements would be best presented as if the entity had always existed in its newly combined form. The results and cash flows of all of the combining bodies (or functions) should be brought into the financial statements of the combined body from the beginning of the financial year in which the combination occurred…..'.

4.2.3 Specialist legal opinion had been sought prior to the merger of Lothian Buses Pension Fund. This concluded that "…Lothian Buses Pension Fund was set up as a 'further fund', within the meaning of the Local Government Superannuation (Funds)

(Scotland) Regulations 1986 (the 'Funds Regulations')….At the time when the Admission Agreement was entered into, there was a clear mechanism under legislation whereby a 'further fund' could be dissolved and transferred back into the Main Fund." Also, "It is worth noting that, under the Admission Agreement…, Lothian Buses was admitted first of all to the Main Fund (immediately following which) the further Fund was set up". Accordingly, with such assurance that "the newly combined body or functions has always existed", the consolidation of Lothian Buses Pension Fund "sub-fund" into Lothian Pension Fund has been accounted for by the 'transfer by merger'.

Contingent liabilities

Court of Appeal age discrimination cases (McCloud and Sargeant)

4.2.4 As previously reported to Pensions Committee in March 2019, there remains significant uncertainty as to the value of current public service pension arrangements following the Court of Appeal judgments in the cases of McCloud and Sargeant on 20 December 2018, namely that these age-related transitional arrangements were held to be discriminatory. It is anticipated that other public service pension schemes across the UK may be affected by this decision, including LGPS Scotland, notwithstanding that the nature of the comparable transitional arrangements implemented for local government pension schemes (statutory underpin) was slightly different from those adopted for the unfunded schemes. Accordingly, a contingent liability is disclosed by LPF (note 32 of the LPF Financial Statements).

Guaranteed Minimum Pension (GMP) indexation and equalisation in respect of the Local Government Pension Scheme

4.2.5 Similarly, the uncertain cost implications of GMP (how government should continue to meet its obligations to index (price protect) and equalise (make equal payments to men and women)) were also reported previously to Pensions Committee.

Further consideration will be given by the UK Government in relation to members whose State Pension Age falls after 5 April 2021. 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."

Governance

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

4.2.7 Related to the Annual Governance Statement is the Statement of Responsibilities for the Statement of Accounts. This sets out the respective

responsibilities of the Administering Authority and those delegated to the Chief Finance Officer, Lothian Pension Fund.

4.2.8 The funds have separate Actuarial Statements, prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2014. This provides a summary of the triennial valuation as at 31 March 2017, with commentary by the actuary of the experience over the subsequent years.

5. Next Steps

5.1 Following the consideration of the unaudited Annual Report 2019 by Pensions Committee, the next steps will be:

(a) City of Edinburgh Council should note the Annual Report 2019 at its its meeting on 27 June 2019.

(b) In order to meet the statutory timetable, the Pensions Audit Sub-Committee of 24 September 2018 and thereafter the Pensions Committee, at its meeting on 25 September 2019, will consider the following reports:

i. the "Lothian Pension Funds 2018/19 Annual Audit Report to Members and the Controller of Audit" by the independent auditor. This report shall summarise all significant matters arising from the audit and overall conclusions about the management of key risks. This shall also fulfil the requirements of "International Standards on Auditing (UK) 260: Communication with those charged with governance";

ii. the audited Annual Report (and Financial Statements) for the year to 31 March 2019 for Lothian Pension fund and Scottish Homes Pension Fund

(c) It is anticipated that City of Edinburgh Council should note the audited Annual Report 2019 at its meeting on 26 September 2019.

6. Financial impact

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

7. Stakeholder/Community Impact

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

7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report. The forward planning of the Committees' agendas should facilitate improved risk management and governance for the pension funds.

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

8. Background reading/external references

8.1 None.

9. Appendices

Appendix 1: Unaudited Annual Report (and Financial Statements) 2019 for Lothian Pension Fund and Scottish Homes Pension Fund;

Appendix 2: City of Edinburgh Council – Statement on the system of internal financial control by Head of Finance; and

Appendix 3: Lothian Pension Funds – Statement on the system of internal financial control by Chief Finance Officer, Lothian Pension Fund

Unaudited Annual Report and Accounts 2018/19

Lothian Pension Fund
Scottish Homes Pension Fund

Contents

Foreword

Report by the Convener of the Pensions Committee

I am delighted to present the Annual Report and Accounts for the Lothian Pension Fund and Scottish Homes Pension Fund for 2018/19.

During the year, a decision was taken to merge Lothian Buses Pension Fund with the Lothian Pension Fund by the Pensions Committee in March 2018. Following completion of a revised admission agreement and shareholders' guarantees, the merger took place on 1 February 2019. The merger puts in place an employer guarantee and, facilitated by the new employer asset tracking system, will see the creation of a bespoke investment strategy for Lothian Buses within the Lothian Pension Fund. This means that there will not be separate accounts or a valuation from this date. The change will not affect member benefits and is expected to result in more efficiencies leading to lower costs.

Within the wider Scottish Local Government Pension Scheme, the Scheme Advisory Board in Scotland initiated a consultation on the future structure of the LGPS in June 2018. The review will determine if the current 11 fund structure best serves the members and employers.

The consultation identified four options for consideration including retaining the current structure, greater co-operation between funds, pooling investments only and full merger into one or more new funds.

The Fund's preferred option would be to work with like-minded partners on a voluntary basis to develop a mutually beneficial merger solution. The Fund has made significant inroads in its collaboration via its FCA authorised company with two other LGPS funds. Partner funds are benefiting from Lothian's internal resource and we are sharing our costs. However, there has not yet been any significant impact on any of Lothian's investments. The arrangements are expected to evolve and for Lothian to benefit from greater overlap in investments. The governance of Lothian's collaborative arrangements is not straightforward. While other funds rely on advice from Lothian, they need to continue to be resourced appropriately to make decisions for their respective funds. Further, there are practical constraints to the expansion of this type of collaboration.

Finally, during the year Clare Scott stepped down after 13 years with the Fund, the last 6 years as Chief Executive Officer. I would like to record my personal thanks and those of the Pensions Committee and Board for leading the transformation of the Fund during her time with the Fund. Doug Heron joined as the new Chief Executive Officer in February of this year. I am delighted Doug has joined us and I believe he is ideally qualified to continue the successful delivery of the Lothian Pension Fund's work and look forward to working with him.

Councillor Alasdair Rankin
Convener, Pensions Committee

Report by the Convener of the Pensions Audit Sub-Committee

The function of the Pensions Audit Sub-Committee is to monitor the operation of the Fund's internal controls, governance, risk and compliance arrangements and financial reporting.

The Sub-Committee formally met three times during the year. The key activities undertaken in 2018-19 included considering the Annual Report and Accounts and both the internal and external audit reports. Other highlights have covered risk assurance, fraud prevention, tax recovery on investment income and investment custodian services.

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

Councillor Cameron Rose
Convener, Audit Sub-Committee

Report by the Chair of the Pension Board

The Pension Board, whilst not a directly decision-making body, holds an important scrutiny function and its role is in ensuring the Fund compliance with the Scheme's rules and other pensions regulations; Including those set out by The Pensions Regulator which relate to the running of the Lothian Pension Fund, thereby ensuring both its effective and efficient governance and administration.

Its members are drawn equally from across the Fund's employers and members and is made up of five employer and five member representatives who meet in session before all quarterly Pension Committee meetings, which they also attend.

Each of the members appointed to the Board is required to undertake extensive training each year in order to ensure their continuing development and understanding of their role, and the management and the various operations of the Fund.

During the preceding 12 months the Board has once again dealt with a wide range of matters, including changes to its own constituent membership. Despite these unexpected personnel changes, the Board has continued to diligently fulfil all of its responsibilities.

I would therefore take this opportunity to offer my personal thanks to all those Board Members that have been involved with, and supported, the Board and its work during this past year.

Earlier in the year the Scottish Government, via the Scottish Scheme Advisory Board, instigated a major review of the 'Effectiveness of the Governance' arrangements for all 11 Local Government Pension Funds across Scotland. The Board has been involved in shaping the Fund's response to this important document taking part in a number of sessions to discuss the options the Fund felt would ultimately ensure the best long-term future for members and employers.

The Board also continued to maintain an active interest in relation to the governance of the Fund's Investment Strategy and its considerations of the various Environmental, Social and Governance issues being brought to its attention.

This year the Board was (for the first time) actively involved in supporting the Fund's selection process relating to the appointment of its new Independent Professional Observer (IPO). This is an important external role in supporting the Pensions Committee and Board.

Having been in existence since 2015 the Board members also considered its 'Constitution' and in particular the required 'annual rotation' of the position of Chair. It was generally felt (and subsequently unanimously agreed) that this arrangement did not give the Chair sufficient time in relation to both the understanding and duties of the role. The Board therefore (with the Pension Committee's subsequent agreement) opted to implement a change to its Constitution.

Therefore from 2019/20 the Chair will have (subject to certain caveats) the ability to undertake a further subsequent year in the role.
This change will now see the position rotate every two years instead of annually and in accordance with this new rule, I will now be continuing as Board Chair until March 2020.

I look forward to once again working on your behalf and with all of the Members of the Board for a further year.

Jim Anderson
Union representative and Chair of the Pension Board

Report by the Independent Professional Observer

I was appointed as the Fund's independent professional observer in August 2018. My role helps strengthen Fund governance by providing the Pensions Committee and Pension Board with independent advice and impartial knowledge independently from the Fund officers.

I have more than 30 years of pension experience working with pension trustees and sponsors on a wide range of investment, actuarial and governance issues.

In my first term as observer I have held surgeries to assist the Pensions Committee and Pension Board to provide oversight of the pension funds. Topics such as funding, investment and collaboration have been considered in addition to the normal business of funds.

Andy McKinnell
Independent Professional Observer

Management commentary

Introduction

During the year we welcomed 4,379 new members to the Fund and supported 1,506 new retirements. We made 384,490 pension payments totalling more than £231 million to 30,623 members to support their lives in retirement. We scored 92.7% for member satisfaction. At Lothian Pension Fund we have a member-first mindset and we're proud to be the Local Government Pension Scheme for 84,317 public sector workers, former workers, or their beneficiaries, across Scotland.

OUR MISSION

To provide a sustainable and valued saving solution for public sector employees and their employers.

Change in structure

During the year, and as stated in the Introduction from the Convener, the Committee approved the merger of the Lothian Buses Pension Fund with the Lothian Pension Fund and I am pleased to report that this was completed earlier this year and the path is set for us to realise a range of operational efficiencies and reductions in overheads.

Within the Lothian Pension Fund, we operate a unitised, or segmented, structure for assets and liabilities which allows us to monitor and manage assets and liabilities according to the sponsoring employer of the member. This allows us to develop and operate appropriate investment strategies and to ensure employers pay contributions aligned to the costs of benefit entitlement for their members.

As a result, Lothian Buses, like any other sponsoring employer in our Fund, pays only the costs of their members but now shares the benefit of lower administration costs from the merged Fund.

Funding Levels

The 2017 triennial valuation was completed in the previous financial year and reflected for Lothian Pension Fund, a funding level increase from 91% at 31 March 2014 to 98% at 31 March 2017.

For Lothian Buses Pension Fund, the funding level on the ongoing basis rose from 117% in 2014 to 121% at 31 March 2017, showing a surplus of £84million.

The funding level for Scottish Homes Pension Fund at 31 March 2017 was 104.7%, increased from 88.8% from the 2014 actuarial valuation.

The next valuation is expected to be undertaken at 31 March 2020. At the time of writing we expect a move to quadrennial, or four-yearly, valuations creating in effect a longer period between valuation points.

In practice this is not expected to result in any added volatility for funding levels across the longer period, with contribution stability mechanisms expected to continue to result in certainty of costs for employers across budget cycles.

Affordability of scheme membership

During the year we were pleased to work with a number of smaller sponsoring employers to facilitate their orderly exit from active scheme membership, allowing those employers to limit the extent of future balance sheet risk. The financial benefits of scheme membership to employees are significant and increasingly costly as economic conditions and longevity factors combine to sustain the pressure on contribution rates. Where employers, primarily community admitted bodies, have affordability concerns or wish to limit their balance sheet risk we seek to agree payment and investment strategy outcomes that achieve our shared goal of sustainable and secure benefits for members.

Our people

The team at LPF now number 68 performing functions of benefit administration and investment management, supported by functions which include member communications, legal, risk, compliance, finance and HR. The team are employees of LPFE limited, an arms-length external organisation of the administering authority, City of Edinburgh Council. LPFE operates under a company board with an independent non-executive member.

During the year we had a change in Chief Executive Officer with Clare Scott moving on in December 2018 and Doug Heron succeeding her in early 2019. During her 13 years with the Fund Clare was instrumental in developing the team and the operations that support our members. We would also like to recognise her contribution to the developments at national level through her role as an advisor to the Scheme Advisory Board (SAB).

The Fund is unique in SLGPS in holding FCA authorisation and employing professionals who manage investments primarily in-house instead of through more costly external asset manager appointments. Our total complement for such roles in our organisational structure grew in the year to 15.

The team therefore requires a matching of skills and experience similar to roles in the private sector and we recognise we must compete with financial services firms to attract and retain colleagues. We are only able to do so with progressive remuneration policies and during the prior year this included taking steps towards offering a variable remuneration component for eligible employees including senior management and our investment management colleagues.

This allows us to more ably retain and attract the specialist skills and experience we need to operate the in-house investment management model that we believe drives a significant reduction in our operating costs and better aligns our investment strategy with pension fund liability profiles. Such arrangements are uncommon in public sector pension funds and there may be member and public interest in the value they create. As a result of such expected interest and our commitment to transparency we have increased the level of disclosure in the remuneration section of this report.

Scottish LGPS (SLGPS) consultation

In the last year, under the direction of the Cabinet Secretary, the Scheme Advisory Board (SAB) undertook a consultation on the prospect of structural reform for the 11 individual funds that comprise the Scottish Local Government Pension

Scheme (SLGPS). Lothian Pension Fund, second largest to Strathclyde, responded in favour of structural reform, specifically the creation of conditions in which like-minded schemes could seek to merge. We await the outcome of the review but recognise there is potential for significant change in the way that assets are managed, and member benefits are administered for the more than 545,000 members of SLGPS.

Notwithstanding the prospect of structural change, we remain active, through our FCA-authorised legal entity, in enabling other funds to achieve their investment goals. This extends to our formal investment advisory partnerships with the pension funds for Falkirk and Fife, our club deal investment partnership with a further two funds, but also to our willingness to provide resource and capital to support operational, administration, commercial and technology related developments for the benefit of all of Lothian Pension Fund and the wider SLGPS.

Economic and investment market developments

With Brexit and developments in international trade markets, political and economic uncertainty have been themes for all defined benefit pension funds over the year. Lothian Pension Fund has for some time held a bias towards lower volatility strategies and during the year, undertook a detailed investment strategy review involving external advisers to best position the Fund for the uncertainty ahead.

Overall returns for our investments are reported in the Investments section of this report.

Interaction with regulators

We were pleased to be selected to be a member of the LGPS cohort review carried out by The Pensions Regulator (TPR) in the prior year. This interaction, made possible by TPR assuming responsibility for LGPS regulation in 2013, extended to a series of thematic reviews across a range of governance and administration aspects of our operations.

TPR expect to report on their findings from the cohort at aggregate level and we look forward to working with TPR as they develop policies and principles in support of better outcomes for LGPS stakeholders.

Future developments

The prospect of structural reform within SLGPS remains the most significant possible development to affect Lothian Pension Fund and we stand ready to work with the Scottish Advisory Board and policy-makers to ensure any change results in material benefit for the primary stakeholders of the LGPS, the members and their sponsoring employers. Aside from reform, the year ahead will see the team undertake significant member-first projects as we look to improve our technology and invest in the capability of our people, delivering more for members as a result.

DR STEPHEN S MOIR
Executive Director of Resources
The City of Edinburgh Council
26 June 2019

DOUG HERON
Chief Executive Officer
Lothian Pension Fund
26 June 2019

Governance and Risk

The City of Edinburgh Council is the administering authority for the Scottish Local Government Pension Scheme (LGPS) in the Lothian area. The Council administers the benefits and invests the assets of two LGPS funds, Lothian Pension Fund and Scottish Homes Pension Fund. In this report we refer to these as the Fund.

Lothian Pension Fund is the second largest LGPS fund in Scotland with assets of £7.8 billion, 83 employers with active members and over 84,000 members. The Scottish Homes Pension Fund investments amount to £0.16 billion with 1,550 members.

Lothian Buses Pension Fund was merged with Lothian Pension Fund on 1 February 2019, changing the way in which the Fund is administered. At the time of merger, Lothian Buses Pension Fund had assets of £0.5bn and 3,700 members. Under the new arrangements, it retains a separate investment strategy.

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 Fund, Statement of Investment Principles, Funding Strategy Statement and Pensions Administration Strategy and Pensions Discretions Policy.

The Pensions Committee and Pensions Audit Sub-Committee

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.

All pension matters are delegated to the Pensions Committee of the Council, supported by the Audit Sub Committee, and its members act as 'quasi trustees'. The Pensions Committee held four meetings and the Audit Sub Committee held three meetings during the year.

The table shows the Committee members for the year 2018/19.

From 1 April 2018 to 31 March 2019
Pensions Committee
Councillor Alasdair Rankin (Convener)
Councillor Maureen Child
Councillor Neil Ross
Councillor Claire Miller
Councillor Cameron Rose
John Anzani (Member representative)
Richard Lamont (Employer representative, VisitScotland)
Pensions Audit Sub-Committee
Councillor Cameron Rose (Convener)
Councillor Maureen Child
John Anzani (Member representative, Midlothian Council)

The Pension Board

The Pension Board was set up on the 1 April 2015 as a result of the Public Services Pensions Act 2013 and the Local Government Pension Scheme (Governance) (Scotland) Regulations 2014.

The role of the Pension Board is to help ensure that the operation of the Funds is in accordance with the applicable law and Regulations.

The Board attends all Pensions Committee meetings and two representatives also attend the Pensions Audit Sub-Committee meetings.

The membership comprises of ten members, five representatives appointed from the employer bodies and five representatives appointed by trade unions for the membership of the Fund. The Pension Board membership for 2018/19 is shown in the table. There were two vacancies as of 31 March 2019.

Member representatives	
Jim Anderson	Unison (Chair)
Thomas Carr Pollock	GMB
Brian Robertson	Unite
Thomas Howorth	Unison (appointed 24/9/18)
Diane Hogarth	Unite (resigned 18/6/18)
Tony Pearson	Unite (appointed 24/9/18) (resigned 25/3/19)
Employer representatives	
Sharon Cowle	Scottish Legal Complaints Commission (appointed 24/9/18)
Darren May	Scottish Water
Sharon Dalli	Police Scotland
Alan Williamson	Edinburgh College
Paul Ritchie	East Lothian Council (resigned 11/10/18)
Eric Adair	EDI Group (resigned 25/4/18)

Pensions Committee and Pension Board training

The Committee and Board members must attend no less than 21 hours of training per year as outlined in the Fund's training policy which is available on our website at www.lpf.org.uk.

All new members of the Pensions Committee and Pension Board attend induction training. Other training provided internally covered topics including governance, guaranteed minimum pensions, responsible investment and investment strategy.

Committee and Board representatives also attended external conferences including the Pensions and Lifetime Savings Association Local Authority Investment Conference 2018 and the 2018 Local Authority Pension Fund Forum Annual conference.

All members of the Pension Committee and all Pension Board members achieved the required training hours during 2018/19. Pensions Committee members collectively attended 313 hours of training over the year and members of the Pension Board undertook 324 training hours.

Joint Investment Strategy Panel

Investment strategy guidance to the Committee is provided by a Joint Investment Strategy Panel (JISP), working in collaboration with the Falkirk Council and Fife Council pension funds. The JISP meets quarterly and includes senior officers and external investment advisers (currently Scott Jamieson and Gordon Bagot).

The Pensions Committee of each pension fund agrees their own investment strategy but delegates the implementation of strategy, including selection of investment managers, to officers.

The JISP advises the three pension fund administrating authorities on implementation of their respective investment strategies.

The assets of Lothian Pension Fund, Falkirk Council Pension Fund and Fife Council Pension Fund remain separate.

Lothian Pension Fund employees

The team is employed by an arms-length company, LPFE Limited (LPFE), which is wholly owned by the Council (in its capacity as administering authority for the Fund) and it is supervised by a board of directors chaired by the Council's Executive Director of Resources and includes the Convener of the Pensions Committee. The team is required to carry out certain activities for the Fund through its Financial Conduct Authority authorised vehicle, LPFI Limited (LPFI).

LPFI is also wholly owned by the Council (in its capacity as administering authority for the Fund). LPFI is supervised by a board of directors chaired by the Council's Head of Finance. Both the boards of LPFI and LPFE comprise an independent non-executive director (Leslie Robb). All the operations, costs and liabilities in relation to the Fund, including those of LPFE and LPFI, are borne by the Fund.

The day-to-day running of the Fund is carried out by a specialist investment and pensions team. The Fund's functions include investment, pension administration, employer liaison, data quality, customer support, accounting, legal, risk and compliance, communications, and general business support.

The investment responsibilities include carrying out in-house investment management and the monitoring and selection of external investment managers, as well as external facing collaborative initiatives with other like-minded pension funds.

Over the year, senior officers directly involved in the governance of the Fund from the City of Edinburgh Council were:

Dr Stephen S Moir, Executive Director of Resources,
Hugh Dunn, Head of Finance
Katy Miller, Head of Human Resources

And senior officers from Lothian Pension Fund were:

Doug Heron, Chief Executive Officer from February 2019
Bruce Miller, Chief Investment Officer
Struan Fairbairn, Chief Risk Officer, (Legal, Risk and Compliance)
John Burns, Chief Finance Officer
Clare Scott, Chief Executive Officer to December 2018

Scheme Advisory Board

The Scheme Advisory Board for the Local Government Pension Scheme in Scotland was set up following the Public Service Pensions Act 2013. The Board's main function is to advise Scottish Ministers, when requested, on the desirability of changes to the Scheme. They can also provide advice to scheme managers and pension boards in relation to effective and efficient administration and management of the Scheme in Scotland.

The membership of the Scheme Advisory Board comprises of seven member representatives and seven employer representatives with a Joint Secretary to support each group. During the year, Councillor Rankin was a member and Chair of the Scheme Advisory Board and Fund officers have also advised the Board and Joint Secretaries. There is more information on the Scheme Advisory Board at www.lgpsab.scot.

Risk

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 the Pensions Committee and Pensions Audit Sub-Committee. On an annual basis the Pensions Audit Sub-Committee reviews the register in full.

Risk Management

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

As at 31 March 2019, the most significant risks (after taking account of risk reduction controls), as assessed using a score out of 100 by the Funds' management team, are shown in the table opposite.

Risk Assurance

The Fund operate a bespoke assurance framework designed to ensure they meets their objectives, are adequately resourced, managed to high professional standards, meet legislative requirements and have high customer satisfaction.

Description	Impact	Likelihood	Risk score
Adverse investment performance leading to pressure on employer contributions	5	4	20
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions	5	7	35
Collapse/restructuring of an employer body leading to pressure on other employers	4	8	32
Failure of IT leading to poor ICT responsiveness, legal exposure and cost/risk implications	8	8	64
Human Resource within the team not sufficient to carry out core task in conjunction with active or anticipated projects.	6	6	36

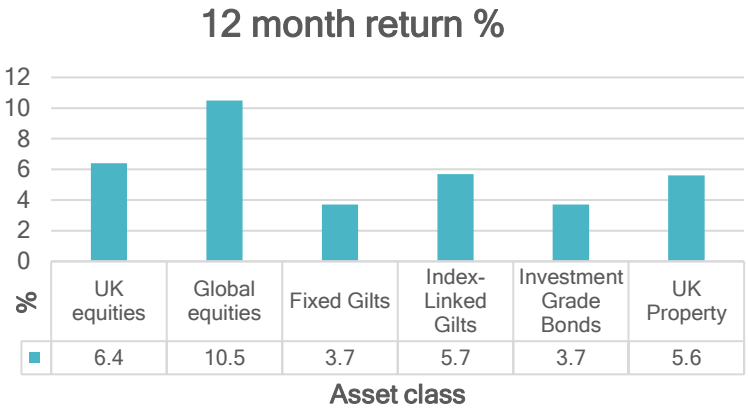
Investment

Investment markets

For the 12 months to 31 March 2019, UK equities (FTSE All Share) returned +6.4%, and global equities (MSCI ACWI, in GBP) returned +10.5%. Global equity returns for sterling-based investors were boosted by the weakness of the pound over the year (global equities returned +5.6% in local currency terms), as investors grappled with the wide range of potential Brexit outcomes. Equities fell sharply in Q4 2018, with markets falling as much as 14% from end September 2018 to their lows in late December, before rallying strongly through the first quarter of 2019.

UK and US government bond yields rose modestly through to September 2018, with the US 10-year bond yield breaching the 3% level for the first time since 2011. However, yields then fell through Q4 2018 as equity markets sold off. Towards the end of December, the US Federal Reserve signalled that the prospect of future rate rises was much less certain than many participants had expected. Bond yields then moved lower through Q1 2019, with US and UK 10-year bond yields ending the year to 31 March 2019 circa 30 basis points (0.3%) lower than they had been 12 months prior. In Europe, the 10-year Bund yield ended the year circa 50 basis points (0.5%) lower as investors sought the safety of German government bonds as economic data showed the internationally sensitive Eurozone slowing. In contrast, Italian bond yields were higher over the year amid heightened concerns over government finances and the domestic political situation.

The table below shows index returns over 12 months to 31 March 2019 for a range of asset classes.



Index: Bloomberg, MSCI UK Property

The OECD's latest economic outlook (March 2019) includes further downgrades to 2019 GDP projections for the world's major economies; this follows a previous set of downgrades in its November 2018 update. Dispersion between regions is highlighted, particularly between the US and Eurozone area, alongside the ongoing risk from a potential China growth shock. For the UK, the OECD estimate the economic loss since the 2016 Brexit referendum at between 0.7% and 1.7% of GDP, with continued uncertainty expected to impact negatively until the situation is resolved. Given this backdrop, it is not a surprise that the OECD also expect that "interest rates are set to stay lower for longer".

The prospect of looser monetary policy has supported support risk assets in the short term and although the outlook for global growth is softer than it was, it remains positive overall. However, economic forecasts have been tilting further in a downward direction. That said, markets are inherently uncertain and a focus on long-term investment strategy remains a prudent approach for long-term investors.

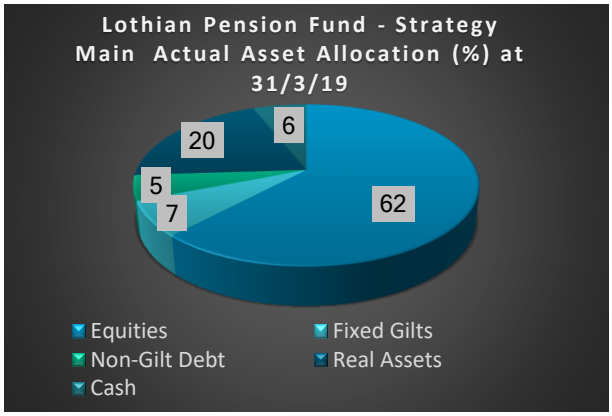
Investment strategies

The investment strategies for the Fund reflects the long-term plans to maintain an acceptable balance between contribution stability and the achievement of positive long-term real returns from the assets owned.

During 2018/19, a review of the investment strategies was undertaken, taking into account the results of the 2017 actuarial valuation. The investment strategy is set at the broad asset class level of Equities, Gilts, Non-Gilt Debt, Real Assets and Cash, which are the key determinants of investment risk and return. Despite an expansion in the number of these 'policy groups' from 3 to 5, the strategic allocation for the whole Fund is broadly similar to the previous allocation, albeit expressed slightly differently.

Lothian Pension Fund

During the course of the year (1 February 2019), Lothian Buses Pension Fund merged into Lothian Pension Fund with a separate, fourth investment strategy specifically created for Lothian Buses within Lothian Pension Fund.

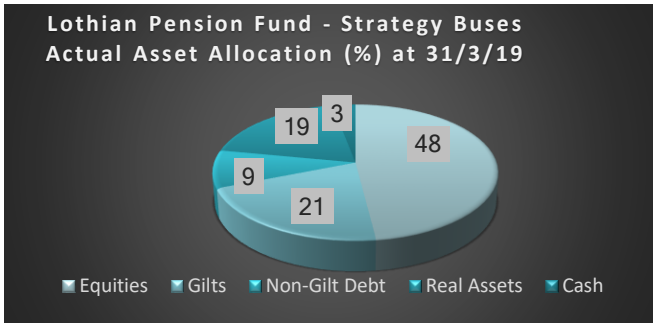


To provide suitable investment strategies for the differing employer requirements, the Fund currently operates four investment strategies. More than 90% of employer liabilities are funded under the Main Strategy, which adopts a long-term investment strategy aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer.

A small number of employers are funded in the Mature Employers Strategy, which invests in a portfolio of UK index-linked gilts (Mature Employer Gilts - MEG) to reduce funding level and contribution rate risk to a level appropriate to their circumstances. The liabilities funded by Mature Employers Strategy represent less than 1% of total Lothian Pension Fund liabilities.

Just over 1% of liabilities are funded by 50/50 Strategy, which is a 50/50 split of the above two strategies. 50/50 Strategy is for employers who are closed to new members but who do not yet qualify for Mature Employers Strategy.

Lothian Buses now has its own strategy, Strategy Buses, within the Fund with the actual asset allocation shown in the chart below. The liabilities associated with the Lothian Buses strategy represent approximately 7% of Lothian Pension Fund liabilities.

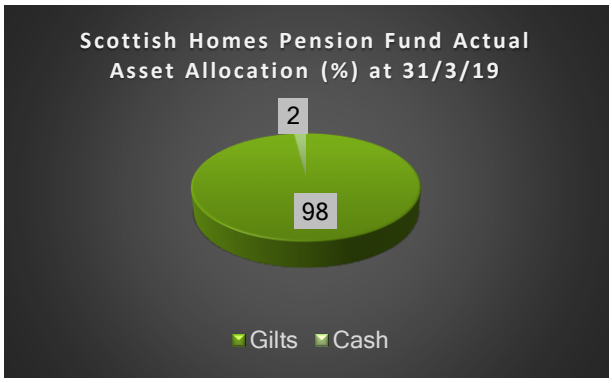


Scottish Homes Pension Fund

The Scottish Homes Pension Fund was invested in index-linked gilts and cash only on 31 March 2018, following the results of the 2017 actuarial valuation which showed that the Fund was 104%+ funded. The gilts were chosen to broadly match the expected liability payments as they fall due.

The analysis focused on the nature of the liabilities, including the proportion that are fixed and index-linked and the timing of expected pension payments. In addition, consideration of the availability of assets to match those payments was undertaken. This resulted in a restructuring of the Fund's bond holdings into both nominal and index-linked UK gilts in early 2019.

By cash flow matching the assets with future liability payments up to one year beyond the next actuarial valuation, which is expected in the March 2020, the Fund has minimised funding level risk.



Internal investment team

Strategies for the Fund are implemented and monitored by an experienced internal team of investment professionals supported by external advisers. Over recent years, the internal team has expanded with very positive effects on costs and capabilities. This is reflected in two structural shifts. Firstly, the percentage of Lothian Pension Fund's listed equity assets managed internally has risen from 23% to 85% and most publicly traded bond assets are also now managed internally. Secondly, the Fund has altered the construction of the listed equity portfolios, increasing the global mandates from 32% to more than 85%.

Despite these large changes in Lothian Pension Fund, performance has been ahead of benchmark over the last five years and this has been achieved with lower risk than the benchmark. The Fund's guiding principle is to use strong internal investment capabilities to their maximum potential and to retain external managers for specialist mandates.

Responsible Investment

The Pensions Committee publicly endorsed and adopted an approach to investing known as Responsible Investment (RI) over a decade ago - in 2008, the Fund became a signatory to the Principles for Responsible Investment (PRI), a United Nations-backed initiative.

This is the cornerstone of the Fund's investment approach, and over the years, the six principles have become increasingly embedded into its investment processes.

"Responsible investment is an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns."
PRI

- **Principle 1**: We will incorporate ESG issues into investment analysis and decision-making processes.
- **Principle 2**: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- **Principle 3**: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- **Principle 4**: We will promote acceptance and implementation of the Principles within the investment industry.
- **Principle 5**: We will work together to enhance our effectiveness in implementing the Principles.
- **Principle 6**: We will each report on our activities and progress towards implementing the Principles.

PRI Annual Assessment

All PRI signatories agree to the PRI organisation undertaking a comprehensive annual assessment of their approach to RI. This independent appraisal is made publicly available on our website www.lpf.org.uk with a summary of Lothian's latest evaluation is shown below. It highlights that the Fund's processes and approach to Responsible Investment are rated at or above the median of asset owner signatories across all categories measured.

PRI rates Lothian's approach to RI highly

Summary Scorecard

AUM	Module Name	Your Score	Your Score / Median Score
	01.Strategy & Governance	A	A
Indirect - Manager Sel., App. & Mon			
<10%	02. Listed Equity	A	B
<10%	05. Fixed Income - Corporate Non-Financial	A	B
<10%	07. Private Equity	A	B
<10%	08. Property	A	B
10-50%	09. Infrastructure	A	A
Direct & Active Ownership Modules			
>50%	10. Listed Equity - Incorporation	B	B
>50%	11. Listed Equity - Active Ownership	A	B

Ethics and Lobbyist Activity

As a public sector asset owner, which strives for high standards of transparency within the constraints of commercial sensitivities, Lothian Pension Fund is subject to considerable scrutiny of its investments. Lobby groups often present ethical arguments for divestment of specific investments. They create adverse publicity to further their campaigns, sometimes being highly selective in their use of facts to raise awareness and to create impact, often with an incomplete understanding of the investments that they oppose.

Campaigners often imply or state that 'Responsible Investment' is synonymous with 'Ethical Investing'.

Lothian Pension Fund is not an 'ethical investor', and nor is it an 'unethical investor'. Rather, it is guided at all times by the legal principle of fiduciary duty and its Principles for Responsible Investment. It recognises that certain investments have the potential to be more contentious than others, but it does not operate a narrow or restrictive policy of excluding investments from its universe of potential investments. What it does do is assess the likely impact of controversial business activities and practices on investment returns by incorporating Environmental, Social and Governance (ESG) considerations into its decision-making processes.

In a world with often complex social, legal or moral issues, it would be impossible to invest efficiently in a manner that meets the expectations of each activist or campaigner. In the past year, special interest groups have demanded divestment of holdings in tobacco producers, defence companies, energy producers and banks.

In contrast to the baseline views of many typical activist representations the Fund does not finance these companies – the Fund is simply a shareholder – and it does not take sides in the moral debate on these investments, but it does recognise that many of the issues raised have the potential to affect financial risk. The information provided by campaigners or other interested groups will always be given due consideration as part of the risk management process and in line with its fiduciary duty to its members and employers. The Fund has its own social purpose, which is to ensure that there are sufficient funds to pay pensions to members as they fall due.

Stewardship Code

Another foundation on which the Fund's Responsible Investment approach is built is the UK Stewardship Code. The premise on which the Code was established is that effective stewardship benefits companies, investors and the economy as a whole. As a large institutional asset owner with voting rights in UK listed companies, Lothian Pension Fund is expected to adhere to the Code on a 'comply or explain' basis. The Fund complies. Its close adherence to the Code means that it is classified as a Tier 1 signatory. "To protect and enhance the value that accrues to the ultimate beneficiary, Institutional investors should follow these principles:

- publicly disclose their policy on how they will discharge their stewardship responsibilities.
- have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.
- monitor their investee companies.
- establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.
- be willing to act collectively with other investors where appropriate.
- have a clear policy on voting and disclosure of voting activity.
- report periodically on their stewardship and voting activities.

More information on the Code can be found on the FRC website at www.frc.org.uk.

Voting

As the UK Stewardship Code makes clear, responsible institutional shareholders must exercise their shareholder rights to vote at company annual general meetings (AGMs) and extraordinary general meetings (EGMs). Voting can send a strong message to company management about how it is conducting business.

Lothian Pension Fund votes on the resolutions of 100% of the companies in which it is invested. Two of its external providers are charged with voting on the Fund's behalf based on pre-agreed policies. Baillie Gifford, who manage assets for Lothian, and Hermes EOS, the Fund's voting and engagement partner, do this. Their quarterly voting activity is available on Lothian's website www.lpf.org.uk/invest.

AGMs present asset owners with other way to influence management on important issues. Shareholders can file resolutions which allow all other shareholders to vote on matters that are not raised by management.

During 2018/19, Lothian co-filed a resolution for BP's AGM in May 2019 calling for greater transparency and disclosure on the company's approach to carbon emission and low-carbon transition planning. The resolution was backed by BP management and supported by 99.14% of investors. BP has since committed to provide investors with a new strategy consistent with the goals of the Paris Agreement, as well as providing further disclosure on capital expenditure and various company metrics and targets, including annual progress reports

Engagement

There is more to Stewardship and Responsible Investment than voting and filing resolutions. Monitoring and engaging with companies on matters of strategic importance is regarded as a key responsibility of institutional investors, which can improve corporate governance standards and protect shareholder value.

The Fund commits significant resources to engagement activity. Most is undertaken by the Fund's voting and engagement service provider and partner, Hermes EOS. What Hermes EOS brings to the Fund is a focus on and expertise in engagement activities as well as scale provided by its other like-minded clients. These allow Lothian to use its position as a shareholder more effectively as Hermes EOS engages on behalf of a wide shareholder base and is, therefore, more likely to influence management to enact positive change in investee companies.

Hermes EOS consults with its clients to develop an engagement plan so that it can prioritise engagement activity. The latest plan (available on the Fund's website) highlights 12 main themes for engagement over the three-year period 2019-21.

In this schematic, these themes surround the core subjects of engagement activity – environment, social issues, governance and strategy, risk and communication.

Each theme is described in detail in the engagement plan, including background information on the importance of each theme, the main outcome objectives, the methodology for tackling each engagement theme and Hermes EOS's description of best practice in each area.

Lothian stands behind Hermes EOS in achieving progress in each of these areas, and the internal team offers support and ideas where appropriate to Hermes EOS in carrying out this vital work.

Collaboration

Engagement activity is highly suitable for collaborative efforts. It is a complex area that benefits from scale. When Hermes EOS engages with companies, it can speak for asset owners with shareholdings worth up to £390bn. Lothian participates in other collaborative initiatives, which helps it fulfil its commitment to be an active and responsible asset owner:

- **LAPFF**, the Local Authority Pension Fund Forum, is a collaborative shareholder engagement group, comprising 80 UK local authority pension funds and 6 of the LGPS pension fund pools in England & Wales. The Convener of Lothian Pension Fund's Pensions Committee, Councillor Rankin, is on the executive board of LAPFF and has represented LAPFF and its member funds in high level engagement with company management.
- **The Cross-Pool RI Working Group** was one of several working groups formed when the England and Wales pools were being set up to take a leadership role in the process. The RI working group was formed to pioneer best practice in RI and share that across the pools. While Scottish funds are not involved in pooling, Lothian was invited to contribute to the group. Participation in the group has been an invaluable source of knowledge and expertise that allowed Lothian to take a leading position amongst UK asset owners in implementation of RI policy.
- **Diversity Project Scotland**. The Diversity Project is "a cross-company initiative championing a more inclusive culture within the Savings and Investment profession." Lothian Pension Fund has long championed diversity in its investee companies and has committed to diversity in its own ranks. Both investment and human resources staff are participating in this initiative.
- **Climate Action 100+** is a collaborative investor initiative supported by PRI and Hermes EOS. Lothian Pension Fund has recently become a participant member. Signatories to Climate Action 100+ are requesting the boards and senior management of companies to:
    - Implement a strong governance framework which clearly articulates the board's accountability and oversight of climate change risks and opportunities;
    - Take action to reduce greenhouse gas emissions across the value chain, consistent with the Paris Agreement's goal of limiting global average temperature increase to well below 2 degrees Celsius above pre-industrial level;
    - Provide enhanced corporate disclosure in line with the final recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) to enable investors to assess the robustness of companies' business plans against a range of climate scenarios, including well below 2-degrees Celsius, and improve investment decision-making.

A proud participant of:

Climate Action 100+

Global Investors Driving Business Transition

As a participant member, Lothian will be directly involved in company engagement with Climate Action 100+, not just through its service provider, Hermes EOS, but directly through the internal team. It is a clear signal that Lothian Pension Fund is focused on the long-term impact of climate change and regulatory pressure on existing business models from expert industry knowledge and from working with experienced engagers in this field.

The internal investment management team already regularly engages with company managements in the normal course of doing due diligence on companies as shareholders or potential shareholders. These meetings, or engagements, are an opportunity to discuss the key factors affecting company performance and strategy, and, of course, these include any significant ESG issues pertinent to that company. Further information on Climate action 100 is available at www.climateaction100.org.

Climate Change

Climate change has become the global issue of our time. As of February 2019, 184 states and the EU (representing 88% of global greenhouse gas emissions) had ratified or acceded to the Paris Agreement of the United Nations Framework Convention on Climate Change. Under this agreement, each country must determine, plan and regularly report on the contribution it undertakes to mitigate global warming. The three key aims of the agreement are:

- Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognising that this would significantly reduce the risks and impacts of climate change;
- Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas emissions development, in a manner that does not threaten food production;
- Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

Separate to this, but part of the overall worldwide change in culture with regards to greenhouse gas emissions, the Financial Stability Board (FSB) of the Bank of England launched the Taskforce on Climate-Related Financial Disclosures (TCFD). TCFD aims to "develop voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders." Further information is available at www.fsb-tcfd.org.

As asset owners, Lothian has been engaging with the companies in its portfolios to enhance disclosures on emissions in line with the recommendations of TCFD, as well as working alongside peer organisations to promote the aims of the TCFD and reporting the Fund's approach to climate change-related risks and opportunities in its PRI reporting.

As part of the TCFD resources, investors and asset owners also have guidance on how to report their approach to climate-related risks and opportunities. These recommendations are split into four key areas of reporting.

Governance relates to the organisation's governance and climate-related risks and opportunities.

Strategy relates to the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning.

Risk management relates to the processes used by the organisation to identify, assess and manage climate-related risks.

Metrics and Targets relates to metrics and targets used to assess and manage relevant climate-related risks and opportunities.

The TCFD is in its relative infancy and Lothian Pension Fund is challenging companies to improve their disclosure and rapidly integrating the specifics of climate change into the risk management and governance of the Fund. Over the few years, it has undertaken substantial work on the issue.

Climate Change - Governance

In accordance with Scheme Regulations, the Pensions Committee and Pension Board are required to undertake a minimum of 21 hours training. Each year, the Fund's provider of voting and engagement services is invited to present to and interact with the Committee and Board. During 2018/19, they received specific training on climate change-related risks and opportunities. This was followed up with the first climate-specific reporting for the Committee, a carbon footprint of the Fund's equity holdings in June 2018. The simplicity of output of a single carbon footprint number belied the complexity of the subject matter, and the following recommendations were agreed:

- Reaffirm the Fund's commitment to integrate environmental, social and governance (ESG) considerations, such as carbon efficiency trends, into its decision-making
- Note that the Fund scrutinises and engages with investment managers to ensure that they are taking ESG issues, including climate change and carbon risk, into account in their investment decision-making
- Reaffirm the Fund's policy of not divesting solely on the grounds of non-financial factors
- Note that the Fund will monitor research on the link between ESG factors (including carbon-related factors) and financial performance to inform future investment strategy, such as stock selection criteria for quantitative strategies; and

- Agree that the Fund should aim to influence engagement activity based on its shareholdings of companies that perform poorly on carbon efficiency measurements.

The carbon footprint report will be updated on an annual basis as part of an annual review of climate-related risks and opportunities.

More broadly, the Committee and Board considers a paper on the Fund's approach to Stewardship on an annual basis. This also covers climate related issues. During 2018/19, the Pension Fund organised an event on responsible investing, to which major stakeholders and elected officials of local authority employers were invited to review the Fund's approach, with the opportunity for discussion with the investment managers, legal professionals, representatives from PRI and Hermes EOS and Committee and Board members. For those unable to attend the event and for those that require to understand the Fund's approach because they receive attention from lobbyists on a range of issues, a recording of the event has been made available on the Fund's website.

Climate-related risks and opportunities are an integral part of the overall investment process for Lothian Pension Fund, and so the Pensions Committee delegates investment decision-making to officers and investment managers with advice from the Joint Investment Strategy Panel. Climate-related risk management is reviewed as part of the regular monitoring process, which includes analysis of ESG integration in the investment mandates. For Real Estate and Infrastructure managers, the Fund has recently incorporated GRESB data into the monitoring process to better assess climate-related risk within the Fund.

Climate Change - Strategy

The Fund recognises the contribution that some specific sectors and industrial activities have towards climate change. While many prefer to label companies in carbon-intensive industries 'bad' and those in low-carbon and alternative energy businesses as 'good', in reality investment is more nuanced than this. The Fund has a policy of engagement rather than blanket divestment, which allows us to exert influence on companies to improve their business practices, align with the Paris goals, and disclose internal climate-related risk and opportunity management with TCFD compliant reporting. Recent academic research commissioned by Lothian Pension Fund* suggests that divestment at best is ineffective, and at worst provides a clear disincentive for management to change.

The Fund's approach to engagement relies heavily on our engagement and voting partner, Hermes EOS. Hermes EOS engages with companies on a range of engagement issues including climate change. The internal management team also engages with company management on a regular basis as part of company roadshows and investment conferences.

**University of Edinburgh Master's in Economics Dissertation, "In response to the recent Paris Agreement, how might pension funds contribute to helping reduce global climate change through investment policy?", Cooper, 2019*

In addition, the Fund has joined the Climate Action 100+ investor initiative and is actively participating in engagement with one of the 167 target companies in the list of systemically important carbon emitters produced by the initiative.

Regular training and development for all staff on climate related issues is provided. This includes governance functions, management, investment decisions makers, and pensions administration staff. This creates an internal culture that is serious about the risks to capital posed by the carbon transition.

The holdings of the Fund can be broadly classified under three approaches: fundamentally managed equity, quantitatively managed equity, passively managed government debt and externally managed funds (covering all asset classes). As part of the stock selection process for the fundamentally managed portfolios, any fundamentally material climate-related risks and opportunities (such as carbon pricing and the low carbon transition) are individually assessed by the managers and monitored in the portfolio holdings. Both the fundamental and quantitively managed equity funds utilise engagement with managers to improve practices. The selection and monitoring process for external managers incorporates ESG elements, and this is continuing to be refined.

The internal managers continue to monitor opportunities in the green energy and future technology space, both in the public and private markets. Much of the public spending on green energy is being done by the incumbent energy providers (the diversification of carbon-extractive companies and carbon burning utilities).

Climate Change - Risk Management

The Fund produces annual carbon footprints for listed equities. Individual companies within this exercise can have their weighted average carbon intensity measured, allowing a look through into the concentration of carbon emission risk associated with each company. This has been useful in helping to guide engagement efforts and highlighting companies that could pose a capital risk in the event of an acceleration in the low carbon transition. To date, no divestment due to outsized climate-related risks have been made. Specific research budget has been allocated to data services associated with ESG and climate-related risks and opportunities.

Climate Change - Monitoring and Metrics

The Joint Investment Strategy Panel, Committee and Board all receive regular papers on general ESG (including climate related) issues and on specific climate-related risks and opportunities. The internal management team has a suite of tools available to them. Within equities, the team utilises MSCI ESG tools, including Carbon Metrics. This allows the managers in depth assessment of ESG risks and individual carbon emissions data for all the underlying companies enabling the Fund to produce annual carbon footprints for the equity portion of the Fund.

Recent additions of data from the Transition Pathway Initiative and Carbon Action 100+ are being incorporated into the equity management process.

Recent access to GRESB data in the infrastructure and real estate asset classes is being assessed and will be incorporated into reporting in these areas over time. Support for the Carbon Disclosure Project also allows access to useful research that is considered during due diligence on investments.

Manager Selection and Monitoring

While most of Lothian Pension Fund assets are equities and bonds that are managed internally, a proportion of investments are managed by third party managers. These external managers transact in public and private markets, investing in the equity and debt of infrastructure-related, corporate and property assets. One of the core elements of due diligence in the appointment process of managers centres on their approach to ESG issues. After appointment, Lothian continues to monitor the managers quarterly and as part of this quarterly reporting and monitoring cycle, managers are obliged to provide information on ESG related issues arising and how the managers are reacting to them.

Impact

An emerging theme in global responsible investment is Impact Investing – the provision of capital to address social and/or environmental issues. Investments are made in projects that aim to generate both a positive financial return and a non-financial return – the latter is often referred to as an environmental dividend or a social dividend.

These non-financial positive impacts can be linked to the aims of the United Nation's Sustainable Development Goals (SDGs), which can be viewed at https://sustainabledevelopment.un.org and are a collection of 17 global policy areas identified to provide the greatest transformational potential to society. While these SDGs were written for policymakers, some investment professionals have begun to adopt them to target specific non-financial outcomes from their investment activities.

Lothian Pension Fund is regularly presented with these types of investment, and while not targeting Social and Environmental Impact alone, it will invest in them where they are expected to deliver an appropriate risk-adjusted return. The Fund makes investments in Private Equity, Private Debt, Infrastructure and Real Estate, which involve the deployment of capital into new projects, which are expected to have a positive impact, such as wind farms and other clean energy and modern, sustainable, energy efficient buildings. In this way, the Fund's capital creates jobs, cutting edge new environments, and the clean energy that society will need in a low-carbon future – and all while providing sustainable risk-adjusted returns for the Fund.

Infrastructure Investment

Infrastructure investments have the potential to generate attractive risk-adjusted returns, with cash flows often linked to inflation. The long-term and defensive nature of these assets also can provide an element of diversification to the Fund's investment strategy.

Over the last decade, the Fund has developed its reputation, networking and execution capabilities to secure access to investment opportunities within this market niche. The Fund's experienced team appraises, and invests in primary and secondary funds as well as co-investments, to achieve its target allocation in a cost-effective manner. An important element of the implementation strategy is to work closely with investment managers to ensure execution certainty and to diligence the commercial and legal terms. Collectively, Lothian and its collaboration partners committed over £200 million in 2018/19 in infrastructure investment.

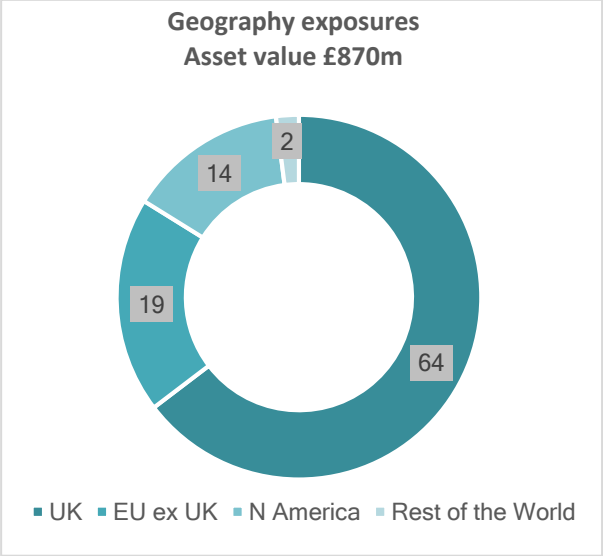
Lothian Pension Fund has a long-standing commitment to responsible investment. In addition to becoming a signatory of the UNPRI (United Nations Principles of Responsible Investment) in 2008, the Fund has subscribed to GRESB (Global Real Estate Sustainability Benchmark) to further enhance our analysis of environmental, social and governance issues.

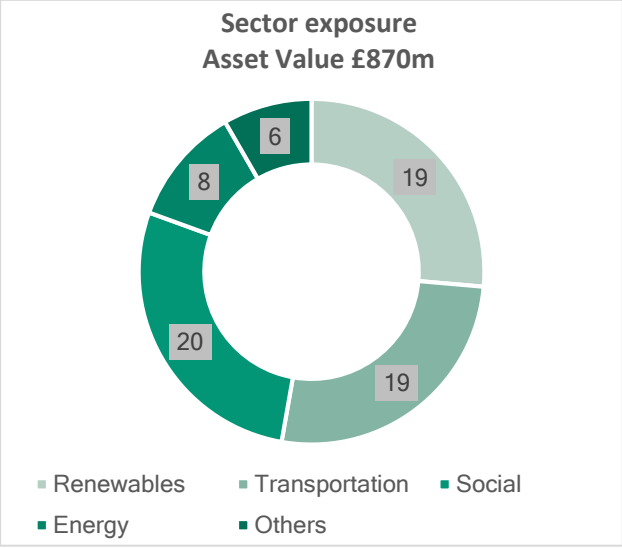
Infrastructure investments represented 11.1% of the value of Lothian Pension Fund assets at 31 March 2019, comprising one of the largest and most diversified allocations among UK LGPS funds. Of the total infrastructure investment of £870 million (31 March 2018: £795 million) invested in infrastructure, the majority is invested in the UK.

During 2018/19, Lothian Pension Fund completed two primary fund investments, acquired seven secondary fund interests and invested in three co-investments. Approximately £135 million has been invested over the year in UK, European and Global infrastructure assets. During the same period, £173 million has been distributed to the Fund. There were two successful realizations during the period generating proceeds of £48 million and recording a blended net internal rate of return of 22.3% and a total value to paid-in multiple of 1.8x. Distributions from secondary fund investments contributed £91 million.

Secondary fund investments completed following the global financial crisis in 2007-2008 boosted returns.
The Fund invested £402 million in ownership interests of 23 funds from 2010 to 2019. It has received £309 million of distributions from those investments and the remaining invested value at 31 March 2019 was £329 million. This generated a total value to paid-in multiple of 1.6x and an internal rate of return of 17% to date.

The geographic and sector exposures for Lothian Pension Fund infrastructure allocations (at 31 March 2019) are shown in the charts below.



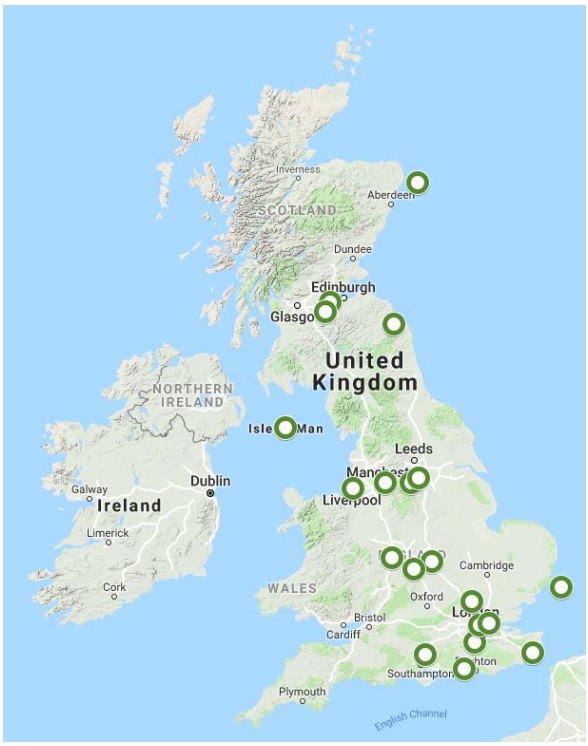


Infrastructure investments in the UK contributed 64% (or £559 million) of the total. The Funds' 20 largest UK investments, representing £400 million of value, are shown in the map below.

Investments are made across a diverse range of projects, in the areas of:

- social infrastructure (including hospitals, schools and roads);
- regulated utilities (including water and electricity);
- energy & renewables (including solar and wind);
- transportation (including ports and rail); and
- others (including car parks and smart meters).

The Fund recognises the role infrastructure investment can make to addressing part of the current environmental challenges related to climate change. Approximately, 20% of the infrastructure portfolio is invested in renewable energy. During the year, the Fund allocated £47 million to co-investments in UK renewable energy projects – a diversified portfolio of wind farms and in an energy from waste facility.



Funding Strategy Statement

The Funding Strategy Statement covers the funding strategies for Lothian Pension Fund and Scottish Homes Pension Fund and can be viewed on our website at www.lpf.org.uk/publications.

The purpose of the Funding Strategy Statement is:

- to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- to support the regulatory framework to maintain as nearly constant employer contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities.

These objectives are desirable individually but may be mutually conflicting.

The Funding Strategy Statement also ensures that the regulatory requirements to set contributions to ensure the solvency and long-term cost efficiency of the Funds (as defined by the Public Service Pensions Act 2013) are met.

Key policies, including the Fund's Admission Policy and Policy on Employers Leaving the Fund are appended to the Funding Strategy Statement. The policy on Employers Leaving the Fund sets out the Fund's approach to dealing with employer exits, including principles for determining payment of cessation debt.

The Funding Strategy Statement was revised at the 2017 Actuarial Valuation and reflects CIPFA guidance "Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme 2016". In addition to updates required as a result of changes to the Scheme Regulations and other pensions legislation, these included:

- the introduction of a new medium risk investment strategy intended to smooth the path to exit and reduce the deficit risk when an employer leaves the fund
- the requirement for employers to provide written confirmation that minimum contribution rates set by the Actuary are not unaffordable.

As required by Scheme Regulations, the Fund consulted with employers as part of the review process. Further amendments have been made to incorporate changes to Scheme Regulations in 2018 and an update to the Fund's bulk transfer policy. A consultation on these amendments is in progress.

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 (derived from the investment strategy). A formal review of the Fund's investment strategies is undertaken at least every three years to ensure appropriate alignment with liabilities. Further information on the investment strategies can be found in the Fund's Statement of Investment Principles also available at www.lpf.org.uk.

Financial Performance

Administration expenses

A summary of the Fund's administrative expenditure for 2018/19, against the budget approved by Pensions Committee, is shown in the table below. This budget includes adjustment agreed by Pensions Committee during the financial year.

The budget focuses on controllable expenditures and therefore excludes all benefit payments and transfers of pensions from the Fund. Similarly, income does not include contributions receivable and pension transfers to the Fund. The total net cost outturn of £28,703k against budgeted of £29,410k represented an underspending of £707k (2.4%) for the Fund. The key budget variances serving to generate this underspending were:

- Investment management fees - £1,169k overspending. This budget also includes investment management fees deducted from capital but excludes the performance related element of these charges due to their unpredictable nature. Broadly speaking both invoiced and uninvoiced investment management fees were within expectations. The overspending related entirely to investment property operational costs, arising from a tenant company entering administration, and the resultant debt being written-off and recognised in the Fund Account.
- Supplies and Services - £605k underspending. Implementation delay of the investment front office software system was the major factor.
- Employees - £602k underspending. This reflected general recruitment delays in the filling of vacant posts and revised accounting advice in respect of the treatment of the vested elements of variable pay.

	Approved budget	Actual outturn	Variance
	£000	**£000**	**£000**
Employees	4,379	3,777	(602)
Transport & Premises	250	224	(26)
Supplies and Services	1,934	1,329	(605)
Investment Managers Fees*	22,300	23,469	1,169
Other Third-Party Payments	1,439	1,120	(319)
Capital funding - Depreciation	132	62	(70)
Direct Expenditure	30,720	29,981	(453)
	Approved budget	**Actual outturn**	**Variance**
Support Costs	286	250	(36)
Income	(1,310)	(1,528)	(218)
Total net controllable cost to the Fund	**29,410**	**28,703**	**(707)**

**Does not include performance element. In 2018/19, £8.5m was paid in fees in relation to the Fund's private market investments.*

Reconciliation to total costs

	Actual outturn
	£000
Actual outturn on budgeted items above	28,703
Add: Securities lending revenue included in income above	943
Investment management fees deducted from capital – performance related element	8,531
IAS19 LPFE retirement benefits	594
LPFE deferred tax on retirement benefits	(101)
Corporation tax	29
Total cost to the Fund (inclusive of full cost investment management fees)	38,699
Per Fund Accounts	
Lothian Pension Fund Group	38,634
Scottish Homes Pension Fund	65
Total	**38,699**

Cash-flow

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

Lothian Pension Fund continued to experience a net reduction in value from its dealings with members. That said, the Fund has seen a £6.8million improvement in this position during the year with outlays exceeding receipts by £13.0million, compared to higher net withdrawals of £19.8million in the previous financial year. This reflects both the first year of higher employer contributions, as determined by the actuarial valuation 2017 results, and the upward trend in the number of active members.

Scottish Homes Pension Fund is a mature fund with no active members. As a result, pension outlays are met from investment income, supplemented by asset sales. Net pension outlays were £7.3million representing a £0.4million change in position from 31 March 2018 (net withdrawals of £6.9million).

It is anticipated that for the next few years these cash flow trends will remain broadly consistent.

Membership statistics and funding statements from the Actuary are provided for both Funds in the Fund Accounts sections.

2017 Actuarial Valuations

The most recent triennial assessment of the funding position of the pension funds was undertaken by the Fund's Actuary as at 31 March 2017. In general, the results showed that despite better than expected asset returns since the 2014 actuarial valuation, employer costs increased due to a reduction in future expected investment returns. The Funding Strategy Statement was reviewed and amended following consultation with employers.

For Lothian Pension Fund, the funding level increased from 91% at 31 March 2014 to 98% at this valuation. The deficit decreased from £417million at 31 March 2014 to £145million at 31 March 2017. Reflecting the differences in the employers in the Fund, a third investment strategy was introduced for employers which are closed to new entrants but not close to exiting the Fund. The Fund also introduced a requirement for employers to provide written confirmation that minimum contribution rates set by the Actuary are affordable. It is not in the best interests of the individual employers or the Fund for employers to continue to accrue unaffordable pension liabilities. Three employers indicated that the minimum contribution rates were unaffordable and the Fund worked with them to manage their exit from the Fund. The Fund continues to work with employers to put in place funding agreement to address repayment of debt when an employer leaves, in order to avoid employer default or insolvency.

The funding level for Scottish Homes Pension Fund at 31 March 2017 was 104.7%, increased from 88.8% from the 2014 actuarial valuation. Consultation was undertaken with the Scottish Government on the potential benefits offered by revising the Funding Agreement for this Fund. However, it advised that it does not wish to revisit this and as a result the investments of the Fund are now fully invested in index-linked government bonds and cash.

Investment management cost transparency

Local authorities are required to account for pension funds in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). The Code is based on approved accounting standards issued by the International Accounting Standards Board and interpretations of the International Financial Reporting Interpretations Committee, except where these are inconsistent with specific statutory requirements. The Code also draws on approved accounting standards issued by the International Public Sector Accounting Standards Board and the UK Financial Reporting Council where these provide additional guidance. Guidance is still awaited from CIPFA as to how these costs should be standardised and reported in the Annual Reports of LGPS Funds.

CIPFA published this guidance in July 2014, which promoted greater transparency of investment management fees. These principles were adopted as best practice in the presentation of the Lothian Pension Fund audited Annual Report 2015. In June 2016, CIPFA revised its guidance including the following "Investment costs incurred by a separate legal entity, or in respect of investment decisions over which the pension fund has no control, should not be included in the Fund Account." The revised guidance changed the disclosure of fees for fund of funds investment arrangements. A "fund of funds" is an investment holding a portfolio of other investment funds rather than investing directly in funds. Typically, fees are payable to the "fund of funds" manager as well as to the managers of the underlying funds. Generally, under the revised guidance from CIPFA, the second and third layer of fees would not be disclosed with just the fees from the "fund of funds" manager stated.

In the preparation of the Fund's Annual Report for 2014/15 and 2015/16, the Fund made efforts to be completely transparent on the totality of costs incurred for managing its investment assets. The Fund's disclosures included all layers of fees. At its meeting on 28 September 2016, the Pensions Committee agreed to instruct the Committee Clerk to communicate to the Chartered Institute of Public Finance and Accountancy (CIPFA), Audit Scotland and the Scottish Local Government Pension Scheme Advisory Board (SLGPSAB), the Committee's and Convener's disquiet with the relaxation of the principle of full cost transparency of investment management fees, as explicit in CIPFA's revised guidance "Accounting for Local Government Pension Scheme Management Costs".

In May 2018, CIPFA published "Proposals for LGPS Fund Reporting in a 'Pooled World'". "This …. sets out proposals for revised reporting for LGPS pension funds to meet a number of objectives", including "to further enhance reporting of costs reflecting the introduction of the LGPS SAB Code of Transparency for asset managers, and initiatives underway by the Financial Conduct Authority (FCA) and Department for Work and Pensions (DWP) which aim to create more transparent and granular reporting standards for both providers and trustees …. This paper has been issued by CIPFA as good practice which is to be incorporated into 2018/19 Annual Report guidance for local government pension funds."

Most recently, in March 2019, CIPFA published "preparing the annual report - Guidance for Local Government Pension Scheme Funds (LGPS) 2019 Edition". The purpose of this guidance is to assist local government pension funds with the preparation and publication of the annual report required by Regulation 55 of The Local Government Pension Scheme (Scotland) Regulations 2018.

The Pensions and Lifetime Saving Association (PLSA) confirmed the launch of new templates in May 2019 in relation to its Cost Transparency Initiative. The aim of the initiative being to provide a standardised way for asset managers to report costs and charges to investors. Guidance is still awaited from CIPFA as to how these costs will be standardised and reported in the Annual Reports of LGPS Funds.

The financial statements of Lothian Pension Fund and Scottish Homes Pension Fund continue to include full transparency for both Funds' internal and external investment management fees.

	Investment management expenses in compliance with CIPFA guidance	Investment management expenses per 2017/18 financial statements	Disclosure in excess of CIPFA guidance
	£000	**£000**	**£000**
Lothian Pension Fund	31,041	36,103	5,062
Scottish Homes Pension Fund	84	84	0
TOTAL	**31,125**	**36,187**	**5,062**

Investment cost benchmarking

Investment strategy focuses on risk adjusted returns, net of costs. The Fund has participated in investment cost benchmarking provided by CEM, an independent benchmarking expert for global pension funds with a database of 346 global pension funds representing £7.3 trillion in assets. To provide a fair comparison, CEM calculates a benchmark based on fund size and asset mix, which are key drivers of investment costs.

The latest analysis shows Lothian Pension Fund's investment costs of 0.43% of Fund assets were significantly lower than CEM's benchmark cost of 0.55%, an equivalent annual saving of approximately £8.0m. This saving largely reflects the fact that the Fund manages a relatively high percentage of assets internally compared with other similar pension funds and that it has low exposure to fund-of-fund investment vehicles.

Performance and Administration

Key Performance Indicators 2018/19

The Fund has a strong commitment to customer service which drives the continuous development of our services to ensure the best possible service for customers whilst recognising potential demands of the future. We set challenging performance targets and measure these through key indicators reported to our Pensions Committee and Pension Board and internal indicators reported to internal management.

The table shows our performance against these targets.

2018/2019	Target	Actual
Maintain Customer Service Excellence Standard (CSE) (Annual assessment)	Retain	Retained
Audit of Annual Report and Accounts 2017/18	Unqualified opinion	Met
Proportion of members receiving a benefit statement and by August	100%	100%
Overall satisfaction of employers, active members and pensioners measured by surveys	90%	92.7%
Percentage by value of pension contributions received within 19 days of end of month to which they relate	99%	99.7%
Investment performance and Risk of Lothian Pension Fund over rolling 5 year period	Meet benchmark	Met
Monthly pension payroll paid on time	Met	Met
Level of sickness absence	4.0%	3.9%
All staff complete at least two days training per year	Yes	100%
Staff engagement index	Greater than 70%	69%

Value for money

Value for Money is the term used to assess whether an organisation has obtained the maximum benefit from services it acquires or provides, within the resources available to it. It has three components to take account of economy, efficiency and effectiveness. The Fund participates in benchmarking provided by the Chartered Institute of Public Finance and Accountancy (CIPFA). The purpose is to help identify the areas where improvements can be made to deliver better value for money. The exercise carried out facilitates:

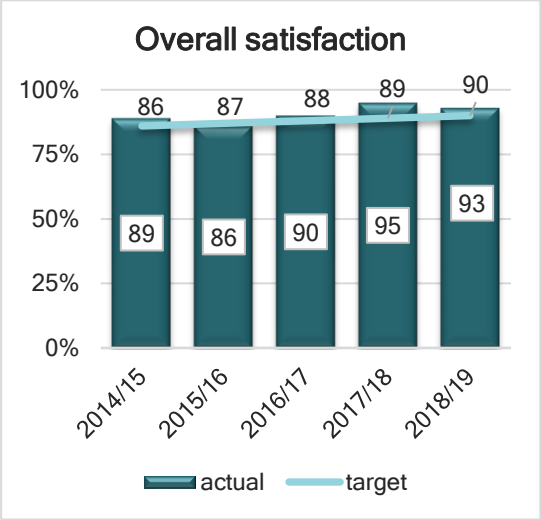
- comparison between costs and performance
- the provision of evidence to support decisions on budget relating to the sustainability and capability of the investment and administrative teams to enhance customer satisfaction

- sharing of information and ideas with peers; and
- a review of performance trends over time.

The outputs and analyses have served to supplement internal performance management information. However, the Chartered Institute of Public Finance and Accountancy (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". We are therefore unable to include full information on the results in the Annual Report.

A summary of the benchmarking is as follows:

- Lothian Pension Fund's cost per member of £23.38 falls within the very wide range of local authority funds of c£11 to £61. However, the cost is higher than the average of all funds of £21.71. The average of funds of comparable scale is £21.16.
- The composition of a Fund's membership impacts costs. Active members represent 39.3% of the Fund membership compared with an average of 34.2%, and pensioners represent 30.8% compared with 24.1%, with the consequence that deferred members represent a lower proportion of membership (22.2%) than the typical fund (29.9%). 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 the proportion of staff holding relevant pension administration qualifications is significantly higher than the average (more than double).
- Moreover, the Fund's administration performance is above average for 7 of the 9 industry standard indicators, in certain instances by a considerable margin.



Customer and complaint feedback

Listening to feedback is key to our services, with the Fund carrying out surveys to monitor individual and overall satisfaction. Our overall satisfaction continues to improve and in 2018/19 remains above the 90% target at 92.7%. This exceeds the target of 90%.

We also monitor complaints and ensure we respond and resolve where possible, within 20 working days. We investigate and learn from both formal and informal complaints to ensure we are continuously improving our services. Complaints are split by those about the service we provide and those about how Scheme Regulations are applied.

We carried out 20,389 processes in 2018/19 and there were very few complaints made, less than 0.1%. Complaints covered a broader range of issues including taking small pensions as a cash lump sum and the time it took to pay a Cash Equivalent Transfer Value to new pension providers.

Internal Dispute Resolution Procedure (IDRP)

Pensions law requires that the Local Government Pension Scheme must have a formal procedure in place for resolving disputes arising from the running of the scheme. The IDRP is a two stage process. An external independent appointed person deals with disputes at the first stage. The second stage is dealt with by the Scottish Ministers.

In 2018/19, there were seven stage 1 disputes for investigation. If a member remains dissatisfied with the Stage 1 decision, they have six months to take their appeal to Stage 2. In 2018/19, there were six Stage two disputes and one remaining from 2017/18 which is included in the statistics below.

Reason for dispute		Stage 1 outcome	Stage 2 outcome	On-going
Error	1	1 not upheld	1 not upheld	0
Overpayment	1	1 not upheld		1
Awards, eg early payment of deferred pension on health grounds	5	5 not upheld	1 upheld	4

Further information about the IDRP and complaints procedure is available on our website at www.lpf.org.uk/complaints.

Our data

We issued 100% of benefit statements by the statutory deadline of 31 August 2018. Although we have achieved over 99% in the past 2 years, this is the first time we have achieved 100% since the target was introduced by the Pensions Regulator in 2015.

All of our employers submit contribution data each month and in October, the Fund moved over to a new service following a tendering process. The previous provider did not tender and so a new service that integrates with our pension administration software was sought. This employer data portal has allowed us to continue to ensure accuracy of member data.

We measure our pension record keeping standards against The Pension Regulator's best practice guidance. Poor record-keeping can lead to significant additional costs in areas such as administration, error correction, claims from members as well as fines from The Pensions Regulator.

Over the year, we have continued data accuracy improvements with our employers and carried out significant additional work as part of the introduction of the new employer portal. We are also carrying out external tracing of members where we do not hold a current address.

Historically, the Fund has prepared its assessment of common and conditional data in-house, calculated as an overall percentage of member records passed in each category tested.

Due to the complexity of the Regulator's illustrative list of conditional data requirements, previous results were based on a small number of conditional data categories. The Annual Report and Accounts 2017/18 cited a score of 99.9% for both the common and conditional data.

This year, the Fund has utilised a new Data Quality Service provided by the software supplier. The Fund can now provide data score measurements required by the Regulator based on more comprehensive analysis and based on the percentage of clean member records without a single data failure.

The conditional data now interrogates five data categories; Member Benefits, Member Details, CARE Benefits, HMRC Data and Contracted Out Data.

The Fund's scores as at 31 March 2018 were 95.6% for common data and 90.9% for conditional data. As this is the first time using the new software, issues have been identified with the way some historic data has been recorded, rather than data being unavailable. The software supplier has stated that the general quality of the Fund's common data is of a high standard compared with other LGPS funds. The data is being prepared for as at 31 March 2019 and the results will be reported in the audited version of the Annual Report and Accounts.

Guaranteed Minimum Pension (GMP)

GMP is the minimum pension which a United Kingdom occupational pension scheme must provide for those employees who were contracted out of the State Earnings-Related Pension Scheme (SERPS) between 6 April 1978 and 5 April 1997. The UK Government has mandated a reconciliation of Guaranteed Minimum Pension details held on scheme pension administration records to those held by HMRC. This was to be completed by the 31 March 2019.

An internal team has been working on this project since the announcement and the reconciliation was 100% complete by March 2019. Underpayments of pensions are being corrected and put into payment, together with lump sum arrears.

The Scottish Ministers have decided any LGPS pension in payment affected by the exercise should not be reduced. Instead it is expected that overpayments will be held separately and remain static going forward and not receive any Pension Increase that may be due on other LGPS pension benefits.

Pension Administration

The introduction of the career average pension scheme in April 2015 has meant that pension administration has become more complex for both the Fund and employers.

New Scheme Regulations were introduced with effect from 1 June 2018 introducing a number of changes, the most significant of which lowered the earliest age members can voluntarily retire to 55.

However, changes were not made to previous transitional Regulations 2014 which meant important regulatory references within the Transitional Regulations were incorrect and therefore not competent. Legal advice at the time confirmed that using these Regulations could leave the Fund open to challenge.

The Fund therefore put a hold on paying retirement and death in service benefits for members with membership prior to April 2015. A letter of comfort from the Scottish Government was received 2 months later which allowed the resumption of these payments.

Also, on 29 October 2018, the UK Government announced a change in the discount rate used to set employer contribution in public service pension schemes. As a result, the Fund had to suspend all non-club Cash Equivalent Transfer Values (CETVs) and Divorce CETVs until new factors were made available on 29 November 2018.

Our in-house pension administration team provides a dedicated service for the pension fund members. We monitor the time taken to complete our procedures. Key procedures include processing of retirement and dependent benefits, providing information for new members, transfers and retirement quotes. Despite the challenging environment, 92% of key procedures in 2018/19 were completed in target. However, in other areas, some delays were experienced while this key work was prioritised.

The table below shows the number and type of retirements in 2018/19.

	Ill health	Early - age 60 to NPA	Early – age 55 to 59	Redundancy	Efficiency	Late	TOTAL
Lothian Pension Fund	118	907	140	115	61	165	1506
Scottish Homes Pension Fund	0	21	0	0	0	0	21

The table below shows performance against key procedures in 2018/19.

	Target	Actual
Proportion of critical pensions administration work completed within standards – individual performance within this indicator are shown below	Greater than 91%	92.2%
Provide a maximum of one guaranteed Cash Equivalent Transfer Value (CETV) within 10 working days of receiving a request	90%	96.7%
Payment of CETV within 20 working days of receiving all completed transfer out forms	95%	97.2%
Pay lump sum retirement grant within 7 working days of receiving all the information we need from the member	95%	97.5%
Notification of dependant benefits within 5 working days of receiving all necessary paperwork	95%	98.3%
Acknowledge of the notification of the death of a member to next of kin within 5 working days.	95%	97.2%
Respond in writing within 20 working days to formal complaints that have escalated from frontline resolution, or recorded directly as an investigation	95%	100%
Provide transfer-in quote within 10 working days of receiving the Cash Equivalent Transfer Value (CETV) from member's previous pension provider.	95%	80.4%
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%	77.0%
Pay a refund of contributions within 7 working days of receiving the completed declaration and bank detail form.	90%	87.7%
Notify early leavers entitled to deferred benefits of their rights and options within 10 days of being informed of end of pensionable service.	90%	81.7%
Estimate requested by employer of retirement benefits within 10 working days	90%	82.3%
Pay any lump sum death grant within 7 working days of receipt of the appropriate documentation	95%	92.7%
Proportion of non-key procedures completed within standard including Additional Regular Contributions, responding to member communications, updating nominations and maintaining the member database.	75%	73.6%

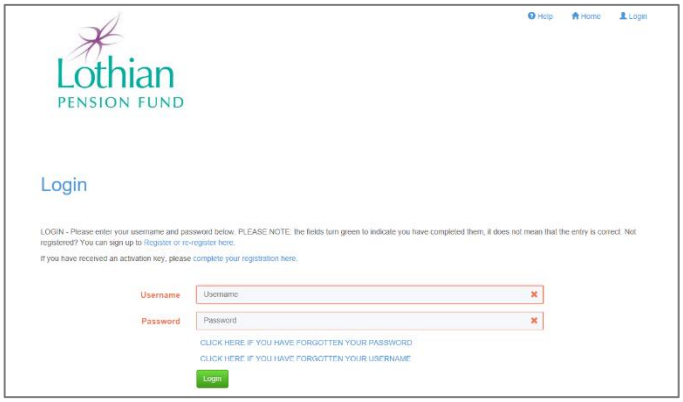
The Fund also participates in the National Fraud Initiative which is a data matching exercise led by Audit Scotland and is carried out every two years. The 2018/19 matching exercise started in Autumn 2018 and matches were made available to the Fund from 31 January 2019. We are currently investigating these and will report the outcomes to the Pensions Committee in September 2019. In 2018/19, the total value of pension overpayments written off under delegated authority (overpayments up to £3,000) between 1 September 2017 and 31 August 2018 was £1,860.33.

There were three cases with a total of £74,978 written off as overpayment of pensions by the Pensions Committee.

The most significant overpayment was for a widow who did not notify us of remarriage. The pension should have been stopped on remarriage due to earlier pension scheme rules that prohibit payment of a widow's pension on remarriage which resulted in the overpayment. However, these regulations do allow reinstatement at a future date should the remarriage end. A caveat has been put in place that any reinstatement would only be paid once the recovery of the overpaid pension amount had taken place.

Online services

The Fund is moving towards providing as many services as possible online. We currently have 44% of active members registered for the online service. We provide retirement estimates and refund information online and are investigating ways to increase the use of improve processing times and enhance services for our members. Information for members is also available via email, phone and in person visitors to our offices.



As part of the pension software tender process, we introduced a new portal for employers to send monthly contribution returns. Data can now be automatically uploaded to the pension software system allowing automation of tasks previously requiring to be done manually.

This project resulted in a small number of employers' data being delayed whilst changes to processes and matching of information was carried out. In 2019/20, all employers should be fully utilising the service.

Unclaimed Monies Account

Where a member leaves the Fund with less than 2 years membership they are entitled to a refund or transfer to another pension provider. Where we do not receive a response to any of our correspondence, we record these as Status 3: Exit – No liability with a marker as unclaimed. We report this figure monthly and at 1 April 2019 the unclaimed amount was £909,056.44 with 2,527 records with the unclaimed marker.

We are continuing to check these unclaimed records and contacting these members to remind them of their options and will work to ensure monies are refunded or transferred where possible.

Employer performance

The Pensions Administration Strategy sets out the roles and responsibilities of both the Fund and employers, specifying the levels of services the parties will provide to each other and referring to four key areas where the Fund will pass on the costs of poor performance from employers:

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

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

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

Due to the ongoing migration to the new data transfer portal, we are unable to provide accurate statistics for new members. Employers have continued to provide new member data and we will be in a position to report accurately in 2019/20.

Whilst the provision of leaver information in target has increased slightly, the majority were received out of target. We have continued to target historical cases and provide missing leaver queries to employers monthly. We are confident that historical cases have now been completed and employers can focus on 'business as usual' cases in 2019/20.

Unfortunately, most retirement information continues to be provided out of target. Just over half of all retirements occur where members are over age 55 and voluntarily take their pension benefits with a permanent actuarial reduction. Only 35% of these retirements were received in target. We shall continue our engagement with employers to seek requisite improvement.

Overall employer performance for 2018/19 is shown below, with 2017/18 shown for comparison purposes.

		2017/18			2018/19		
Case type	**Target (working days)**	**Number received**	**Number within target**	**% within target**	**Number received**	**Number within target**	**% within target**
New members	20	6,204	5,439	88%	4,379	N/A	N/A
Leavers	20	2,460	1,058	43%	3,628	1,715	47%
Retirements	20	1,050	427	41%	1,249	488	39%
Deaths in Service	10	26	13	50%	11	7	64%

Employer contributions

We monitor the payment of employer contributions as employers are required under the Pensions Act 1995 to pay contributions by the 19th of the month after the deduction was made. This is a key performance indicator with a target of was 99% contributions paid in time.

The primary rate for the whole Fund at the triennial valuation for 2018/19 was 31.8% shown as a percentage of pay. Each employer has its own individual rate based on its own circumstances.

99.7% of contributions by value were paid on time. Of the 1,022 payments made, 46 were paid later than the 19th and these are shown in the table. The option to levy interest on overdue contributions was not exercised in 20118/19 as late contributions were not received significantly later than the 19th significant.

Employer	Number of late payments	Employer	Number of late payments
Scotland's Learning Partnership	10	Young Scot Enterprise	2
Freespace Housing	5	Baxterstorey	1
Skanska	5	Canongate Youth Project	1
Homeless Action Scotland	4	Enjoy East Lothian	1
North Edinburgh Dementia Care	3	Morrison Construction	1
EDI Group Ltd	3	Scottish Futures Trust	1
Four Square	2	St Columba's Hospice	1
Heriot Watt University	2	Visit Scotland	1
Stepping Out Project	2	West Lothian College	1
TOTAL			46

Scotland's Learning Partnership has been late with payments on ten occasions and at time of writing in May 2019, the January, February and March secondary payments were still outstanding. It should be noted that, on 26 April 2019, Scottish Public Pensions Agency (SPPA) advised that "Ministers have agreed that Scottish Government will provide a guarantee in respect of the liabilities for the staff from the former Community Learning Scotland who transferred to the Local Government Pension Scheme".

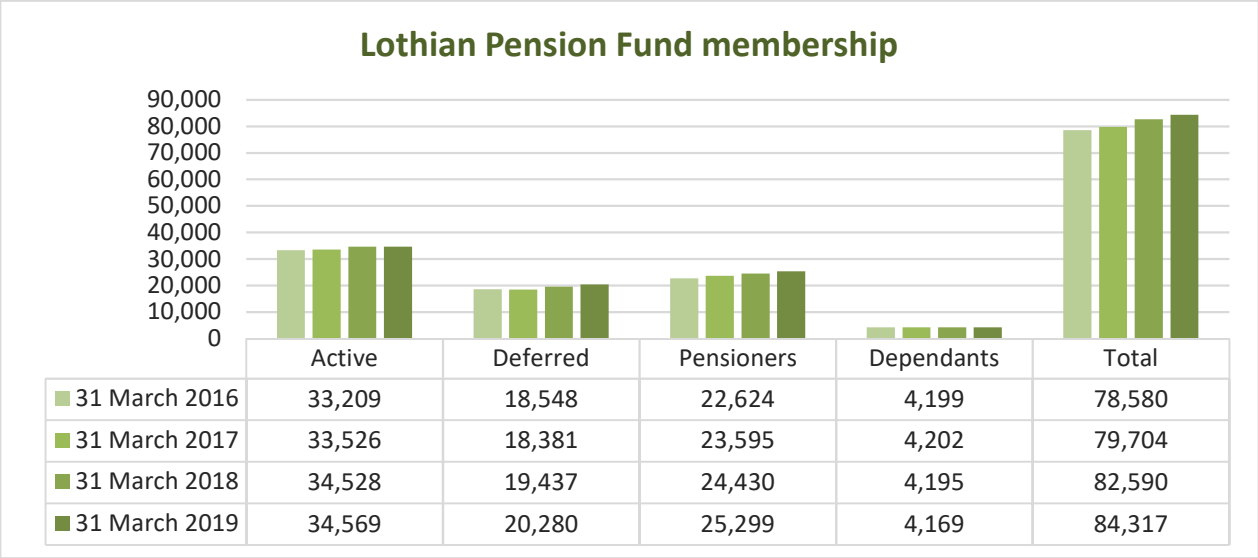
Management commentary approved by:

ANDREW KERR
Chief Executive Officer
The City of Edinburgh Council
26 June 2019

DOUG HERON
Chief Executive
Lothian Pension Fund
26 June 2019

JOHN BURNS
Chief Finance Officer
Lothian Pension Fund
26 June 2019

Lothian Pension Fund



Membership include Lothian Buses members as the Funds were merged in January 2019. Lothian Buses membership as at 31 March 2019 totalled 898 active members, 1,011 deferred members, 1,382 pensioner members and 384 dependants.

Investment Strategy

In order to provide suitable investment strategies for the differing requirements of employers, the Fund currently operates four investment strategies. Most employer liabilities are funded under the Main Strategy, which adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer. The investment strategy is set at broad asset class levels, which are the key determinants of investment risk and return. During 2018, the previous broad asset classes of Equities, Index-linked assets and Alternatives were replaced by five policy groups - Equities, Real Assets, Non-Gilt Debt, Gilts and Cash - to better reflect the risk and return characteristics of each group.

A small number of employers are funded in the Mature Employers Strategy, which invests in a portfolio of UK index-linked gilts to reduce funding level and contribution rate risk as these employers approach exit from the Fund. The liabilities funded by the Mature Employers Strategy represent less than 1% of total liabilities.

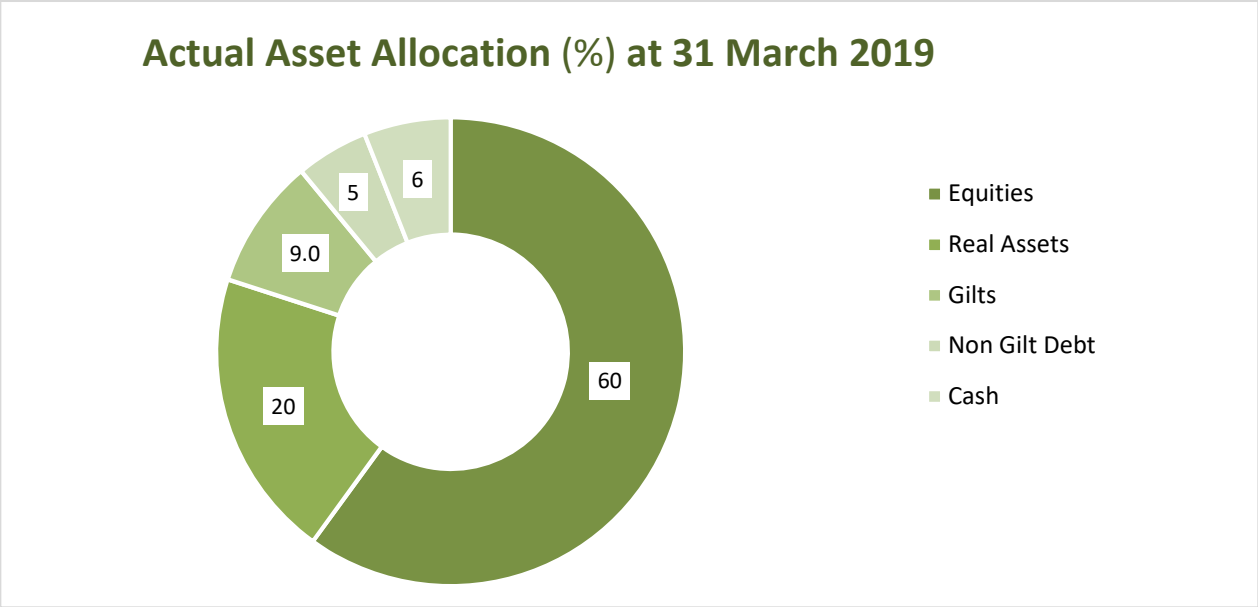
The 50/50 Strategy enables another small group of less mature employers to fund liabilities with a 50/50 mix of the Main Strategy and the Mature Employers Strategy. The liabilities funded by the 50/50 Strategy represent just over 1% of total liabilities.

The Buses Strategy was introduced on 31 January 2019 when the assets and liabilities of Lothian Buses Pension Fund were consolidated into the Lothian Pension Fund. It is the same strategy that the Buses Pension Fund followed previously (agreed by Committee in 2016) when it was managed as a separate Fund

Following on from the 2017 actuarial valuation and a comprehensive review of strategy. This review focused on the Main Strategy because the Mature Employers Strategy is entirely invested in gilts, the 50/50 Strategy is invested in a 50/50 combination of the Main Strategy and the Mature Employers Strategy, and the Buses Strategy is the previously agreed Lothian Buses Strategy.

The conclusion of the strategy view was that the Fund should continue with its previous investment strategy (65% invested in lower risk equities) whilst continuing to monitor the impact of bond yields. Opportunities to reduce risk, by reducing equities by up to 15%, should be considered if bond yields and funding levels increase significantly. The Fund's investment strategy was approved by the Pensions Committee in December 2018.

Lothian Pension Fund At 31 March 2019	Main Strategy	Mature Ers Strategy	50/50 Strategy	Buses Strategy	Total Fund Strategy
Equities	65.0%	0.0%	32.5%	51.5%	63.1%
Real Assets	18.0%	0.0%	9.0%	18.0%	17.7%
Non-Gilt Debt	10.0%	0.0%	5.0%	10.5%	9.9%
Gilts	7.0%	100.0%	53.5%	20.0%	9.3%
Cash	0.0%	0.0%	0.0%	0.0%	0.0%
Total	**100%**	**100%**	**100%**	**100%**	**100%**



A key objective of the Fund's investment strategy is to reduce risk and this is largely achieved by reducing risk within the equity pool of assets. Implementation of the strategy has involved a shift from a regional to a global manager structure. Significant steps have been taken in this regard in prior years with the introduction of the internally managed global equity portfolios. As such, 2018/19 represented much more of a "steady state" in terms of the structure within the equity exposure.

The activity in recent years (2012-2015) has been to increase the proportion of internally managed global equity strategies to reduce investment risk. The resultant equity pool of assets is expected to perform relatively well when equity markets are weak and produce good positive absolute returns in rising equity markets.
Almost 85% of the Fund's listed equities are managed internally with the majority of these in low cost, low turnover strategies, which are expected to enhance the Fund's risk-adjusted returns over the long term. The Fund also hedges exposures to the currencies of overseas listed equities with the explicit aim of reducing volatility rather than seeking to generate improved returns. The Fund therefore maintains exposure to currencies that are expected to reduce volatility, such as the US Dollar and Japanese Yen which tend to fall as equities rise, and hedges exposure to currencies that are expected to increase volatility, such as the Australian Dollar which tends to rise as equities rise.

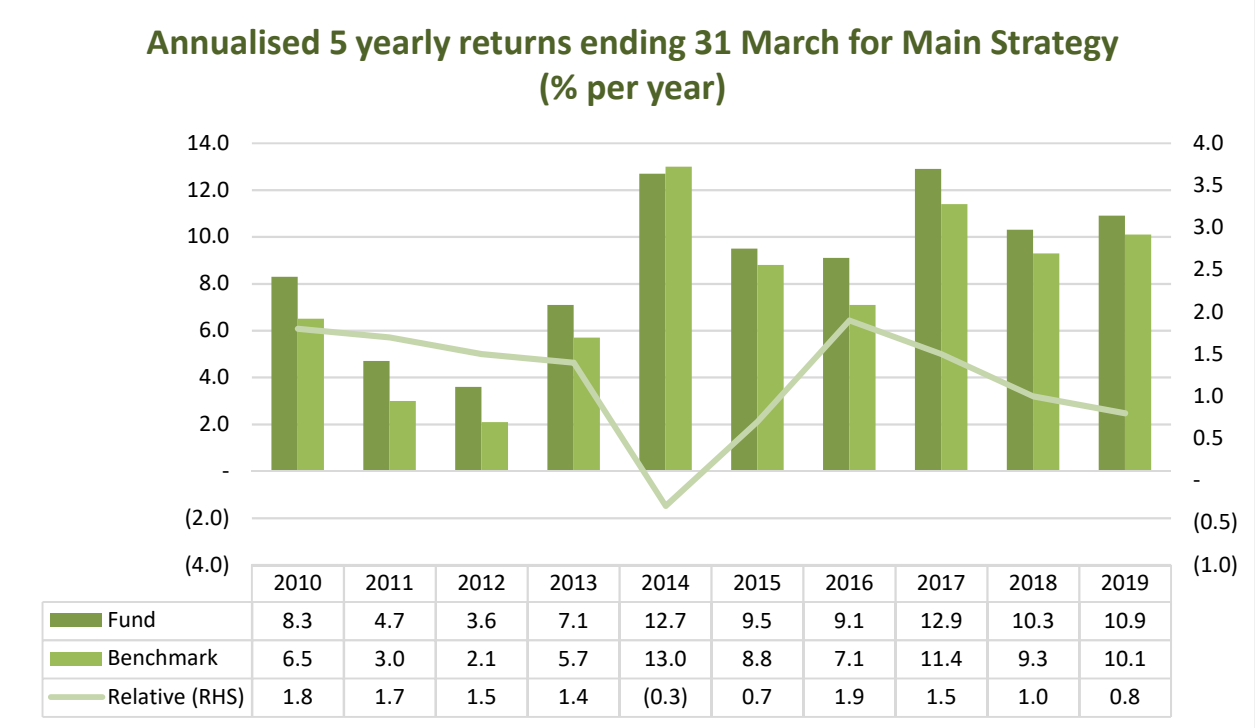
Investment performance

The Fund's performance over the last year and over longer-term timeframes is shown in the table below.

Annualised returns to 31 March 2019 (% per year)	1 year	5 year	10 years
Lothian Pension Fund - Main Strategy	9.6	10.9	11.8
Benchmark*	9.1	10.1	11.5
Lothian Pension Fund - Mature Employers Strategy	4.9	-	-
Benchmark	4.6	-	-
Retail Price Index (RPI)	2.5	2.3	3.0
Consumer Price Index (CPI)	2.0	1.4	2.2

*Comprises equity, index-linked gilts and cash indices as well as an inflation-linked index for the alternatives allocation

**estimated



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Fund	8.3	4.7	3.6	7.1	12.7	9.5	9.1	12.9	10.3	10.9
Benchmark	6.5	3.0	2.1	5.7	13.0	8.8	7.1	11.4	9.3	10.1
Relative (RHS)	1.8	1.7	1.5	1.4	(0.3)	0.7	1.9	1.5	1.0	0.8

The objectives of the Fund are:

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

The performance of the Mature Employers Strategy was broadly in line with benchmark over the year, returning +4.9%. Performance of this strategy has also been broadly in line with benchmark since inception (29 March 2016), with a return of +8.4% per annum.

The Fund's return has exceeded its objective of meeting the benchmark return over the economic cycle, with both the 5 and 10 year return ahead of benchmark. The direction of the Fund's performance when markets are increasing and decreasing is one way of measuring volatility. The lower volatility objective and strategy for the Main Strategy was put in place in December 2013 and over this period market volatility has been relatively benign, for the most part. Nevertheless, performance since the change in structure (with the launch of the global low volatility equity portfolio and the shift from regional passive to active) indicates that the Fund is delivering returns with lower volatility than its benchmark.

For the Main Strategy, performance from March 2014 to March 2019 has been:

- better than the strategic allocation when markets fell (18 out of 60 months) with average performance of 0.41% better than the strategic benchmark and,
- marginally worse than the strategic allocation when markets were rising (42 out of 60 months) with average performance 0.09% behind the strategic benchmark.

Risk analysis also shows that the portfolio is positioned well if markets fall significantly.

Lothian Pension Fund

Fund Account for year ended 31 March 2019

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

Lothian Pension Fund Parent Restated 2017/18 £000	Lothian Pension Fund Group Restated 2017/18 £000		Note	Lothian Pension Fund Parent 2018/19 £000	Lothian Pension Fund Group 2018/19 £000
		Income			
156,402	156,402	Contributions from employers	**5**	175,540	175,540
45,409	45,409	Contributions from members	**6**	47,416	47,416
4,204	4,204	Transfers from other schemes	**7**	3,852	3,852
206,015	**206,015**			**226,808**	**226,808**
		Less: expenditure			
158,139	158,139	Pension payments including increases	**8**	167,997	167,997
45,117	45,117	Lump sum retirement payments	**9**	50,270	50,270
6,642	6,642	Lump sum death benefits	**10**	5,542	5,542
600	600	Refunds to members leaving service		720	720
129	129	Premiums to State Scheme		(82)	(82)
13,174	13,174	Transfers to other schemes	**11**	13,028	13,028
2,049	2,250	Administrative expenses	**12b**	2,283	2,532
225,850	**226,051**			**239,758**	**240,007**
(19,835)	**(20,036)**	**Net (withdrawals)/additions from dealing with members**		**(12,950)**	**(13,199)**
		Returns on investments			
171,948	171,948	Investment income	**13**	190,975	190,975
(25,539)	(25,539)	Change in market value of investments	**15, 20b**	503,734	503,734
(35,067)	(35,685)	Investment management expenses	**12c**	(35,938)	(36,102)
111,342	**110,724**	**Net returns on investments**		**658,771**	**658,607**
91,507	**90,688**	**Net increase in the Fund during the year**		**645,821**	**645,408**
7,083,573	7,083,034	**Net assets of the Fund at 1 April 2018**		7,175,080	7,173,722
7,175,080	**7,173,722**	**Net assets of the Fund at 31 March 2019**		**7,820,901**	**7,819,130**

Lothian Pension Fund

Net Assets Statement as at 31 March 2019

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

Lothian Pension Fund Parent Restated 31 March 2018 £000	Lothian Pension Fund Group Restated 31 March 2018 £000	Investments	Note	Lothian Pension Fund Parent 31 March 2019 £000	Lothian Pension Fund Group 31 March 2019 £000
7,139,849	7,139,849	Assets		7,790,671	7,790,671
(5,362)	(5,362)	Liabilities		(1,912)	(1,912)
7,134,487	**7,134,487**	**Net investment assets**	**14**	**7,788,759**	**7,788,759**
		Non current assets			
1,525	1,525	Debtors	**24**	3,330	3,330
168	168	Computer systems		430	430
60	-	Share Capital		60	-
-	292	Deferred tax	**29a**	-	393
1,753	**1,985**			**3,820**	**4,153**
		Current assets			
3,083	3,083	The City of Edinburgh Council	**28**	884	884
48,833	48,926	Cash balances	**21, 28**	35,897	36,238
16,406	16,476	Debtors	**25**	22,340	22,563
68,322	**68,485**			**59,121**	**59,685**
		Non current liabilities			
-	(1,715)	Retirement benefit obligation	**30**	-	(2,309)
-	-	Creditors		-	(13)
-	**(1,715)**			**-**	**(2,322)**
		Current liabilities			
(29,482)	(29,520)	Creditors	**26**	(30,799)	(31,145)
(29,482)	**(29,520)**			**(30,799)**	**(31,145)**
7,175,080	**7,173,722**	**Net assets of the Fund at 31 March**		**7,820,901**	**7,819,130**

The unaudited accounts were issued on 26 June 2019 and the audited accounts were authorised for issue on XX September 2019.

JOHN BURNS FCMA CGMA, PgC
Chief Finance Officer, Lothian Pension Fund
26 June 2019

Notes to the net asset statement

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

Notes to the Financial Statements

1 Statement of Accounting Policies

The statement of accounting policies for all Funds can be found on page 105.

2 Prior Year Restatement of Financial Statements

At its meeting on 26 March 2018, the Pensions Committee approved the merger 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 guarantees. Having received the necessary admission agreement and shareholder guarantees, the Lothian Buses Pension Fund assets were merged into Lothian Pension Fund on 1 February 2019.

As per the statement of accounting policies on page 106, the Fund has deemed the most appropriate treatment for the transfer of assets is 'transfer by merger'. This requires a restatement of 2017/18 financial figures of Lothian Pension Fund to include Lothian Buses Pension Fund assets for the same period.

The analysis below demonstrates the impact of merging Lothian Buses Pension Fund assets and liabilities in to Lothian Pension Fund Parent and Group Fund Account and Net Asset Statement for the 2017/18 financial period.

Lothian Pension Fund Parent 2017/18 £000	Lothian Pension Fund Group 2017/18 £000	Lothian Buses 2017/18 £000		RESTATED Lothian Pension Fund Parent 2017/18 £000	RESTATED Lothian Pension Fund Group 2017/18 £000
			Income		
148,821	148,821	7,581	Contributions from employers	156,402	156,402
43,421	43,421	1,988	Contributions from members	45,409	45,409
4,191	4,191	13	Transfers from other schemes	4,204	4,204
196,433	**196,433**	**9,582**		**206,015**	**206,015**
			Less: expenditure		
149,384	149,384	8,755	Pension payments including increases	158,139	158,139
42,533	42,533	2,584	Lump sum retirement payments	45,117	45,117
6,359	6,359	283	Lump sum death benefits	6,642	6,642
596	596	4	Refunds to members leaving service	600	600
129	129	-	Premiums to State Scheme	129	129
12,517	12,517	657	Transfers to other schemes	13,174	13,174
1,950	2,151	99	Administrative expenses	2,049	2,250
213,468	**213,669**	**12,382**		**225,850**	**226,051**
(17,035)	**(17,236)**	**(2,800)**	**Net (withdrawals)/additions from dealing with members**	**(19,835)**	**(20,036)**
			Returns on investments		
163,869	163,869	8,079	Investment income	171,948	171,948
(43,288)	(43,288)	17,749	Change in market value of investments	(25,539)	(25,539)
(32,643)	(33,261)	(2,424)	Investment management expenses	(35,067)	(35,685)
87,938	**87,320**	**23,404**	**Net returns on investments**	**111,342**	**110,724**
70,903	**70,084**	**20,604**	**Net increase in the Fund during the year**	**91,507**	**90,688**
6,595,430	6,594,891	488,143	**Net assets of the Fund at 1 April 2017**	7,083,573	7,083,034
6,666,333	**6,664,975**	**508,747**	**Net assets of the Fund at 31 March 2018**	**7,175,080**	**7,173,722**

Notes to the Financial Statements

2 Prior Year Restatement of Financial Statements (cont)

Lothian Pension Fund Parent 31 March 2018 £000	Lothian Pension Fund Group 31 March 2018 £000	Lothian Buses 31 March 2018 £000		Lothian Pension Fund Parent 31 March 2018 £000	Lothian Pension Fund Group 31 March 2018 £000
			Investments		
6,633,467	6,633,467	506,382	Assets	7,139,849	7,139,849
(5,112)	(5,112)	(250)	Liabilities	(5,362)	(5,362)
6,628,355	**6,628,355**	**506,132**	**Net investment assets**	**7,134,487**	**7,134,487**
1,753	**1,985**	**-**	**Non current assets**	**1,753**	**1,985**
			Current assets		
2,784	2,784	299	The City of Edinburgh Council	3,083	3,083
47,024	47,117	1,809	Cash balances	48,833	48,926
15,564	15,634	842	Debtors	16,406	16,476
65,372	**65,535**	**2,950**		**68,322**	**68,485**
-	**(1,715)**	**-**	**Non current liabilities**	**-**	**(1,715)**
			Current liabilities		
(29,147)	(29,185)	(335)	Creditors	(29,482)	(29,520)
(29,147)	**(29,185)**	**(335)**		**(29,482)**	**(29,520)**
6,666,333	**6,664,975**	**508,747**	**Net assets of the Fund at 31 March 2018**	**7,175,080**	**7,173,722**

Prior year comparative figures in the notes that follow will be marked with * if they have been affected by the merger.

3 Lothian Pension Fund Group

Basis of consolidation, presentation of financial statements and notes

Commencing with the year ended 31 March 2018, Consolidated Financial Statements have been prepared for Lothian Pension Fund. The Financial Statements of Scottish Homes Pension Fund continue to be prepared on a single entity basis.

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

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

Notes to the Financial Statements

3 Lothian Pension Fund Group (cont)

Note	Description
28	Related party transactions and balances Describes transactions during the year and balances at year end which relate to the parent and the companies.
29a	Consolidated Lothian Pension Fund group - LPFE Limited - deferred tax Describes the deferred tax non-current asset of the Company. See 2 f) ii) in the Statement of Accounting Policies and General notes for more information.
29b	Consolidated Lothian Pension Fund group - LPFE Limited and LPFI Limited - share capital Describes the share capital of the Company.
30	Retirement benefits obligation - group Provides the information on the retirement benefits obligation of the Company as required under IAS19 - Employee Benefits. See 2 q) ii) in the Statement of Accounting Policies and General notes for more information.

Prior to the consolidation of the group accounts, the LPFE and LPFI boards met on the 21st May 2019 and approved their respective audited financial statements for 2018/19. The figures used in the consolidation are from these audited financial statements.

4 Events after the Reporting Date

There have been no events since 31 March 2019, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

5 Contributions from employers

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

By category	2017/18* £000	2018/19 £000
Primary Contribution (future service)	144,549	160,778
Secondary Contribution (past service deficit)	7,694	8,057
Strain costs	2,747	4,082
Cessation contributions	1,412	2,623
	156,402	175,540

By employer type	2017/18* £000	2018/19 £000
Administering Authority	55,041	59,830
Other Scheduled Bodies	81,273	92,644
Community Admission Bodies	19,629	22,282
Transferee Admission Bodies	459	784
	156,402	175,540

Notes to the Financial Statements

5 Contributions from employers (cont)

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

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

Included within the above contributions are accruals for:

- receipt of six months past service deficit for Scottish Learning Partnership (SLP) of £24k. The Fund continues to pursue these payments, whilst noting that the Scottish Government has indicated that it expects to sign as guarantor for SLP liabilities.
- City of Edinburgh Council has advised the Fund of revised sums in respect of assumed pensionable pay. £107k has been accrued covering payments due in the financial period 2015/16 to 2017/18. These payments will be transferred to the Fund in the first quarter of 2019/20.

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

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

6 Contributions from members

By employer type	2017/18* £000	2018/19 £000
Administering Authority	15,633	16,437
Other Scheduled Bodies	23,463	24,507
Community Admission Bodies	6,161	6,217
Transferee Admission Bodies	152	255
	45,409	47,416

7 Transfers in from other pension schemes

	2017/18* £000	2018/19 £000
Group transfers	-	-
Individual transfers	4,204	3,852
	4,204	3,852

Notes to the Financial Statements

8 Pensions payable

By employer type	2017/18* £000	2018/19 £000
Administering Authority	73,922	76,932
Other Scheduled Bodies	70,484	75,860
Community Admission Bodies	13,537	14,993
Transferee Admission Bodies	196	212
	158,139	167,997

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

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

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

The Fund has requested that responsibility for these "unfunded transfer payments" should transfer to the Scottish Public Pension's Agency (SPPA). A response from SPPA is awaited.

9 Lump sum retirement benefits payable

By employer type	2017/18* £000	2018/19 £000
Administering Authority	16,623	17,374
Other Scheduled Bodies	23,234	27,818
Community Admission Bodies	5,131	5,053
Transferee Admission Bodies	129	25
	45,117	50,270

10 Lump sum death benefits payable

By employer type	2017/18* £000	2018/19 £000
Administering Authority	3,375	2,943
Other Scheduled Bodies	2,854	2,049
Community Admission Bodies	413	550
Transferee Admission Bodies	-	-
	6,642	5,542

Notes to the Financial Statements

11 Transfers out to other pension schemes

	2017/18* £000	2018/19 £000
Group transfers	-	-
Individual transfers	13,174	13,028
	13,174	13,028

12a Total management expenses

In accordance with CIPFA guidance, the analysis below considers the combined administration and investment management expenses in notes 12b and c and splits out the costs to include a third category covering oversight and governance expenditure.

	LPF Parent 2017/18* £000	LPF Group 2017/18* £000	LPF Parent 2018/19 £000	LPF Group 2018/19 £000
Administrative costs	1,693	1,879	1,988	2,176
Investment management expenses	33,943	34,241	34,422	34,629
Oversight and governance costs	1,481	1,815	1,811	1,829
	37,117	37,935	38,221	38,634

12b Administrative expenses

	LPF Parent 2017/18* £000	LPF Group 2017/18* £000	LPF Parent 2018/19 £000	LPF Group 2018/19 £000
Employee Costs	1,198	1,222	1,494	1,540
System costs	306	307	304	305
Actuarial fees	127	127	72	72
External/Internal audit fees	68	74	49	52
Legal fees	2	2	20	20
Printing and postage	120	120	111	111
Depreciation	60	60	45	45
Office costs	107	107	100	100
Sundry costs less sundry income	61	60	88	73
IAS19 retirement benefit adjustments - see note 30	-	206	-	249
Deferred tax on retirement benefit obligation - see note 29a	-	(35)	-	(42)
Corporation tax	-	-	-	6
	2,049	2,250	2,283	2,531

LPFE, which is a wholly owned subsidiary of the Council, is responsible for providing the staffing resource to administer the pension funds. The Fund has a service level agreement in place with the Council for certain support services. Costs directly attributable to a specific Fund are charged to the relevant Fund, costs that are common to the two Funds are allocated on a defined basis.

Notes to the Financial Statements

12c Investment management expenses

	LPF Parent 2017/18* £000	LPF Group 2017/18* £000	LPF Parent 2018/19 £000	LPF Group 2018/19 £000
External management fees -				
invoiced	4,931	4,931	4,977	4,977
deducted from capital (direct investment)	19,777	19,777	17,657	17,657
deducted from capital (indirect investment)	5,912	5,912	5,062	5,062
Securities lending fees	191	191	189	189
Transaction costs - Equities	1,207	1,207	1,498	1,498
Property operational costs	337	337	2,615	2,615
Employee costs	1,368	1,471	2,075	2,165
Custody fees	396	396	356	356
Engagement and voting fees	93	93	114	114
Performance measurement fees	85	85	92	92
Consultancy fees	52	52	125	125
Research fees	65	65	329	329
System costs	322	323	441	442
Legal fees	71	99	134	137
Depreciation	8	8	16	16
Office costs	84	84	76	76
Sundry costs less sundry income	168	(38)	182	(56)
IAS19 retirement benefit adjustments - see note 30	-	824	-	345
Deferred tax on retirement benefit obligation - see note 29	-	(140)	-	(59)
Corporation tax	-	-	-	23
Corporation tax losses utilised by CEC group	-	8	-	-
	35,067	35,685	35,938	36,103

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

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

The external investment management fees (deducted from capital) above include £8.5m (£6.1m direct, £2.4m indirect) in respect of performance-related fees compared to £9.4m in 2017/18 (£7.1m direct, £2.3m indirect).

It should be noted that Lothian Pension Fund's disclosure on investment management fees exceed CIPFA's "Accounting for Local Government Pension Scheme Management Costs" revised guidance on cost transparency which came into effect from 1st April 2016. Consistent with previous years, the Fund recognises fees deducted from investments not within its direct control (such as fund of fund fees) to give a full picture of its investment management costs. Further details can be found on page 31. This further disclosure highlights an extra £5.1m in costs (2018 £5.9m).

Notes to the Financial Statements

13 Investment income

	2017/18* £000	2018/19 £000
Income from bonds	4,267	11,622
Dividends from equities	138,584	152,814
Unquoted private equity and infrastructure	7,601	5,005
Income from pooled investment vehicles	6,207	2,432
Gross rents from properties	23,079	23,501
Interest on cash deposits	708	2,156
Stock lending and sundries	957	943
	181,403	198,473
Irrecoverable withholding tax	(9,455)	(7,498)
	171,948	190,975

Included within the dividend from equities income for the year is cross border withholding tax yet to be received. The Fund's custodian Northern Trust manages this process and due to the high certainty of success it is assumed that the Fund will make full recovery of these reclaims. For the period of 2018/19 £4,526k of the stated income relates to tax yet to be received. At the 31st March 2019 £9,066k (including prior periods) of investment income receivable related to cross border withholding tax. The Fund monitors these claims to ensure its optimum tax efficiency and provides an annual progress report to the Pensions Audit Sub-Committee.

Notes to the Financial Statements

14 Net investment assets

Investment Assets	Region	31 March 2018* £000	31 March 2019 £000
Bonds			
Public sector fixed interest	UK	153,585	158,219
Public sector index linked gilts quoted	UK	582,893	697,211
		736,478	855,430
Equities			
Quoted	UK	557,735	641,038
Quoted	Overseas	3,729,729	3,918,803
		4,287,464	4,559,841
Pooled investment vehicles			
Private equity, infrastructure, private debt & timber	UK	527,172	616,556
Private equity, infrastructure, private debt & timber	Overseas	597,899	633,487
Property	UK	108,125	90,358
Other	UK	31,357	31,978
		1,264,553	1,372,379
Properties			
Direct property	UK	392,743	411,978
		392,743	411,978
Derivatives			
Derivatives - forward foreign exchange		12,121	3,025
		12,121	3,025
Cash deposits			
Deposits		426,380	569,190
		426,380	569,190
Other investment assets			
Due from broker		2,947	1,037
Dividends and other income due		17,163	17,791
		20,110	18,828
Total investment assets		7,139,849	7,790,671
Investment liabilities			
Derivatives			
Derivatives - forward foreign exchange		(204)	(854)
		(204)	(854)
Other financial liabilities			
Due to broker		(5,158)	(1,058)
		(5,158)	(1,058)
Total investment liabilities		(5,362)	(1,912)
Net investment assets		7,134,487	7,788,759

Notes to the Financial Statements

15a Reconciliation of movement in investments and derivatives

	Market value at 31 March 2018* £000	Purchases at cost & derivative payments £000	Sale & derivative receipts £000	Change in market value £000	Market value at 31 March 2019 £000
Bonds	736,478	227,909	(150,897)	41,940	855,430
Equities	4,287,464	1,090,848	(1,122,578)	304,107	4,559,841
Pooled investment vehicles	1,264,553	219,829	(261,125)	149,122	1,372,379
Property	392,743	21,290	-	(2,055)	411,978
Derivatives - futures	-	30	(30)	-	-
Derivatives - forward foreign exchange	11,917	8,223	(12,199)	(5,770)	2,171
	6,693,155	1,568,129	(1,546,829)	487,344	7,201,799
Other financial assets / liabilities					
Cash deposits*	426,380			16,376	569,190
Broker balances*	(2,211)			14	(21)
Investment income due*	17,163			-	17,791
	441,332			16,390	586,960
Net financial assets	7,134,487			503,734	7,788,759

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

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

	Market value at 31 March 2017* £000	Purchases at cost & derivative payments £000	Sale & derivative receipts £000	Change in market value £000	Market value at 31 March 2018* £000
Bonds	732,628	42,200	(39,305)	955	736,478
Equities	4,494,078	907,719	(962,127)	(152,206)	4,287,464
Pooled investment vehicles	1,223,996	70,066	(149,092)	119,583	1,264,553
Property	356,741	40,758	(17,329)	12,573	392,743
Derivatives - futures	-	11	163	(174)	-
Derivatives - forward foreign exchange	657	2,983	(3,722)	11,999	11,917
	5,141,969	1,063,737	(1,171,412)	(7,270)	6,693,155
Other financial assets / liabilities					
Cash deposits*	432,072			(18,272)	426,380
Broker balances*	(852)			3	(2,211)
Investment income due*	29,042			-	17,163
	256,994			(18,269)	441,332
Net financial assets	5,398,963			(25,539)	7,134,487

** As per CIPFA disclosures the change in market value intentionally does not balance opening/closing market values*

Notes to the Financial Statements

15d Reconciliation of fair value measurements within level 3

Pooled investments	Market value at 31 March 2018*	Level 3 transfers in	Level 3 transfers out	Purchases at cost & derivative payments	Sales & derivative receipts	Unrealised gains / (losses)	Realised gains / (losses)	Market value at 31 March 2019
Infrastructure	773,193	-	-	136,416	(137,747)	32,426	40,572	844,860
Property	66,638	-	-	-	(15,891)	(1,611)	(153)	48,983
Private Equity	90,403	-	-	2,283	(26,834)	18,669	(8,362)	76,159
Timber	118,235	-	-	579	(14,724)	11,044	8,894	124,028
Private debt	143,245	-	-	80,893	(21,155)	(95)	2,108	204,996
Freehold Property	- 392,743	-	-	21,290	-	(2,055)	-	411,978
	1,584,457	-	-	241,461	(216,351)	58,378	43,059	1,711,004

Unrealised and realised gains and losses are recognised in the profit and losses on disposal and changes in the market value of investments line of the fund account.

16 Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2019

Contract settlement within	Currency bought	Currency sold	Local currency bought 000	Local currency sold 000	Asset value £000	Liability value £000
Up to one month	GBP	AUD	49,327	91,691	59	(702)
Up to one month	CAD	GBP	12,909	7,565	-	(152)
Up to one month	GBP	CAD	142,170	242,817	2,720	-
Up to one month	USD	JPY	253	28,011	-	-
Up to one month	GBP	JPY	26	3,800	-	-
Up to one month	USD	ZAR	531	7,661	-	-
One to six months	USD	CHF	7,393	6,991	246	-

Open forward currency contracts at 31 March 2019	3,025	(854)
Net forward currency contracts at 31 March 2019		2,171

Prior year comparative

Open forward currency contracts at 31 March 2018*	12,121	(204)
Net forward currency contracts at 31 March 2018		11,917

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

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

Notes to the Financial Statements

17 Investment managers and mandates

Manager	Mandate	Market value at 31 March 2018* £000	% of total 31 March 2018 %	Market value at 31 March 2019 £000	% of total 31 March 2019 %
In-house	UK all cap equities	139,655	2.0	144,692	1.9
In-house	UK mid cap equities	131,607	1.8	121,698	1.6
Total UK equities		271,262	3.8	266,390	3.5
In-house	European ex UK equities	130,696	1.8	125,418	1.6
In-house	US equities	146,279	2.3	160,148	2.1
Total regional overseas equities		276,975	4.1	285,566	3.7
In-house	Global high dividend	988,159	13.9	1,006,587	12.9
In-house	Global low volatility	1,097,057	17.7	1,249,276	16.1
In-house	Global multi factor value	934,708	15.0	993,535	12.8
Harris	Global equities	273,298	3.8	278,794	3.6
Nordea	Global equities	268,444	3.8	306,617	3.9
Baillie Gifford	Global equities	141,217	2.0	123,103	1.6
Total global equities		3,702,883	56.1	3,957,912	50.9
In-house	Currency hedge	11,885	0.2	1,925	-
Total currency overlay		11,885	0.2	1,925	-
Total listed equities		4,263,005	64.2	4,511,793	58.1
In-house	Private equity unquoted	90,403	1.3	76,159	1.0
In-house	Private equity quoted	67,490	0.9	78,382	1.0
Total private equity		157,893	3.2	154,541	2.0
Total equity		4,420,898	67.4	4,666,334	60.1
In-house	Index linked gilts	530,560	7.4	595,360	7.6
In-house	Mature employer gilts	54,571	0.8	116,095	1.5
Total inflation linked assets		585,131	7.4	711,455	9.1
In-house	Property	37,447	0.5	35,421	0.5
Standard Life	Property	495,917	7.0	516,767	6.6
Total property		533,364	7.5	552,188	7.1
In-house	Infrastructure unquoted	773,194	10.8	844,860	10.8
In-house	Infrastructure quoted	21,931	0.3	24,819	0.3
In-house	Timber	118,235	1.7	124,029	1.6
Total other real assets		913,360	12.8	993,708	12.7
Baillie Gifford	Corporate bonds	30,490	0.4	31,835	0.4
In-house	Private debt	143,245	2.0	204,996	2.6
In-house	Sovereign bonds	158,280	2.2	165,183	2.1
Total debt assets		332,015	4.7	402,014	5.1

Notes to the Financial Statements

17 Investment managers and mandates (cont)

Manager	Mandate	Market value at 31 March 2018 £000	% of total 31 March 2017 %	Market value at 31 March 2019 £000	% of total 31 March 2018 %
In-house	Cash	348,105	4.9	462,976	5.9
In-house	Transitions	1,614	0.0	84	0.0
Total cash and sundries		349,719	4.9	463,060	5.9
Net financial assets		7,134,487	100.0	7,788,759	100.0

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

18 Securities lending

During the year Lothian Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2019, £407.2m (2018 £271.7m) of securities were released to third parties. Collateral valued at 107.3% (2018 105.5%) of the market value of the securities on loan was held at that date.

19 Property holdings

	2017/18 £000	2018/19 £000
Opening balance	356,741	392,743
Additions	40,875	21,290
Disposals	(17,329)	-
Net change in market value	12,456	(2,055)
Closing balance	392,743	411,978

As at 31 March 2019, there were no restrictions on the realisability of the property or the remittance of income or sale proceeds. As at 31 March 2018 The Fund had approval in place for the planning, design and contractor procurement to potentially re-develop 100 St John Street, London. During the year this has progressed and the Fund is currently in the process of developing 100 St John Street, London. As at 31 March 2019 the Fund is contractually obliged to further construction costs of £4.8m

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

	2017/18 £000	2018/19 £000
Within one year	23,327	23,257
Between one and five years	66,574	58,867
Later than five years	101,160	92,633
	191,061	174,757

Notes to the Financial Statements

20 Financial Instruments

20a Classification of financial instruments

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

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

Classification of financial instruments - parent	31 March 2018			31 March 2019		
	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000
Investment assets						
Bonds	736,477	-	-	855,430	-	-
Equities	4,287,464	-	-	4,559,841	-	-
Pooled investments	1,264,553	-	-	1,372,379	-	-
Property Leases	4,376	-	-	2,284	-	-
Derivative contracts	12,121	-	-	3,025	-	-
Margin balances	-	-	-	-	-	-
Cash	-	426,380	-	-	569,189	-
Other balances	-	20,110	-	-	18,828	-
	6,304,991	446,490	-	6,792,959	588,017	-
Other assets						
City of Edinburgh Council	-	3,083	-	-	884	-
Cash	-	48,833	-	-	35,897	-
Share Capital	-	60	-	-	60	-
Debtors - current	-	16,406	-	-	22,340	-
Debtors - non-current	-	1,525	-	-	3,330	-
	-	69,907	-	-	62,511	-
Assets total	6,304,991	516,397	-	6,792,959	650,528	-
Financial liabilities						
Investment liabilities						
Derivative contracts	(204)	-	-	(854)	-	-
Other investment balances	-	-	(5,158)	-	-	(1,058)
	(204)	-	(5,158)	(854)	-	(1,058)
Other liabilities						
Creditors	-	-	(29,482)	-	-	(30,799)
Liabilities total	(204)	-	(34,640)	(854)	-	(31,857)
Total net assets	6,304,787	516,397	(34,640)	6,792,105	650,528	(31,857)

Total net financial instruments	6,786,544		7,410,776
Amounts not classified as financial instruments	388,536		410,125
Total net assets - parent	7,175,080		7,820,901

Notes to the Financial Statements

20a Classification of financial instruments (cont)

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

	31 March 2018			31 March 2019		
	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000
Other assets						
Cash	-	93	-	-	341	-
Share Capital	-	(60)	-	-	(60)	-
Debtors - current	-	70	-	-	223	-
Debtors - non-current	-	292	-	-	393	-
	-	395	-	-	897	-
Assets total	-	395	-	-	897	-
Other liabilities						
Retire. benefit obligation	-	-	(1,715)	-	-	(2,309)
Creditors	-	-	(38)	-	-	(346)
Creditors - non current	-	-	-	-	-	(13)
Liabilities total	-	-	(1,753)	-	-	(2,668)
Total net assets	-	395	(1,753)	-	897	(2,668)

Total adjustments to net financial instruments	(1,358)		(1,771)
Total net assets - group	7,173,722		7,819,130

20b Net gains and losses on financial instruments

	2017/18 £000	2018/19 £000
Designated as fair value through fund account	(19,843)	489,399
Loans and receivables	(18,269)	16,390
Financial liabilities at amortised cost	-	-
Total	(38,112)	505,789

Gains and losses on directly held freehold property	12,573	(2,055)
Change in market value of investments per fund account	(25,539)	503,734

20c Fair Value Hierarchy

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

Level 1

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

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

Level 2

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

Level 3

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

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

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

	31 March 2019			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Investment assets				
Designated as fair value through fund account	4,563,196	928,453	1,299,026	6,790,675
Non-financial assets at fair value through profit and loss	-	-	411,978	411,978
Total investment assets	4,563,196	928,453	1,711,004	7,202,653
Investment liabilities				
Designated as fair value through fund account	-	(854)	-	(854)
Total investment liabilities	-	(854)	-	(854)
Net investment assets	4,563,196	927,599	1,711,004	7,201,799

20c Fair Value Hierarchy

	31 March 2018			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Investment assets				
Designated as fair value through fund account	4,372,429	736,477	1,197,953	6,306,859
Non-financial assets at fair value through profit and loss	-	-	386,500	386,500
Total investment assets	4,372,429	736,477	1,584,453	6,693,359
Investment liabilities				
Designated as fair value through fund account	-	(204)	-	(204)
Total investment liabilities	-	(204)	-	(204)
Net investment assets	4,372,429	736,273	1,584,453	6,693,155

21 Nature and extent of risk arising from financial instruments

Risk and risk management

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

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

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

Types of investment risk

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

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

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

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

The Fund manages these risks in a number of ways:

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

Sensitivity analysis

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

Asset type	Potential price movement (+ or -)
Equities - Developed Markets	20.5%
Equities - Emerging Markets	30.0%
Private Equity	30.0%
Timber and Gold	18.0%
Secured Loans	7.5%
Fixed Interest Gilts	6.7%
Index-Linked Gilts	11.2%
Infrastructure	12.0%
Property	13.0%
Cash	0.9%

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

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

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

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

	Value at 31 March 2019 £m	% of fund %	Potential Change +/- %	Value on increase £m	Value on decrease £m
Equities - Developed Markets	4,253	54.6	20.5%	5,124.9	3,381.1
Equities - Emerging Markets	256	3.3	30.0%	332.8	179.2
Private Equity	155	2.0	30.0%	201.5	108.5
Timber and Gold	124	1.6	18.0%	146.3	101.7
Secured Loan	237	3.0	7.5%	254.8	219.2
Fixed Interest Gilts	165	2.1	6.7%	176.1	153.9
Index-Linked Gilts	711	9.1	11.2%	790.6	631.4
Infrastructure	870	11.2	12.0%	974.4	765.6
Property	552	7.1	13.0%	623.8	480.2
Cash and forward foreign exchange	466	6.0	0.9%	470.2	461.8
Total [1]	7,789	100.0	16.8%	9,095.3	6,482.7
Total [2]			13.2%	8,814.0	6,764.0
Total [3]			13.8%	8,863.1	n/a

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

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

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

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

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

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

Credit risk

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

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

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

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

Cash deposits

At 31 March 2019, cash deposits represented £605.1m, 7.74% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2019	Balances at 31 March 2018 £000	Balances at 31 March 2019 £000
Held for investment purposes			
Northern Trust Global Investment Limited - liquidity funds	Aaa-mf	10,571	13,517
Northern Trust Company - cash deposits	Aa2	324,100	443,357
The City of Edinburgh Council - treasury management	See below	91,709	112,315
Total investment cash		426,380	569,189
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	48,833	35,897
Total cash - parent		475,213	605,086
Cash held by LPFE/LPFI Limited			
Royal Bank of Scotland	A1	93	341
Total cash - group		475,306	605,427

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

	Moody's Credit Rating at 31 March 2019	Balances at 31 March 2018 £000	Balances at 31 March 2019 £000
Money market funds			
Deutsche Bank AG, London	Aaa-mf	608	3,979
Goldman Sachs	Aaa-mf	1	58
Aberdeen Standard Sterling Liquidity Fund	Aaa-mf	20,830	21,746
Bank call accounts			
Bank of Scotland	Aa3	13,876	14,578
Royal Bank of Scotland	A1	511	573
Santander UK	Aa3	368	1
Barclays Bank	A1	11	13
Svenska Handelsbanken	Aa2	689	6
HSBC Bank PLC	Aa3	52	14
Notice accounts			
HSBC Bank PLC	Aa3	-	17,527
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa1	103,596	89,717
		140,542	148,212

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2019 was 'Aa1').

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

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

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

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

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

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

Securities lending

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

Derivatives

The Fund transacts foreign currency derivatives over-the-counter and hence is exposed to credit risk in the event of a counterparty defaulting on the net payment or receipt that remains outstanding. This risk is minimised by the use of counterparties that are recognised financial intermediaries with acceptable credit ratings and by netting agreements. At 31 March 2019, the Fund was owed £2.2m on over-the-counter foreign currency derivatives.

Refinancing risk

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

Liquidity risk

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

The majority (estimated to be approximately 78% (2018 77%)) of the Fund's investments could be converted to cash within three months in a normal trading environment.

22 Actuarial statement

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

23 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £9,333m (2018 £8,254m). This figure is used for statutory accounting purposes by Lothian Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end.

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

	31 March 2018 % p.a.	31 March 2019 % p.a.
Inflation / pensions increase rate	2.4	2.5
Salary increase rate	4.1	4.2
Discount rate	2.7	2.4

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements in line with the CMI 2016 model, assuming that the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	31 March 2018		31 March 2019	
	Males	Females	Males	Females
Current pensioners	21.7 years	24.3 years	21.7 years	24.3 years
Future pensioners (assumed to be currently 45)	24.7 years	27.5 years	24.7 years	27.5 years

Commutation assumption

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

24 Non-current Debtors

	LPF Parent 31 March 2018 £000	LPF Group 31 March 2018 £000	LPF Parent 31 March 2019 £000	LPF Group 31 March 2019 £000
Contributions due - employers' cessation	1,525	1,525	3,330	3,330
	1,525	1,525	3,330	3,330

In accordance with the Funding Strategy Statement and in recognition of severe affordability constraints facing the charitable sector, “Funding Agreements” have been put in place to allow certain former employers to repay cessation valuation debt over longer terms (up to twenty years), to avoid potential default or insolvency.

The above debtors all relate to community admission bodies.

Notes to the Financial Statements

25 Debtors

	LPF Parent 31 March 2018* £000	LPF Group 31 March 2018* £000	LPF Parent 31 March 2019 £000	LPF Group 31 March 2019 £000
Contributions due - employers	12,250	12,250	16,827	16,827
Contributions due - members	3,690	3,690	4,691	4,691
Benefits paid in advance or recoverable	33	33	6	6
Sundry debtors	97	168	503	717
Prepayments	325	335	314	322
LPFE & LPFI Limited Loan facility - see note 28	11	-	-	-
	16,406	16,476	22,341	22,563

26 Creditors

	LPF Parent 31 March 2018* £000	LPF Group 31 March 2018* £000	LPF Parent 31 March 2019 £000	LPF Group 31 March 2019 £000
Benefits payable	6,914	6,914	8,886	8,886
VAT, PAYE and State Scheme premiums	1,432	1,571	1,354	1,738
Contributions in advance	18,290	18,290	17,785	17,785
Miscellaneous creditors and accrued expenses	1,982	2,167	2,332	2,488
Office - operating lease	243	243	220	220
Corporation tax	-	-	-	28
Intra group creditor - see note 28	287	-	222	-
	29,148	29,185	30,799	31,145

27 Additional Voluntary Contributions

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

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

Total contributions during year for Lothian Pension fund	2017/18* £000	2018/19 £000
Standard Life	312	312
Prudential	2,059	2,225
	2,371	2,537

Total value at year end for Lothian Pension Fund	31 March 2018* £000	31 March 2019 £000
Standard Life	4,850	4,685
Prudential	6,634	7,676
	11,484	12,361

Notes to the Financial Statements

28 Related parties

The City of Edinburgh Council

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

LPFE, which is a wholly owned subsidiary of the Council, is responsible for providing the staffing resource to administer the pension funds. The Fund has a service level agreement in place with the Council for certain support services. Costs directly attributable to a specific Fund are charged to the relevant Fund, costs that are common to the two Funds are allocated on a defined basis.

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

	31 March 2018* £000	31 March 2019 £000
Year end balance of holding account	3,083	884
	3,083	884

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2019, the fund had an average investment balance of £139.1m (2017/18 £119.9m). Interest earned was £977.1k (2017/18 £453.6k).

Year end balance on treasury management account	31 March 2018* £000	31 March 2019 £000
Held for investment purposes	91,709	112,315
Held for other purposes	48,833	35,897
	140,542	148,212

Scheme employers

All scheme employers to the fund are (by definition) related parties, a full list of employers can be found on page 84. The employer contributions for the ten largest scheme employers are as follows -

	31 March 2018* £000	31 March 2019 £000
City of Edinburgh Council	50,041	59,694
West Lothian Council	22,895	25,841
Scottish Water	9,526	15,975
East Lothian Council	13,812	14,746
Midlothian Council	13,148	14,041
Lothian Buses	7,581	7,002
Edinburgh Napier University	4,938	5,199
Heriot-Watt University	3,324	3,026
Scottish Police Authority	2,945	3,016
Edinburgh College	2,289	2,676

28 Related parties (cont)

Governance

As at 31 March 2019, all members of the Pensions Committee, with the exception of Richard Lamont, and all members of the Pension Board, were members of the Lothian Pension Fund. One member of both the Pensions Committee and the Pension Board are in receipt of pension benefits from Lothian Pension Fund.

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

During the period from 1 April 2018 to the date of issuing of these accounts, a number of employees of the City of Edinburgh Council and its wholly owned subsidiary, LPFE Limited, held key positions in the financial management of the Lothian Pension Fund. Total compensation paid in relation to key management personnel employed by LPFE Limited during the period was as follows:

	31 March 2018 £000	31 March 2019 £000
Short-term employee benefits	415	647
Post-employment benefits - employer pension contributions	85	111

Key management personnel employed by LPFE had accrued pensions totalling £120,245 (1 April 2018: £97,456) and lump sums totalling £132,375 (1 April 2018: £110,889) at the end of the period. Further details on senior management remuneration can be found within the remuneration report on page 134.

Remuneration of key management personnel employed by City of Edinburgh Council is disclosed separately in the Financial Statements of City of Edinburgh Council.

The Councillors, who are members of the Pensions Committee, are also remunerated by City of Edinburgh Council.

LPFE Limited & LPFI Limited- loan facility

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

Interest payable by LPFE Limited during the period was £1,434 of which £787 was due at the year end and for LPFI Limited there was no interest payable for the year. At 31 March 2019, there was zero balance on the loan facilities for both LPFE Limited and LPFI Limited.

LPFE Limited - staffing services

Staffing services are provided to Lothian Pension Fund for the purposes of administering the Funds under a intra-group resourcing agreement. The agreement also provides for the running costs of the company to be covered as part of a service charge and allows for the provision of staffing services to LPFI Limited. During the year to 31 March 2019, the Fund was invoiced £3,614k (2018 £1,450k) for the services of LPFE Limited staff.

Notes to the Financial Statements

29a Consolidated Lothian Pension Fund Group - LPFE Limited & LPFI Limited - deferred tax

Movement in deferred tax asset (Non-current asset)	LPF Group 2017/18 £000	LPF Group 2018/19 £000
At 1 April 2018	117	292
Credit for year to Fund Account	175	101
At 31 March 2019	292	393

Elements of closing deferred tax asset	LPF Group 31 March 2018 £000	LPF Group 31 March 2019 £000
Pension liability	292	393
	292	393

29b Shares in group companies - LPFE Limited & LPFI Limited

	31 March 2018 £	31 March 2019 £
Allotted, called up and fully paid Ordinary shares of £1 each - LPFE Limited*	1	1
Allotted, called up and fully paid Ordinary shares of £1 each - LPFI Limited	60,000	60,000
	60,001	60,001

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

30 Retirement benefits obligation - group

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

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

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

Fund assets

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

30 Retirement benefits obligation - group (cont)

Asset		Fair value at 31 March 2018 £000	% of total 31 March 2018 %	Fair value at 31 March 2019 £000	% of total 31 March 2019 %
Equity securities:	Consumer	1,185	14.0	1,094	14.0
	Manufacturing	1,288	15.0	1,265	15.0
	Energy and utilities	541	6.0	777	6.0
	Financial institutions	769	9.0	865	9.0
	Health and care	424	5.0	559	5.0
	Information technology	528	6.0	335	6.0
	Other	543	6.0	1,003	6.0
Debt securities:	Corporate Bonds	169	2.0	-	2.0
	UK Government	839	10.0	1,045	10.0
	Other	-	0.0	-	0.0
Private equity:	All	158	2.0	139	2.0
Real property	UK property	556	6.0	697	6.0
	Overseas property	9	0.0	-	0.0
Investment funds and unit trusts:	Equities	83	1.0	102	1.0
	Commodities	-	0.0	-	0.0
	Bonds	-	0.0	261	0.0
	Infrastructure	1,025	12.0	1,277	12.0
	Other	20	0.0	-	0.0
Derivatives:	Foreign Exchange	4	0.0	3	0.0
Cash and cash equivalents:	All	511	6.0	863	6.0
		8,652	100.0	10,285	100.0

Amounts recognised in the Net Assets Statement

	LPF Group 31 March 2018 £000	LPF Group 31 March 2019 £000
Fair value of Fund assets	8,652	10,285
Present value of Fund liabilities	(10,367)	(12,594)
	(1,715)	(2,309)

30 Retirement benefits obligation - group (cont)

Movement in the defined benefit obligation during the period

	LPF Group 2017/18 £000	LPF Group 2018/19 £000
Brought forward	3,513	10,367
Current service cost	336	843
Interest cost on obligation	131	294
Fund participants contributions	7,175	186
Benefits paid	-	-
Actuarial losses arising from changes in financial assumptions	(788)	904
Actuarial losses arising from changes in demographic assumptions	-	-
Other actuarial losses	-	-
Balance at year end	10,367	12,594

Movement in the fair value of Fund assets during the period

	LPF Group 2017/18 £000	LPF Group 2018/19 £000
Brought forward	2,828	8,652
Benefits paid		
Interest income on Fund assets	104	244
Contributions by employer	204	567
Contributions by member	91	194
Contributions in respect of unfunded benefits	-	-
Unfunded benefits paid	(4)	(8)
Effect of business combinations and disposals	5,711	-
Return on assets excluding amounts included in net interest	(282)	636
Balance at year end	8,652	10,285

Amounts recognised in the Fund Account

	LPF Group 2017/18 £000	LPF Group 2018/19 £000
Interest received on Fund assets	(104)	(244)
Interest cost on Fund liabilities	131	294
Current service costs	336	843
Effect of business combinations and disposals	1,377	-
Employer contributions	(204)	(567)
Actuarial gain due to re-measurement of defined benefit obligation	(788)	904
Return on Fund assets (excluding interest above)	282	(636)
Net cost recognised in Fund account	1,030	594

30 Retirement benefits obligation - group (cont)

Principal actuarial assumptions used in this valuation	31 March 2018 % p.a.	31 March 2019 % p.a.
Inflation / pensions increase rate	2.3	2.4
Salary increase rate	4.0	4.1
Discount rate	2.7	2.5

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

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

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

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

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

	31 March 2018		31 March 2019	
	Males	Females	Males	Females
Current pensioners	22.1 years	23.7 years	21.7 years	24.3 years
Future pensioners	24.2 years	26.3 years	24.7 years	27.5 years

Expected employer contributions to the defined benefit plan for the year ended 31 March 2020 are £643,000, based on a pensionable payroll cost of £2,374,000.

31 Contractual commitments

Investment commitments

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

	31 March 2018* £000	31 March 2019 £000
Outstanding investment commitments	213,774	325,361
	213,774	325,361

31 Contractual commitments (cont)

Office accommodation - 144 Morrison Street, Edinburgh

The Fund is committed to making the following future payments.

	31 March 2018 £000	31 March 2019 £000
Within one year	115	115
Between one and five years	345	345
After five years	762	647
	1,222	1,107
Recognised as an expense during the year	92	92

The above expense has been allocated across the three Funds, Lothian Pension Fund's share is £85.1k.

32 Contingent assets and liabilities

Contribution refunds

At 31st March 2019, Lothian Pension Fund had £909k (2018: £894k) in unclaimed refunds due to members.

Employer Cessations

a) Funding Agreements

As stated in note 24, "In accordance with the Funding Strategy Statement and in recognition of severe affordability constraints facing the charitable sector, "Funding Agreements" have been put in place with certain former employers to repay cessation valuation debt"…. In exceptional circumstances, this includes "repayment of 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". At 31 March 2019, such contingent assets of the Fund totalled £1,635k.

b) Homeless Action Scotland

On 24 January 2019, the Chief Finance Officer, Lothian Pension Fund, made a request for direction by Scottish Ministers that the assets and liabilities of Homeless Action Scotland (HAS) should be transferred from Lothian Pension Fund (LPF) to the Scottish Homes Pension Fund. HAS became an "Admitted Body" of Lothian Pension Fund when its predecessor (The Scottish Council for Single Homeless) was admitted in 1978, pursuant to Regulation B4(4) of the Local Government Superannuation (Scotland) Regulations 1974, being 'a body to whom a grant is made out of moneys provided by Parliament'. Since 1978, HAS accrued pension liabilities for the ongoing pension entitlements of the HAS employees admitted to membership of LPF. Following confirmation by HAS that it would be unable to meet the minimum contribution rate assessed at the actuarial valuation of 31 March 2017 (certified by LPF's actuary), LPF terminated HAS's admission to LPF with effect from 12 July 2018 in accordance with LPF's Funding Strategy Statement. Upon HAS becoming an exiting employer, LPF's actuary was instructed to calculate the liabilities that remained with LPF on cessation and the final contribution due from HAS, as required under Regulation 62(2) of the 2018 Regulations. The Actuary's cessation valuation is £641,000.

A response to the request for such direction is awaited from Scottish Ministers.

32 Contingent assets and liabilities (cont)

EU Tax claims & income recovery

The Fund participates in various claims to recover withheld investment income. EU tax claims relate to the recovery of tax deducted from dividend payments prior to receipt or payable tax credits thereon. The claims can be divided into three main types – "Manninen" / Foreign Income Dividends (Fids), "Fokus Bank" and Manufactured Dividends. Given the high level of uncertainty as to the eventual success of such claims from EU tax authorities, no accrual of income is made in the financial statements. The value of these outstanding claims is approximately £11.4m. To date, the amount of tax recovered exceeds the cost of pursuing claims. Legal costs are shared across a pool of claimants and the Fund has the right to cease participation without incurring further costs. An annual progress report is provided to Pensions Audit Sub-Committee.

Variable pay arrangements

During the year, the company introduced three variable pay schemes, two of which have vesting periods. The Portfolio Manager and Senior Management schemes entitle staff to receive an assessed percentage of their salary as an additional variable pay award if they meet certain objectives during the year. The assessment year runs from 1 February 2018 to 31 January 2019. The award then vests over three years. The first part is payable at the end of the first year if the objectives are met and the remaining two parts are payable in the following two years if the requirement that the employee is still employed by the company at such time is met. Payment one has been made in January 2019. A liability has been raised at 31 March 2019 for the 2 months of service which the employees have delivered with regards to the second and third payments in the scheme.

In the event that all the staff involved in the arrangements at 31 January 2019 remain in the company's employment there is a contingent liability of £319,900 in excess of the current and non-current liabilities, as recognised in these financial statements in accordance with IAS19. This amount would be payable over two years.

Guaranteed Minimum Pension (GMP) – Reconciliation to HMRC records

GMP is the minimum pension which a United Kingdom occupational pension scheme must provide for those employees who were contracted out of the State Earnings-Related Pension Scheme (SERPS) between 6 April 1978 and 5 April 1997.

The UK Government mandated a reconciliation of Guaranteed Minimum Pension details held on scheme pension administration records to those held by HMRC, this to be completed by a revised date of 31 March 2019. Whilst this reconciliation of GMP mismatches has been completed by the Fund, work is ongoing to calculate "lump sum" arrears of any pension underpayments arising, together with the correct pension now being put into payment. It is not anticipated, however, that such arrears should represent a material sum.

On 8 February 2018, SPPA published "Circular No.1/2018", the purpose of which was to "Confirm how GMP related overpayments which arise from the current reconciliation exercise should be managed going forward…" This stated that "Scottish Minister 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."

Guaranteed Minimum Pension (GMP)

Following The High Court ruling from 26 October 2016, all defined benefit pension schemes must equalise Guaranteed Minimum Pension (GMP) for men and women. There is insufficient basis to estimate reliably the amount to be recognised in the past service cost until actuaries complete their assessment of the impact and reflect it fully in the pension reports. The Funds actuary, Hymans Robertson LLP has advised that following discussions with the National Audit Office and other LGPS actuaries, the general expectation is that a 'trigger event' is yet to occur in the LGPS and their default approach is to ignore any GMP impact in the 31 March 2019 accounts.

32 Contingent assets and liabilities (cont)

Local Government Pension Scheme (Scotland) cost management update from Scottish Public Pensions Agency (SPPA)

In February 2019, the SPPA provided the Local Government Association (LGA) Secretariat with the following update for Scottish administering authorities:

As you are aware, the Public Service Pensions Act 2013 requires all public service pension schemes to undergo regular valuations, in addition to the regular fund valuations undertaken by LGPS fund actuaries. At the October meeting of the LGPSAB (Scheme Advisory Board) (Scotland), Government Actuary's Department (GAD) presented demographic assumptions which have been agreed. The UK Government and Scottish Ministers chose to allow certain exceptions which were designed to protect those closest to retirement from the impact of those reforms. As you will be aware, the Court of Appeal handed down judgment in the cases of McCloud and Sargeant on 20 December 2018: these age-related transitional arrangements were held to be discriminatory. It is anticipated that other public service pension schemes across the UK may be affected by this decision, including LGPS Scotland, notwithstanding that the nature of the comparable transitional arrangements implemented for local government pension schemes [statutory underpin] was slightly different from those adopted for the unfunded schemes. The judgment therefore has implications for post-reform members' benefits, and the UK Government is seeking permission to appeal to the Supreme Court. Meantime, the substantial impact of the judgment is such that it is impossible to assess with certainty the value of current public service pension arrangements.

On 30 January 2019 HM Treasury therefore announced in a Written Ministerial Statement that the UK Government intends to pause the 'cost cap' mechanism under the current round of scheme valuations, pending the final outcome of the appeal. As noted in the Ministerial Statement, if the UK Government is successful in its appeal, the cost cap process will resume. If unsuccessful, steps will need to be taken to compensate members who have been unfairly disadvantaged in the post reform schemes. Accordingly, the nature, and the timescale for implementation, of changes to the provisions of LGPS Scotland flowing from the actuarial valuation of the scheme for cost cap purposes being undertaken by the Government Actuary's Department (GAD) is not currently clear. We understand that changes which were scheduled to come into force this April in the England & Wales LGPS have been put on hold. We are liaising closely with HM Treasury and MHCLG on this matter. Meanwhile, GAD is progressing its valuation calculations only to the extent necessary at this stage, pending greater clarity on the legal position and the UK Government's consequent policy intent".

33 Impairment losses

During the year the Fund recognised an increase in impairment losses in respect of specific benefit over payments for which reimbursement has been requested of £15k. This increased the impairment to £42.7k at the year end.

Lothian Pension Fund

Actuarial Statement for 2018/19

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

Description of Funding Policy

The funding policy is set out in the Administering Authority's Funding Strategy (FSS), dated March 2018. In summary, the key funding principles are as follows:

- 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.

The FSS sets out how the Administering Authority seeks to achieve these objectives.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014 was as at 31 March 2017. This valuation revealed that the Fund's assets, which at 31 March 2017 were valued at £6,598 million, were sufficient to meet 98% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2017 valuation was £145 million. For the avoidance of doubt, these results are based on the assumptions that apply to the Fund's Primary investment strategy.

Each employer had contribution requirements set at the valuation with the aim of achieving full funding within a given time horizon. Contribution rates were set using one of two approaches depending on each employer's circumstances:

- Certain low risk and open employers participate in a contribution stability mechanism which limits annual changes in contribution rates. The mechanism is tested at each valuation to make sure it achieves the desired funding objectives.
- Other employers pay the contributions required to cover the cost of future service benefits and to recover the deficit/surplus identified as at 31 March 2017 over a given time period.

Individual employers' contributions for the period 1 April 2018 to 31 March 2021 were set in accordance with the Fund's funding policy as set out in its FSS, which includes further detail on the approaches mentioned above.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the 2017 valuation report.

Lothian Pension Fund

Actuarial Statement for 2018/19

Method

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

Assumptions

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

The key financial assumptions adopted under the Primary investment strategy for the 2017 valuation were as follows:

Financial assumptions	31 March 2017 % p.a.
Discount rate	3.2%
Salary increase assumption	4.1%
Benefit increase assumption (CPI)	2.4%

The key demographic assumption was the allowance made for longevity. The life expectancy assumption was based on the Fund's Vita Curves alongside future improvements 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. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	21.7 years	24.3 years
Future Pensioners *	24.7 years	27.5 years

*Aged 45 as at 31 March 2017

Copies of the 2017 valuation report and Funding Strategy Statement are available on request from the Administering Authority to the Fund.

Experience over the period since 31 March 2017

Asset returns under the Primary investment strategy over the period have been higher than the valuation discount rate but real bond yields have fallen slightly since 31 March 2017. Combining the impact of these may mean that the overall funding level at 31 March 2019 is broadly similar to the last valuation.

The next actuarial valuation will be carried out as at 31 March 2020. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden FFA
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
20 Waterloo Street, Glasgow, G2 6DB
26 April 2019

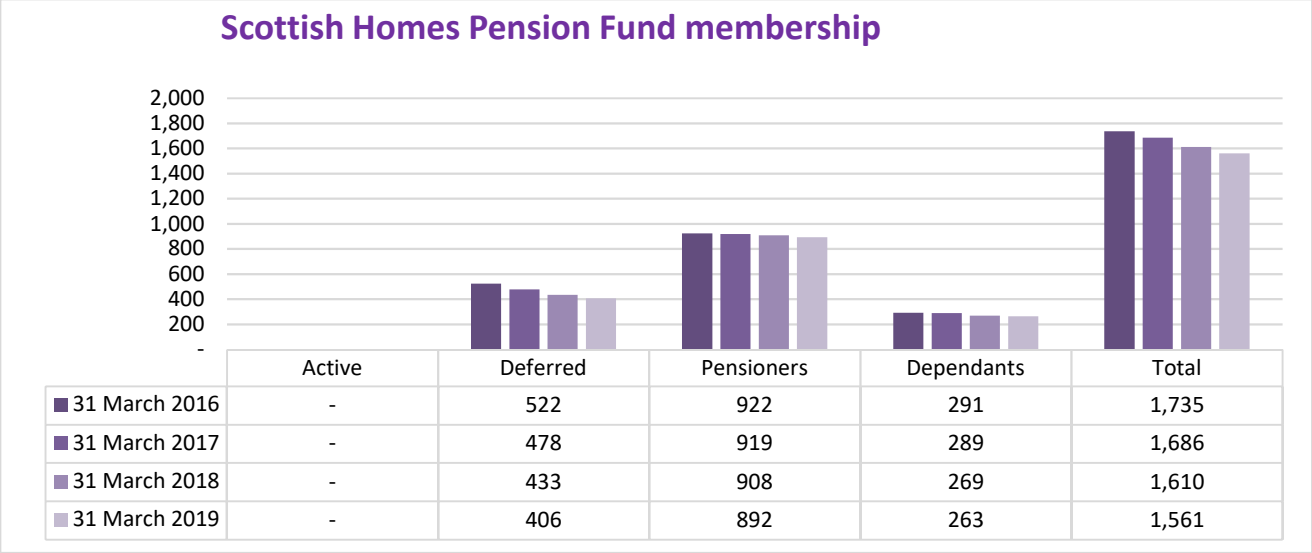
List of active employers at 31 March 2019

Scheduled Bodies	
City of Edinburgh Council (The)	Scottish Fire and Rescue Service
East Lothian Council	Scottish Police Authority
Edinburgh College	Scottish Water
Heriot-Watt University	SESTRAN
Lothian Buses	Visit Scotland
Lothian Valuation Joint Board	West Lothian College
Midlothian Council	West Lothian Council
Scotland's Rural College (SRUC)	

Admitted Bodies	
Amey Services	Improvement Service (The)
Audit Scotland	Into Work
Barony Housing Association Ltd	ISS UK Ltd
Baxter Storey	LPFE Ltd
Bellrock Property and Facilities Management	Melville Housing Association
Canongate Youth Project	Mitie (Edinburgh College)
Capital City Partnership	Mitie PFI
CGI UK Ltd	Morrison Facilities Services Ltd
Children's Hearing Scotland	Museums Galleries Scotland
Children's Hospice Association Scotland	Newbattle Abbey College
Citadel Youth Centre	North Edinburgh Dementia Care
Compass Chartwell	NSL Services Ltd
Convention of Scottish Local Authorities	Penumbra
Cyrenians	Pilton Equalities Project
Dacoll Limited	Queen Margaret University
Edinburgh Business School	Royal Edinburgh Military Tattoo
Edinburgh Development Group	Royal Society of Edinburgh
Edinburgh International Festival Society	Scotland's Learning Partnership
Edinburgh Leisure	Scottish Adoption Agency
Edinburgh Napier University	Scottish Futures Trust
ELCAP	Scottish Legal Complaints Commission
Enjoy East Lothian	Scottish Schools Education Research Centre (SSERC)
Family Advice and Information Resource	Skanska UK
Family and Community Development West Lothian	Sodexo Ltd
First Step	St Andrew's Children's Society Limited
Forth and Oban Ltd	St Columba's Hospice
Four Square (Scotland)	Stepping Out Project
Freespace Housing Association	Waverley Care
Granton Information Centre	University of Edinburgh (Edinburgh College of Art)
Handicabs (Lothian) Ltd	Weslo Housing Management
Hanover (Scotland) Housing Association	West Granton Community Trust
Health in Mind	West Lothian Leisure
Homes for Life Housing Partnership	Young Scot Enterprise
HWU Students Association	Youthlink Scotland

There are currently 13 ceased employers not included in the above list that are currently or in the process of setting up funding agreements to repay cessation debt over a number of years.

Scottish Homes Pension Fund



Investment strategy

The Fund's actuary estimated that the funding level of the Scottish Homes Pension Fund was 104.7% at 31 March 2017.

Achievement of full funding meant that the Fund no longer needed to take investment risk by investing in equities and property. Instead, the Fund was able to minimise risk by investing solely in bonds, specifically UK gilts. These financial instruments move proportionately with liability values.

After a year of significant change, the year to 31 March 2019 brought no change to the strategy allocation of 100% bonds and this should not change until at least the results of the next actuarial valuation (March 2020) are known. At that point in time, the actuary will amend financial and demographic estimates based on actual experience over the prior three years.

The strategic and actual asset allocations for the Fund at the end of the 2018 and 2019 financial years are shown in the table below.

	Strategic Allocation 31 March 2018 %	Actual Allocation 31 March 2018 %	Strategic Allocation 31 March 2019 %	Actual Allocation 31 March 2019 %
Equities	-	-	-	-
Bonds	100.0	91.9	100.0	97.8
Property	-	2.7	-	-
Cash	-	5.4	-	2.2
Total	**100.0**	**100.0**	**100.0**	**100.0**

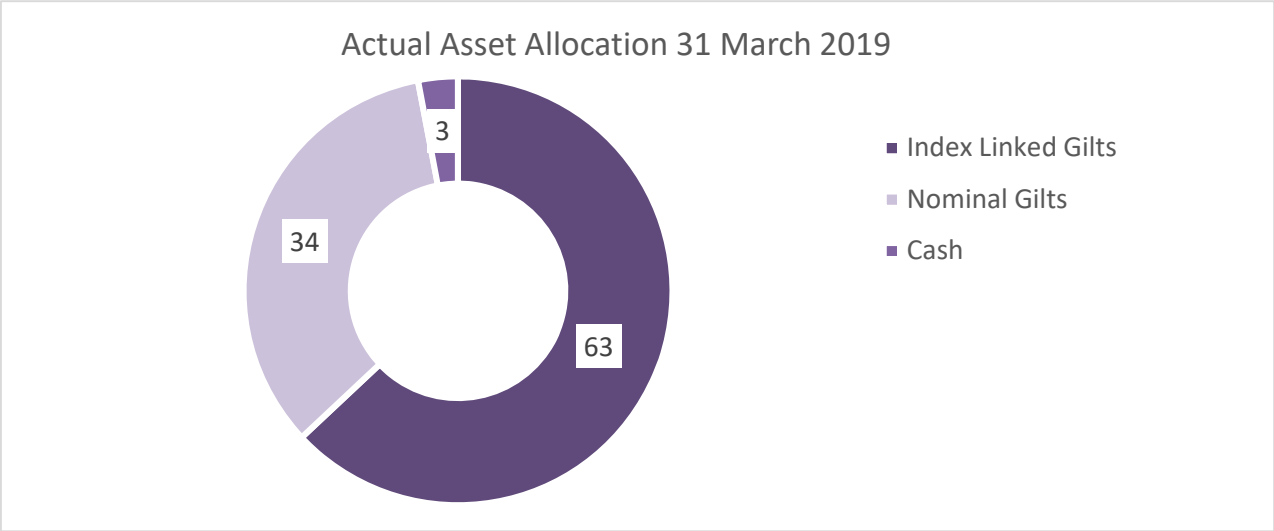
Shortly after the end of March 2018, the final sale of property assets was completed, leaving the Fund entirely invested in index-linked gilts and cash. The index linked gilts were structured to broadly match the expected liability payments as they fall due.

Given that the Fund had achieved full funding, the Pensions Committee approved a new investment objective in June 2018:

"to match the cash flow from gilt income and redemption payments as closely as possible with the expected liability payments of the fund"

Detailed analysis of the Scottish Homes liabilities was undertaken during 2018/19 to ensure that the invested assets are as closely matched with the liability profile as possible, taking into consideration the expected duration of liabilities and whether they are fixed or index-linked in nature.

This resulted in a portion of index-linked gilts being sold and reinvested in nominal gilts to achieve a closer asset-liability match. At 31 March 2019, the Fund is 'cash flow matched' up to one year beyond the next actuarial valuation expected at 31 March 2020, and 'duration matched' liabilities beyond that. This is because there is greater certainty in the earlier period - funding levels will continue to be subject to the actuary's financial or demographic assumptions of future experience, which will be reassessed during 2020/21.



Investment movements

As the Scottish Homes Pension Fud is mature, it must sell assets to pay pensions. Cash or cash equivalents are held to enable pensions to be paid in between the dates when gilts redeem.

The Fund's assets have increased in value by 4.6% over the year, adjusted for cash flow movements to pay pensions, while a proxy for the value of liabilities increased by 4.4%, which suggests that the asset-liability match is quite effective.

Scottish Homes Pension Fund

Fund Account for year ended 31 March 2019

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

Restated 2017/18 £000		Note	2018/19 £000
	Income		
575	Contributions from the Scottish Government	*4*	-
-	Transfers from other schemes		-
575			**-**
	Less: expenditure		
6,666	Pension payments including increases		6,572
767	Lump sum retirement payments		591
4	Lump sum death benefits		5
47	Transfers to other schemes	*5*	129
(31)	Administrative expenses	*6b*	(19)
7,453			**7,278**
(6,878)	**Net withdrawals from dealing with members**		**(7,278)**
	Returns on investments		
2,474	Investment income	*7*	1,824
(1,615)	Change in market value of investments	*8, 11b*	5,767
(165)	Investment management expenses	*6c*	(84)
694	**Net returns on investments**		**7,507**
(6,184)	**Net increase/(decrease) in the Fund during the year**		**229**
170,644	**Net assets of the Fund at 1 April 2018**		164,460
164,460	**Net assets of the Fund at 31 March 2019**	*11*	**164,689**

Scottish Homes Pension Fund

Net Assets Statement as at 31 March 2019

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

31 March 2018 £000		Note	31 March 2019 £000
	Investment Assets		
148,064	Bonds - UK		158,743
9,094	Cash Deposits		3,650
4,904	Other investment assets		618
162,062			**163,011**
	Investment Liabilities		
-	Other investment liabilities		-
-			-
162,062	**Net investment assets**	***9***	**163,011**
	Current assets		
194	The City of Edinburgh Council	***17***	10
2,240	Cash balances	***12, 17***	1,741
12	Debtors	***15***	1
2,446			**1,752**
	Current liabilities		
(48)	Creditors	***16***	(74)
(48)			**(74)**
2,398	**Net current assets**		**1,678**
164,460	**Net assets of the Fund at 31 March 2019**	***11***	**164,689**

JOHN BURNS FCMA CGMA, PgC
Chief Finance Officer, Lothian Pension Fund

Note to the net asset statement

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

Notes to the Financial Statements

1 Statement of Accounting Policies

The statement of accounting policies for all Funds can be found on page 105.

2 Prior Year Adjustment

During the year, the Fund has changed its accounting policy in respect to the recognition of income received by the Fund from Scottish Government in relation to the administration of the Fund.

Previously this income was recognised within the employer contributions received by the Fund in relation to deficit funding. As the Scottish Homes Pension Fund now has a funding surplus no deficit funding is required and the Fund has reviewed its previous treatment. The administration charge is no longer recognised in employer contribution and is now recognised as income against the administrative expenses of the Fund.

	2017/18 Audited £000	Adjustment £000	2017/18 Restated £000
Contributions from the Scottish Government	675	(100)	575
Administrative expenses	(69)	100	31

3 Events after the Reporting Date

There have been no events since 31 March 2019, and up to the date when these Financial Statements were authorised, that require any adjustments to these Financial Statements.

4 Contributions from the Scottish Government

The Scottish Homes Pension Fund (SHPF) is a single employer pension fund for former employees of Scottish Homes (subsequently Communities Scotland) (and persons who were employed by the Scottish Special Housing Association, but who did not become employees of Scottish Homes). The City of Edinburgh Council was selected by the Scottish Executive to be the administering authority of a fund created prior to the wind up of the Scottish Homes Residuary Body and therefore became the administering authority of SHPF on 1 July 2005, pursuant to section 2(a)(1A) of The Local Government Pension Scheme (Scotland) Amendment (No. 2) Regulations 2005 (SSI 315/2005) (the 2005 Regs).

SHPF is a mature, non-active fund (that is, the fund has no contributions paid into it by active members but consists only deferred and pensioner members and therefore only pays money out to the pensioners).

Section 2 (1C) of the 2005 Regs stipulates that:
Where the actuary determines, after having regard to the existing and prospective liabilities of the fund, that additional funding is necessary to maintain the solvency of the fund (SHPF), then Scottish Ministers will make payments to the administering authority to maintain that solvency.

In this way, the Scottish Government acts as the 'Guarantor' for SHPF's liabilities, as confirmed in the Funding agreement, signed on behalf of the Scottish Executive and dated 6 July 2005.

As at the latest triennial actuarial valuation date of 31 March 2017, SHPF showed a funding surplus of £7.7million with a funding level of 104.7%, derived from a market valuation of assets of £170.6million and liabilities of £162.9million.

4 Contributions from the Scottish Government (cont)

Having implemented the investment strategy as required by the Funding Agreement, the assets of SHPF are invested entirely in low risk, index-linked gilts. With a funding surplus, the Scottish Government is not required to provide any contribution, but as Guarantor has the reponsibility to pay towards the administration expenses of the Fund estimated to be £70,000 per annm (for years 2018 to 31 March 2021.

In addition the Guarantor is responsible for meeting the cost of investment expenses . Given the Fund's surplus the Fund are comfortable that investment expenses can be met directly by the Fund until the next triannual valuation.

5 Transfers out to other pension schemes

	2017/18 £000	2018/19 £000
Group transfers	-	-
Individual transfers	47	129
	47	129

6a Total Management expenses

	Restated 2017/18 £000	2018/19 £000
Administrative costs	(31)	15
Investment management expenses	107	19
Oversight and governance costs	58	31
	134	65

This analysis of costs for the Scottish Homes Pension Fund has been prepared in accordance with CIPFA guidance. The analysis looks at the combined administration and investment management expenses in note 6b and c and splits out the costs to include a third heading covering oversight and governance expenditure.

6b Administrative expenses

	Restated 2017/18 £000	2018/19 £000
Employee costs	24	28
System costs	8	8
Actuarial fees	30	8
External audit fees	1	1
Printing and postage	2	2
Depreciation	1	1
Office costs	2	2
Sundry costs less sundry income	1	1
	69	51
Administration fee received	(100)	(70)
	(31)	(19)

LPFE, which is a wholly owned subsidiary of the Council, is responsible for providing the staffing resource to administer the pension funds. The Fund has a service level agreement in place with the Council for certain support services. Costs directly attributable to a specific Fund are charged to the relevant Fund, costs that are common to the two Funds are allocated on a defined basis.

Notes to the Financial Statements

6c Investment management expenses

	2017/18 £000	2018/19 £000
External management fees - deducted from capital (direct)	54	-
Transaction costs	30	2
Employee costs	31	44
Custody fees	7	6
Engagement and voting fees	2	2
Performance measurement fees	10	3
Consultancy fees	16	3
System costs	7	9
Legal fees	1	2
Office costs	2	2
Sundry costs less sundry income	5	11
	165	84

The Fund has not incurred any performance-related investment management fees in 2018/19 or 2017/18.

7 Investment income

	2017/18 £000	2018/19 £000
Income from fixed interest securities	1,449	1,749
Dividends from equities	799	-
Income from pooled investments - property	270	-
Interest on cash deposits and sundries	29	75
	2,547	1,824
Irrecoverable withholding tax	(73)	-
	2,474	1,824

8 Reconciliation of movement in investments

	Market value at 31 March 2018 £000	Purchases at cost £000	Sales & proceeds £000	Change in market value £000	Market value at 31 March 2019 £000
Bonds	148,064	54,948	(50,036)	5,767	158,743
Equities	-	-	-	-	-
Pooled investment vehicles	-	-	-	-	-
	148,064	54,948	(50,036)	5,767	158,743
Other financial assets / (liabilities)					
Cash deposits*	9,094			-	3,650
Investment income due/amounts payable*	4,904			-	618
	13,998			-	4,268
Net financial assets	162,062			5,767	163,011

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

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

Notes to the Financial Statements

8 Reconciliation of movement in investments (cont)

	Market value at 31 March 2017 £000	Purchases at cost £000	Sales & proceeds £000	Change in market value £000	Market value at 31 March 2018 £000
Bonds	127,970	33,345	(11,838)	(1,413)	148,064
Equities	28,221	932	(28,451)	(702)	-
Pooled investment vehicles	7,998	-	(8,621)	623	-
	164,189	34,277	(48,910)	(1,492)	148,064
Other financial assets / (liabilities)					
Cash deposits*	3,602			(123)	9,094
Investment income due/amounts payable*	459			-	4,904
	4,061			(123)	13,998
Net financial assets	168,250			(1,615)	162,062

** Per CIPFA disclosure guidance the change in market value intentionally does not balance opening/closing market values*

9 Investment managers and mandates

Manager	Mandate	Market value at 31 March 2018 £000	% of total 31 March 2018 %	Market value at 31 March 2019 £000	% of total 31 March 2019 %
In-house	High Div Equity	87	0.1	31	0.0
Total global equities		87	0.1	31	0.0
In-house	UK Index linked gilts	148,858	91.9	159,330	97.8
Total fixed interest and	**inflation linked bonds**	148,858	91.9	159,330	97.8
Schroders	Property	4,363	2.7	-	-
Total property		4,363	2.7	-	-
In-house	Cash	8,754	5.4	3,650	2.2
Total cash		8,754	5.4	3,650	2.2
Net financial assets		162,062	100.0	163,011	100.0

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

	Market value at 31 March 2018 £000	% of total 31 March 2018 %	Market value at 31 March 2019 £000	% of total 31 March 2019 %
UK Gov 2.5% Index Linked 16/04/20	12,309	7.5	11,619	7.1
UK Gov 4.25% 07/06/32	-	-	9,366	5.7
UK Gov 4.125% Index Linked 22/07/30	-	-	9,124	5.5
UK Gov 2.5% Index Linked 17/07/24	12,431	7.6	9,053	5.5
UK Gov 1.25% Index Linked 22/11/27	11,149	6.8	8,914	5.4
UK Gov 1.875% Index Linked 22/11/22	12,530	7.6	8,240	5.0
UK Gov 4.125% Index Linked 22/11/17	21,410	13.0	-	-
UK Gov 1.125% Index Linked 22/11/37	12,465	7.6	-	-

Notes to the Financial Statements

11 Financial Instruments

11a Classification of financial instruments

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

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

	31 March 2018			31 March 2019		
Financial assets	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000	Designated as fair value through fund account £000	Loans and receivables £000	Financial liabilities at amortised cost £000
Investment assets						
Bonds	148,064	-	-	158,743	-	-
Equities	-	-	-	-	-	-
Pooled investments	-	-	-	-	-	-
Cash	-	9,094	-	-	3,650	-
Other balances	-	4,904	-	-	618	-
	148,064	13,998	-	158,743	4,268	-
Other assets						
City of Edinburgh Council	-	194	-	-	10	-
Cash	-	2,240	-	-	1,741	-
Debtors	-	12	-	-	1	-
	-	2,446	-	-	1,752	-
Assets total	148,064	16,444	-	158,743	6,020	-
Financial liabilities						
Other liabilities						
Creditors	-	-	(48)	-	-	(74)
Liabilities total	-	-	(48)	-	-	(74)
Total net assets	148,064	16,444	(48)	158,743	6,020	(74)

Total net financial instruments	164,460		164,689

11b Net gains and losses on financial instruments

	2017/18 £000	2018/19 £000
Designated as fair value through fund account	(1,492)	5,767
Loans and receivables	(123)	-
Financial liabilities at amortised cost	-	-
Total	(1,615)	5,767

11c Valuation of financial instruments carried at fair value

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

Level 1

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

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

Level 2

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

Level 3

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

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

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

	31 March 2019			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
Investment assets				
Designated as fair value through fund account	-	158,743	-	158,743
Total investment assets	-	158,743	-	158,743
Investment liabilities				
Designated as fair value through fund account	-	-	-	-
Total investment liabilities	-	-	-	-
Net investment assets	-	158,743	-	158,743

11c Valuation of financial instruments carried at fair value (cont)

	31 March 2018			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
Investment assets				
Designated as fair value through fund account	-	148,064	-	148,064
Total financial assets	-	148,064	-	148,064
Investment liabilities				
Designated as fair value through fund account	-	-	-	-
Total financial liabilities	-	-	-	-
Net investment assets	-	148,064	-	148,064

12 Nature and extent of risk arising from financial instruments

Risk and risk management

The Fund's primary aim is to ensure that all members and their dependants receive their benefits when they become payable. As directed by Scottish Governemnt, after 31 March 2017 triennial valuation showed a funding level of 104.7%, the assets of the Fund were invested entirely in low risk gilts. In addition, the Fund ensures that sufficient cash is available to meet all liabilities when they are due to be paid.

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

Types of investment risk

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

Market risk also changes over time as economic conditions and investor sentiment change. The market risk of Scottish Homes Pension Fund has to some extent been mitigated. The Fund's assets have been matched to its liabilities as at the 31 March 2017 triennial valuation so interest rate risk has been minimised and as all assets held are valued in Pound Sterling no exchange risk occurs. A review of the asset matching of the Fund will next take place to coincide with the results of 31 March 2020 triennial valuation.

Sensitivity analysis

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

Asset type	Potential price movement (+ or -)
Index-Linked Gilts	11.2%
Cash	0.9%

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

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

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

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

	Value at 31 March 2019 £000	% of fund %	Potential Change +/- %	Value on increase £000	Value on decrease £000
Index-Linked Gilts	159,329	97.7	11.2	177,174	141,484
Cash	3,681	2.3	0.9	3,714	3,648
Total [1]	163,010	100.0	11.0	180,888	145,132
Total [2]			11.0	180,892	145,128
Total [3]			4.8	170,834	n/a

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

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

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

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

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

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

Credit risk

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

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

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

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

Cash deposits

At 31 March 2019, cash deposits represented £9m, 5.5% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2019	Balances at 31 March 2018 £000	Balances at 31 March 2019 £000
Held for investment purposes			
Northern Trust Company - cash deposits	A2	1,077	580
The City of Edinburgh Council - treasury management	See below	8,017	3,070
		9,094	3,650
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	2,240	1,741
Total cash		11,334	5,391

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

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

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

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

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

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

	Moody's Credit Rating at 31 March 2019	Balances at 31 March 2018 £000	Balances at 31 March 2019 £000
Money market funds			
Deutsche Bank AG, London	Aaa-mf	44	129
Goldman Sachs	Aaa-mf	-	2
Aberdeen Standard Sterling Liquidity Fund	Aaa-mf	-	706
Bank call accounts			
Bank of Scotland	Aa3	1,013	473
Royal Bank of Scotland	A3	37	19
Santander UK	Aa3	27	-
Barclays Bank	A1	1	-
Svenska Handelsbanken	Aa2	50	-
HSBC Bank PLC	Aa3	4	-
Notice accounts			
HSBC Bank PLC	Aa3	-	569
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa1	7,561	2,913
		8,737	4,811

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2018 was 'Aa1').

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

Refinancing risk

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

Liquidity risk

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

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

13 Actuarial statement

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

Notes to the Financial Statements

14 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £135m (2018 £134m). This figure is used for statutory accounting purposes by Scottish Homes Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end.

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

	31 March 2018 % p.a.	31 March 2019 % p.a.
Inflation/pensions increase rate	2.4%	2.5%
Discount rate	2.7%	2.4%

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements in line with the CMI 2016 model, assuming that the current rate of improvements has reached a peak and will converge to a long term rate of 1.75% p.a.. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	31 March 2018		31 March 2019	
	Males	Females	Males	Females
Current pensioners	22.4 years	24.8 years	22.4 years	24.8 years
Future pensioners (assumed to be currently 45)	24.8 years	27.8 years	24.8 years	27.8 years

Commutation assumption

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

15 Debtors

	31 March 2018 £000	31 March 2019 £000
Sundry debtors	12	1
	12	1

16 Creditors

	31 March 2018 £000	31 March 2019 £000
Benefits payable	3	73
Miscellaneous creditors and accrued expenses	45	1
	48	74

17 Related party transactions

The City of Edinburgh Council

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

17 Related party transactions (cont)

LPFE, which is a wholly owned subsidiary of the Council, is responsible for providing the staffing resource to administer the pension funds. The Fund has a service level agreement in place with the Council for certain support services. Costs directly attributable to a specific Fund are charged to the relevant Fund, costs that are common to the two Funds are allocated on a defined basis.

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

	31 March 2018 £000	31 March 2019 £000
Year end balance of holding account	194	10
	194	10

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2019, the fund had an average investment balance of £10.6m (2018 £6.3m). Interest earned was £74k (2018 £29k).

Year end balance on treasury management account	31 March 2018 £000	31 March 2019 £000
Held for investment purposes	8,011	3,070
Held for other purposes	2,240	1,741
	10,251	4,811

Fund Guarantor

The Fund guarantor (by definition) is a related party to the scheme. The Scottish Government's contributions to the Fund can be found in note 4 (page 89) of the notes to the Financial Statements.

LPFE Limited - staffing services

Staffing services are provided to Lothian Pension Fund for the purposes of administering the Funds under a intra-group resourcing agreement. The agreement also provides for the running costs of the company to be covered as part of a service charge and allows for the provision of staffing services to LPFI Limited. During the year to 31 March 2019, the Fund was invoiced £3,614k (2018 £1,450k) for the services of LPFE Limited staff.

Governance

As at 31 March 2019, all members of the Pensions Committee, with the exception of Richard Lamont, and all members of the Pension Board, were members of the Lothian Pension Fund. One member of both the Pensions Committee and the Pension Board are in receipt of pension benefits from Lothian Pension Fund.

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

17 Related party transactions (cont)

During the period from 1 April 2018 to the date of issuing of these accounts, the Fund was charged by City Of Edinburgh Councils via its service level agreement for time spent by its Executive Management team on pension fund issues. All other staff that held key positions in the financial management of Lothian Pension Fund were employed by LPFE Limited. Total compensation paid in relation to key management personnel employed by LPFE Limited during the period was as follows:

	31 March 2018 £000	31 March 2019 £000
Short-term employee benefits	415	567
Post-employment benefits - employer pension contributions	85	111

Key management personnel employed by LPFE, had accrued pensions totalling £120,245 (1 April 2018: £97,456) and lump sums totalling £132,375 (1 April 2018: £110,889) at the end of the period.

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

18 Contingent assets/liabilities

Request for direction by Scottish Ministers to transfer the assets and liabilities of Homeless Action Scotland from the Lothian Pension Fund to the Scottish Homes Pension Fund

On 24 January 2019, the Chief Finance Officer, Lothian Pension Fund, made a request for direction by Scottish Ministers that the assets and liabilities of Homeless Action Scotland (HAS) should be transferred from Lothian Pension Fund (LPF) to the Scottish Homes Pension Fund. HAS became an "Admitted Body" of Lothian Pension Fund when its predecessor (The Scottish Council for Single Homeless) was admitted in 1978, pursuant to Regulation B4(4) of the Local Government Superannuation (Scotland) Regulations 1974, being 'a body to whom a grant is made out of moneys provided by Parliament'. Since 1978, HAS accrued pension liabilities for the ongoing pension entitlements of the HAS employees admitted to membership of LPF. Following confirmation by HAS that it would be unable to meet the minimum contribution rate assessed at the actuarial valuation of 31 March 2017 (certified by LPF's actuary), LPF terminated HAS's admission to LPF with effect from 12 July 2018 in accordance with LPF's Funding Strategy Statement. Upon HAS becoming an exiting employer, LPF's actuary was instructed to calculate the liabilities that remained with LPF on cessation and the final contribution due from HAS, as required under Regulation 62(2) of the 2018 Regulations. The Actuary's cessation valuation is £641,000.

A response to the request for such direction is awaited from Scottish Ministers.

Guaranteed Minimum Pension (GMP)

Following The High Court ruling from 26 October 2016, all defined benefit pension schemes must equalise Guaranteed Minimum Pension (GMP) for men and women. There is insufficient basis to estimate reliably the amount to be recognised in the past service cost until actuaries complete their assessment of the impact and reflect it fully in the pension reports. The Funds actuary, Hymans Robertson LLP has advised that following discussions with the National Audit Office and other LGPS actuaries, the general expectation is that a 'trigger event' is yet to occur in the LGPS and their default approach is to ignore any GMP impact in the 31 March 2019 accounts.

18 Contingent assets/liabilities (cont)

Local Government Pension Scheme (Scotland) cost management update from Scottish Public Pensions Agency (SPPA)

In February 2019, the SPPA provided the Local Government Association (LGA) Secretariat with the following update for Scottish administering authorities:

As you are aware, the Public Service Pensions Act 2013 requires all public service pension schemes to undergo regular valuations, in addition to the regular fund valuations undertaken by LGPS fund actuaries. At the October meeting of the LGPSAB (Scheme Advisory Board) (Scotland), Government Actuary's Department (GAD) presented demographic assumptions which have been agreed. The UK Government and Scottish Ministers chose to allow certain exceptions which were designed to protect those closest to retirement from the impact of those reforms. As you will be aware, the Court of Appeal handed down judgment in the cases of McCloud and Sargeant on 20 December 2018: these age-related transitional arrangements were held to be discriminatory. It is anticipated that other public service pension schemes across the UK may be affected by this decision, including LGPS Scotland, notwithstanding that the nature of the comparable transitional arrangements implemented for local government pension schemes [statutory underpin] was slightly different from those adopted for the unfunded schemes. The judgment therefore has implications for post-reform members' benefits, and the UK Government is seeking permission to appeal to the Supreme Court. Meantime, the substantial impact of the judgment is such that it is impossible to assess with certainty the value of current public service pension arrangements.

On 30 January 2019 HM Treasury therefore announced in a Written Ministerial Statement that the UK Government intends to pause the 'cost cap' mechanism under the current round of scheme valuations, pending the final outcome of the appeal. As noted in the Ministerial Statement, if the UK Government is successful in its appeal, the cost cap process will resume. If unsuccessful, steps will need to be taken to compensate members who have been unfairly disadvantaged in the post reform schemes. Accordingly, the nature, and the timescale for implementation, of changes to the provisions of LGPS Scotland flowing from the actuarial valuation of the scheme for cost cap purposes being undertaken by the Government Actuary's Department (GAD) is not currently clear. We understand that changes which were scheduled to come into force this April in the England & Wales LGPS have been put on hold. We are liaising closely with HM Treasury and MHCLG on this matter. Meanwhile, GAD is progressing its valuation calculations only to the extent necessary at this stage, pending greater clarity on the legal position and the UK Government's consequent policy intent".

19 Contractual commitments

The Fund had no contractual commitments at the year end.

20 Impairment losses

No impairment losses have been identified during the year.

Scottish Homes Pension Fund

Actuarial Statement for 2018/19

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

Description of Funding Policy

The Administering Authority's Funding Strategy Statement (FSS), dated March 2018, states that a bespoke funding strategy has been adopted for the Fund.

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

As the Fund was well ahead of its Target Funding Level at the 2017 valuation, it took the decision to derisk its investment strategy and now invests 100% of its assets in index-linked gilts.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014 was as at 31 March 2017. This valuation revealed that the Fund's assets, which at 31 March 2017 were valued at £170.6 million, were sufficient to meet 104.7% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2017 valuation was £7.7 million.

The Guarantor's contributions for the period 1 April 2018 to 31 March 2021 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the 2017 valuation report.

Method

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

Assumptions

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

The key financial assumptions adopted for the 2017 valuation were as follows:

Financial assumptions	31 March 2017
Discount Rate	Bank of England nominal yield curve
Benefit increase assumption (CPI)	Bank of England implied (RPI) curve less 1.0% p.a.

Scottish Homes Pension Fund

Actuarial Statement for 2018/19

The key demographic assumption was the allowance made for longevity. The life expectancy assumption was based on the Fund's Vita Curves alongside future improvements 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.

Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	22.4	24.8
Future Pensioners *	24.8	27.8

*Aged 45 as at 31 March 2017

Copies of the 2017 valuation report and Funding Strategy Statement are available on request from the Administering Authority to the Fund.

Experience over the period since 31 March 2017

Since the last formal valuation, real bond yields have fallen placing a higher value on the liabilities but there have been positive asset returns over the 2 years. Both events are of broadly similar magnitude with regards to the impact on the funding position.

The next actuarial valuation will be carried out as at 31 March 2020. The Funding Strategy Statement will also be reviewed at that time.

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

26 April 2019

Statement of Accounting Policies and General Notes

1 Basis of preparation

The Financial Statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The Financial Statements summarise the transactions of the funds for the 2018/19 financial year and report on the net assets available to pay pension benefits as at 31 March 2019. The Financial Statements do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present values of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, are disclosed in the Notes to the Financial Statements.

2 Summary of significant accounting policies

General

a) Basis of consolidation

i) Group accounts

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

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

Further details of the consolidation are provided in the Notes to the Financial Statements of Lothian Pension Fund.

LPFE Limited (LPFE) and LPFI Limited (LPFI) are wholly owned by the City of Edinburgh Council in its capacity as administering authority for the Local Government Pension Scheme in the Lothian area.

The purpose of LPFE is to provide staff services in respect of management of the Fund. LPFI's purpose is to provide FCA regulated services to the Fund and other Local Government Pension Scheme funds. It is considered appropriate to consolidate the Financial Statements of the two companies with those of Lothian Pension Fund.

ii) Lothian Buses Pension Fund merger

At its meeting on 26 March 2018, the Pensions Committee approved the merger 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. Having received the necessary admission agreement and shareholder guarantees the Lothian Buses Pension Fund assets were merged into Lothian Pension Fund on 1 February 2019.

Section 2.5 of the Code states that 'The combination of two or more local authorities into one new authority, or the transfer of functions from the responsibility of one authority to another, shall be accounted for under the principles that apply to group reconstructions and shall be accounted for as either a transfer by absorption or a transfer by merger.' 'Transfers by merger are rare transactions but may occur when legal transfers take place and management of the local government entity consider that in substance for a true and fair presentation of the local government entity the financial statements would be best presented as if the entity had always existed in its newly combined form. The results and cash flows of all of the combining bodies (or functions) should be brought into the financial statements of the combined body from the beginning of the financial year in which the combination occurred…..'.

Specialist legal opinion had been sought prior to the merger of Lothian Buses Pension Fund. This concluded that "…Lothian Buses Pension Fund was set up as a 'further fund', within the meaning of the Local Government Superannuation (Funds) (Scotland) Regulations 1986 (the 'Funds Regulations')….At the time when the Admission Agreement was entered into, there was a clear mechanism under legislation whereby a 'further fund' could be dissolved and transferred back into the Main Fund." Also, "It is worth noting that, under the Admission Agreement…, Lothian Buses was admitted first of all to the Main Fund (immediately following which) the further Fund was set up". Accordingly, with such assurance that "the newly combined body or functions has always existed", the consolidation of Lothian Buses Pension Fund "sub-fund" into Lothian Pension Fund has been accounted for by the 'transfer by merger'.

Fund account - revenue recognition

b) Contribution income

Normal contributions, both from the members and from employers, are accounted for on an accruals basis at the rate certified by the Scheme Actuary in the payroll period to which they relate.

Similarly, employer deficit funding contributions are accounted for on the due date on which they are payable as certified by the Scheme Actuary.

Employers' pensions strain contributions are accounted for in the period in which the liability arises. Any amount due but unpaid will be classed as a current financial asset. Amounts not due until future years are classed as long-term financial assets.

c) Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the Fund during the financial year and are calculated in accordance with the Local Government Pension Scheme Regulations.

Individual transfers in/out are accounted for when received/paid, which is normally when the member liability is accepted or discharged.

Transfers in from members wishing to use the proceeds of their additional voluntary contributions to purchase scheme benefits are accounted for on a receipts basis and are included in transfers in.

Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

d) Investment income

i) Interest income

Interest income is recognised in the Fund accounts as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transaction costs or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.

ii) Dividend income

Dividend income is recognised on the date the shares are quoted ex-dividend. Any amount not received by the end of the reporting period is disclosed in the Net Assets Statement as a current financial asset.

iii) Distributions from pooled funds

Distributions from pooled funds are recognised at the date of issue. Any amount not received by the end of the reporting period is disclosed in the Net Assets Statement as a current financial asset.

iv) Income from unquoted private equity and infrastructure investments

Income from the above sources is recognised when it is notified by the manager. Distributions are split into capital and income elements with the latter being included under investment income in the Fund Account.

v) Property related income

Property-related income consists primarily of rental income. Rental income from operating leases on properties owned by Lothian Pension Fund is recognised on a straight-line basis over the term of the lease. Any lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

Rental income is reported gross with the operational costs of the properties included in investment management expenses.

Contingent rents based on the future amount of a factor that changes other than with the passage of time, such as turnover rents, are only recognised when contractually due.

vi) Movement in the net market value of investments

Changes in the net market value of investments (including investment properties) are recognised as income and comprise all realised and unrealised profits/losses during the year.

Fund Account - expense items

e) Benefits payable

Pensions and lump sum benefits payable include all amounts known to be due as at the end of the financial year. Any amounts due but unpaid are disclosed in the Net Assets Statement as current liabilities.

f) Taxation

i) Pension Funds

The Local Government Pension Scheme is a registered public service scheme under section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a fund expense as it arises.

ii) Controlled entities - LPFE and LPFI

The Companies are mutual traders and are therefore not liable to corporation tax on any surpluses generated from services provided in respect of the Fund. The tax charges for the period are based on any profit for the period from non-mutual trade, adjusted for any non-assessable or disallowed items. They are calculated using tax rates that have been enacted or are substantively enacted by the period end date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Financial Statements. No deferred tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is credited in the income statement except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred tax assets are recognised to the extent that it is probable that future profits will be available against which deductible temporary differences can be utilised.

The amount of benefit brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the economic entity will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

g) Administrative expenses

All administrative expenses are accounted for on an accruals basis. The Lothian Pension Fund is responsible for administering the two Funds. The costs include charges from LPFE and LPFI for services rendered. The Fund receives an allocation of the overheads of the Council, this is based on the amount of central services consumed. In turn, these costs are allocated to the two Funds.

Costs directly attributable to a specific fund are charged to the relevant Fund. Investment management costs that are common to all funds are allocated in proportion to the value of each Fund as at the end of the year. Other administration costs are allocated in proportion to the number of members in each of the Funds at the end of the year.

h) Investment management expenses

All investment management expenses are accounted for on an accruals basis.

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change. For some investment managers, an element of their fee is performance related. The amount of any performance related fees paid is disclosed in the note to the accounts on investment management expenses provided for each Fund.

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, it has been decided to recognise investment management costs that are deducted from the value of an investment and recognised this as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments.

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

The impact of this is that investment management costs deducted from any underlying fund in a "fund of funds" investment would not be included in the costs disclosed in the Fund Account. As this would significantly under-report investment management costs the decision has been made not to adopt this element of the CIPFA guidance. However, this type of cost is separately identified as "external management fees - deducted from capital (indirect)" in the notes on investment management expenses.

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are not treated as an expense. Such costs are accounted for as part of the acquisition costs or sale proceeds.

The cost of obtaining investment advice from external consultants is included in investment management charges.

The costs of the in-house investment management team are charged to the Fund. The basis of allocation is as described in section g.

Securities lending revenue is reported gross and their fees are disclosed in investment management expenses.

i) Operating lease

Lease payments under an operating lease are recognised as an expense on a straight-line basis over the term of the lease. In accordance with Standard Interpretations Committee (SIC) 15, subsequently endorsed by the International Accounting Standards Board (IASB), lease incentives are recognised as a reduction in the lease expense over the term of the lease on a straight-line basis.

Net Assets Statement

j) Financial assets

Financial assets are included in the Net Assets Statement on a fair value basis as at the reporting date. A financial asset is recognised in the Net Assets Statement on the date the Fund becomes party to the contractual acquisition of the asset. From this date, any gains or losses arising from changes in the fair value of asset are recognised by the Fund.

The values of investments as shown in the Net Assets Statement have been determined at fair value in accordance with the requirements of the Code and IFRS13. For the purposes of disclosing levels of fair value hierarchy, the Fund has adopted the classification guidelines recommended in Practical Guidance on Investment Disclosures (PRAG/Investment Association, 2016).

The basis of the valuation of each class of investment assets is set out below. There has been no change in the valuation techniques used during the year. All assets have been valued using fair value techniques which represent the highest and best price available at the reporting date.

Description of asset	Valuation hierarchy	Basis of valuation	Observable and unobservable inputs	Key sensitivity affecting the valuations provided
Market quoted investments - Equities	Level 1	Closing bid value on published exchanges	Not required	Not required
Exchange traded pooled investments	Level 1	Closing bid value on published exchanges	Not required	Not required
Future derivative contracts	Level 1	Determined using exchange prices at the reporting date. Amounts due from or owed to the broker are the amounts outstanding in respect of the initial margin and variation margin.	Not required	Not required

Description of asset	Valuation hierarchy	Basis of valuation	Observable and unobservable inputs	Key sensitivity affecting the valuations provided
Forward foreign exchange derivatives	Level 1	Based on market forward exchange rates at the year-end date and determined as the gain or loss that would arise if the outstanding contract were matched at the year-end with an equal and opposite contract.	Not required	Not required
Government bonds - fixed interest / index linked gilts	Level 2	Recorded at net market value based on their current yields.	Evaluated price feeds	Not required
Freehold and leasehold properties	Level 3	Valued at fair value at the year-end using the investment method of valuation by John Symes-Thompson FRICS of independent valuers, CBRE Ltd in accordance with RICS Valuation – Global Standards 2017	Existing lease terms and rentals. Independent market research. Nature of tenancies. Covenant strength for existing tenants. Assumed vacancy levels. Estimated rental growth. Discount rate	Significant changes in rental growth, vacancy levels or the discount rate could affect valuations as could more general changes to market price
Unquoted Pooled investments – Private Equity, Infrastructure, Timber, Private Secured Loans & Property	Level 3	Comparable valuation of similar companies in accordance with International Private Equity and Venture Capital Guidelines (2015)	EBITDA multiple Revenue multiple. Discount for lack of marketability. Control premium.	Valuations could be affected by material events occurring between the date of the financial statements provided and the Fund's own reporting date, by changes to expected cashflows, and by any differences between audited and unaudited accounts.

Sensitivity of assets valued at level 3

Having analysed historical data and current market trends, and consulted with independent investment advisers, the Fund has determined that the valuation methods described above are likely to be accurate to within the following ranges, and has set out below the consequent potential impact on the closing value of investments held at 31 March 2019.

Lothian Pension Fund Unquoted	Assessed Valuation range (+ or -)	Value at 31 March 2019 £m	Value on increase £m	Value on decrease £m
Private Equity	30%	76.1	98.9	53.3
Infrastructure	12%	844.9	946.3	743.5
Timber	18%	124.0	146.3	101.7
Private Secured Loans	7.5%	205.0	220.4	189.6
Property	13%	461.0	520.9	401.1
		1,711.0	1,932.8	1,489.2

Scottish Homes Pension Fund has no assets valued at Level 3.

k) Foreign currency transactions and balances

Dividends, interest and purchases and sales of investments in foreign currencies have been accounted for at the spot market rates at the date of the transaction. End-of-year spot market exchange rates are used to value cash balances held in foreign currency bank accounts, market values of overseas investments and purchases and sales outstanding at the end of the reporting period.

l) Cash and cash equivalents

Cash comprises cash in hand and demand deposits. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to minimal risk of changes in value.

m) Financial liabilities

The Fund recognise financial liabilities at fair value as at the reporting date. A financial liability is recognised in the Net Assets Statement on the date the Fund becomes party to the liability. From this date, any gains or losses arising from changes in the fair value of the liability are recognised.

n) Actuarial present value of promised retirement benefits

The actuarial present value of promised retirement benefits of each of the Fund is assessed on an annual basis by the Scheme Actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

As permitted under IAS26, the Fund have opted to disclose the actuarial present value of promised retirement benefits by way of a note to the Net Assets Statements.

o) Additional voluntary contributions

The Lothian Pension Fund and Lothian Buses Pension Fund provide an additional voluntary contributions (AVC) scheme for their members, the assets of which are invested separately from those of the Fund. The Fund has appointed Standard Life and Prudential as their AVC providers. AVCs are paid to the AVC providers by employers and are specifically for providing additional benefits for individual contributors. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year.

In accordance with regulation 5(2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 1998, AVCs are not included in pension fund financial statements. Details of contributions paid and the total value of funds invested are disclosed by way of note.

p) Contingent assets and contingent liabilities

A contingent liability arises where an event has taken place prior to the year-end giving rise to a possible financial obligation whose existence will only be confirmed or otherwise by the occurrence of future events. Contingent liabilities can also arise in circumstances where a provision would be made, except that it is not possible at the balance sheet date to measure the value of the financial obligation reliably.

A contingent asset arises where an event has taken place giving rise to a possible asset whose existence will only be confirmed or otherwise by the occurrence of future events.

Contingent assets and liabilities are not recognised in the Net Assets Statement but are disclosed by way of narrative in the notes.

q) Employee benefits

The employees of LPFE are eligible to participate in Lothian Pension Fund.

In the Consolidated Financial Statements, the current service cost for the period is charged to the Fund Account. The assets of Lothian Pension Fund are held separately from those of the Company. The Company has fully adopted the accounting principles as required by IAS19 – Employee Benefits.

The liability recognised in the Net Asset Statement in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognised past-service costs.

The defined benefit obligation is calculated annually, by the Scheme Actuary, using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in a currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligations.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the Fund Account in the period in which they arise.

Past-service costs are recognised immediately in the Fund Account, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

3 Accounting Standards that have been issued but not yet adopted

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This applies to the adoption of the following new or amended standards within the 2019/20 Code:

The Code requires implementation from 1 April 2019 and there is therefore no impact on the 2018/19 financial statements.

- Amendments to IAS 40 Investment Property: Transfers to Investment Property
- Annual Improvements to IFRS Standards 2014-2016 Cycle
- IFRIC 22 Foreign Currency Transactions and Advance Consideration
- IFIRC 23 Uncertainty over Income Tax Treatments
- Amendments to IAS 9 Financial Instruments

The amendments are generally minor or principally providing clarification. Overall, these new or amended standards are not expected to have a significant impact on the financial statements.

4 Critical judgements in applying accounting policies

Unquoted private equity and infrastructure investments

It is important to recognise the highly subjective nature of determining the fair value of private equity and infrastructure investments.

They are inherently based on forward-looking estimates and judgements involving many factors. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of IFRS.

For the Lothian Pension Fund, the value of unquoted private equity, infrastructure, timber and secured loan investments at 31 March 2019 was £1,250.0m (2018 £1,125.1m).

Actuarial present value of promised retirement benefits

Each Fund is required to disclose the estimated actuarial present value of promised retirement benefits as at the end of the financial year. These estimates are prepared by the Fund Actuary. These values are calculated in line with International Accounting Standard 19 (IAS19) assumptions and comply with the requirements of IAS26. However, the results are subject to significant variances based on changes to the underlying assumptions.

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

5 Assumptions made about the future and other major sources of estimation uncertainty

The Financial Statements contain estimated figures that are based on assumptions made by the Council; private equity and infrastructure managers; other providers of valuation information; and the Scheme Actuary about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because amounts cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the Net Assets Statement at 31 March 2019 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

a) Actuarial present value of promised retirement benefits

Uncertainties

Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on the Fund's assets. The Fund Actuary advises on the assumptions to be applied and prepares the estimates.

Effect if actual results differ from assumptions - Lothian Pension Fund

The effects on the net pension liability of changes in individual assumptions can be illustrated as follows:

Change in assumptions - year ended 31 March 2019	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in the real discount rate	11	1,004
1 year increase in member life expectancy	4	326
0.5% increase in salary increase rate	2	163
0.5% increase in pensions increase rate	8	773

Effect if actual results differ from assumptions - Scottish Homes Pension Fund

The effects on the net pension liability of changes in individual assumptions can be illustrated as follows:

Change in assumptions - year ended 31 March 2019	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in the real discount rate	5	7
1 year increase in member life expectancy	4	6
0.5% increase in pensions increase rate	5	7

b) Valuation of unquoted private equity and infrastructure investments

Uncertainties

These investments are not publicly listed and therefore there is a degree of estimation involved in their valuation, see 2j above for more details on the valuation methodology.

Effect if actual results differ from assumptions

There is a risk that these investments may be under or overstated in the accounts at any point in time. The actual financial return of this type of investment is only known with certainty when they reach the end of their lifecycles and the final distributions are made to investors. A sensitivity analysis can be found in note 2j above.

c) Quantifying the cost of investment fees deducted from capital

Uncertainties

Section 2 h) describes the accounting policy for investment management expenses in relation to expenses deducted from the capital value of investments. Quantification of these costs involves asking the relevant managers for information and only some of this information can be independently verified. In cases where the charges relate to an investment as a whole, an estimate needs to be made of the costs applicable to the holding owned by the relevant Fund.

Effect if actual results differ from assumptions

There is a risk that the cost of investment fees deducted from capital may be under or overstated. However, as the costs are included in the Fund Account by adjusting the change in market value of investments, any inaccuracy in the cost estimate will not change the reported net change in the Fund for the year.

Statement of responsibilities for the Annual Accounts

The responsibilities of the Administering Authority

The Administering Authority's responsibilities require it to:

- Make arrangements for the proper administration of the financial affairs of the Fund in its charge and to secure that one of its officers has the responsibility for the administration of those affairs. The Head of Finance serves as the Section 95 Officer for all the Council's accounting arrangements, including those of Lothian Pension Fund and Scottish Homes Pension Fund. For the Fund, this Section 95 responsibility has been delegated to the Chief Finance Officer, Lothian Pension Fund.
- Manage its affairs to secure economic, efficient and effective use of its resources and safeguard its assets.
- Ensure the Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014) and, so far as is compatible with that legislation, in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003).
- Approve the Audited Annual Accounts for signature.

HUGH DUNN
Head of Finance
The City of Edinburgh Council
26 June 2019

The responsibilities of the Chief Finance Officer, Lothian Pension Fund

The Chief Finance Officer, Lothian Pension Fund, is responsible for the preparation of the Fund's Financial Statements which, in terms of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 (the Code of Practice), is required to present a true and fair view of the financial position of the Fund at the accounting date and their income and expenditure for the year (ended 31 March 2019).

In preparing this statement of accounts, the Chief Finance Officer, Lothian Pension Fund, has:

- Selected suitable accounting policies and then applied them consistently
- Made judgements and estimates that were reasonable and prudent
- Complied with the Code of Practice.

The Chief Finance Officer, Lothian Pension Fund, has also:

- Kept proper accounting records which were up to date
- Taken reasonable steps for the prevention and detection of fraud and other irregularities.

The Statement of Accounts presents a true and fair view of the financial position of the Fund as at 31 March 2019, and their income and expenditure for the year ended 31 March 2019.

JOHN BURNS, FCMA CGMA PgC
Chief Finance Officer
Lothian Pension Fund
26 June 2019

Annual Governance Statement

Roles and responsibilities

The City of Edinburgh Council (the Council) has statutory responsibility for the administration of the Local Government Pension Scheme (LGPS) in the Lothian area of Scotland. This responsibility is for two separate funds: the Lothian Pension Fund and Scottish Homes Pension Fund (the Fund). The Lothian Pension Fund group comprises the investment and pensions team employed by LPFE Limited (LPFE) supporting the Council in its separate statutory capacity as the administering authority of the Fund (Administering Authority) and LPFI Limited (LPFI), the Group's regulated investment vehicle (together the LPF Group).

The main functions of the Administering Authority are administration of scheme benefits and the investment of the assets of the Fund. These functions are conducted in accordance with the Local Government Pension Scheme (Scotland) Regulations which are statutory instruments made under the Superannuation Act 1972. The role of Administering Authority is carried out via:

- the Pensions Committee and the Pensions Audit Sub-Committee
- the Pension Board
- the Joint Investment Strategy Panel; and
- the LPF Group.

Further details on the above arrangements can be found in the Governance section of the Management Commentary towards the front of this document.

Scope of responsibility

As the Administering Authority of the Fund, the Council is responsible for ensuring that its business in administering the Fund, is conducted in accordance with the law and appropriate standards, and that monies are safeguarded, properly accounted for, and used economically, efficiently and effectively. The Council also has a statutory duty under the Local Government in Scotland Act 2003, to make arrangements to secure best value, which is defined as continuous improvement in the way its functions are carried out.

In discharging these overall responsibilities, elected members, senior officers and external representatives are responsible for implementing effective arrangements for governing the affairs of the LPF Group, and facilitating the effective exercise of its functions, including arrangements for the management of risk. The Pensions Committee oversees the operational administration of the Fund by the LPF Group.

The LPF Group has adopted a Local Code of Corporate Governance that is consistent with the principles of the Chartered Institute of Public Finance and Accountancy (CIPFA) and Society of Local Authority Chief Executives (SOLACE) framework 'Delivering Good Governance in Local Government'.
This statement explains how the LPF Group has complied with the Local Code of Corporate Governance and how it meets the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom.

The governance framework

The LPF Group operates within the wider governance framework of the Council but within specific ringfenced governance structures focused on the Fund themselves. The governance framework comprises the systems, controls, processes, cultures and values by which the LPF Group directs and controls the Fund. It also describes the way the LPF Group engages with and accounts to its stakeholders in relation to the management of the administration of the Fund. It enables the LPF Group to monitor the achievement of its objectives and consider whether those objectives have led to the delivery of appropriate, cost-effective services. The framework also applies to any subsidiary companies which are members of the LPF Group, namely LPFI and LPFE. The LPF Group is also directly regulated by The Pensions Regulator, the Financial Conduct Authority (regarding its regulated investment activity), the Scottish Information Commissioner and is subject to other corporate and public sector rules and regulations.

The LPF Group's ongoing compliance with its governance framework and regulatory obligations is monitored on an ongoing basis by the Pensions Committee, the Audit Sub-Committee and the Pension Board and the respective boards of LPFI and LPFE.

The wider Council's Local Code of Corporate Governance is regularly reviewed and considered by the Governance, Risk & Best Value Committee. It has implemented arrangements for monitoring each element of the framework and providing evidence of compliance. The Council's Democracy, Governance and Resilience Senior Manager reviewed the arrangements and is satisfied that the Code continues to be adequate and effective. Internal Audit has also reviewed the annual assurance questionnaire process in relation to Arms-Length Companies and has found that this provides the Chief Executive Officer with a level of assurance on the adequacy of the governance arrangements. The Council's Corporate governance framework meets the principles of effective governance.

The LPF Group places reliance upon certain of the internal financial controls within the Council's financial systems and the monitoring in place to ensure the effectiveness of these controls. The relevant key elements of the LPF Group and the Fund governance framework within the Council, include:

- Identifying the objectives of the Fund in the Funding Strategy Statement, Statement of Investment Principles, Pension Administration Strategy and Service Plan.
- Since April 2015, The Pensions Regulator has been responsible for setting standards of governance and administration for the Local Government Pension Scheme. The LPF Group has taken steps to fully integrate compliance with these standards within the overall governance framework.
- A systematic approach to monitoring service performance by the Pensions Committee, Pensions Audit Sub-Committee, Pension Board (each including external stakeholder representation), Independent Professional Observer and senior officers.
- A structured programme to ensure that Pensions Committee and Pension Board members have the required standard of knowledge and understanding of Local Government Pension Scheme matters.
- Operating within clearly established investment guidelines defined by the Local Government Pension Scheme Investment Regulations and the Fund's Statement of Investment Principles.

- Compliance with the CIPFA Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme.
- With the exception of managed funds, unlisted investments and property, all investments are held under custody by a global custodian. The Fund benefits from the custodian's extensive internal control framework.
- Benchmarking of services in terms of standards and cost against other pension funds.
- LPFE and LPFI operating within their respective constitutional documentation and the relevant companies regulations.
- LPFI operating within the relevant governance policies and procedures to ensure compliance with the Financial Conduct Authority's rules, regulations and guidance.
- For LPF Group and Fund matters, the Pensions Committee, Pensions Audit Sub-Committee and Pension Board are responsible for scrutiny and challenge and a quarterly risk reporting process is in place to ensure full consideration of such matters.
- Officers of the LPF Group are managed separately through the processes and procedures of LPFE, overseen by its board of directors, with terms and conditions and a human resources performance review and management strategy tailored to the express needs of the Fund and their stakeholders.
- The directors of LPFE and LPFI have obligations to report to the Pensions Committee as the governing body for the Fund and Council in being the sole shareholder. In addition, the board and staff of LPFI are each individually regulated by the Financial Conduct Authority and so bound by the associated Principles and Standards of governance best practice.

Elements of the governance framework of the Council that are relevant to the LPF Group and Fund include:

- The Council is embedding a culture of commercial excellence to ensure that its services always deliver Best Value. That is ongoing and seeks to improve standards in buying practices and processes across the Council including, to the extent applicable, the LPF Group and the Fund which bear the cost of its operation and administration
- The submission of reports, findings and recommendations from the external auditor, other inspectorates and internal audit, to the Pensions Committee, Pensions Audit Sub-Committee for all matters affecting the LPF Group and Fund and, in certain circumstances strictly for Council wide oversight purposes, the Corporate Leadership Team, Governance, Risk and Best Value Committee and wider Council.
- The roles and responsibilities of Elected Members and Officers are defined in Procedural Standing Orders, Committee Terms of Reference and Delegated Functions, Contract Standing Orders, Scheme of Delegation to Officers, the Member/officer protocol and Financial Regulations. These are subject to annual review.
- The Chief Executive Officer has overall accountability to Council, for all aspects of operational management and overall responsibility for ensuring the continued development and improvement of systems and processes concerned with ensuring appropriate direction, accountability and control.

- The Section 95 Officer has overall responsibility for ensuring appropriate advice is given to the Council and the LPF Group on all financial matters, keeping proper financial records of accounts and maintaining an effective system of internal financial control. For the Fund, the Section 95 officer responsibility has been sub-delegated to the Chief Finance Officer of the LPF Group.
- The Chief Internal Auditor has overall responsibility to review, appraise and report to management and the Governance, Risk and Best Value Committee, and for matters relating to the LPF Group and Fund to the Pensions Committee and Pensions Audit Sub-Committee, on the adequacy of relevant internal control and corporate governance arrangements and on risks relating to approved policies, programmes and projects.
- The Council's Democracy, Governance and Resilience Manager, reporting to the Head of Strategy and Communications, has responsibility for advising the Council on corporate governance arrangements and supports the LPF Group on certain aspects of its governance arrangements.
- The Governance, Risk and Best Value Committee, and for LPF Group and Fund matters the Pensions Committee and Pensions Audit Sub-Committee, provides the Council with independent assurance of the adequacy of the governance and risk management frameworks and internal control environment. Also providing independent scrutiny of financial and non-financial performance, approving and monitoring the progress of the Internal Audit risk-based plan, and monitoring performance of the internal audit service.
- The risk management policy and framework set out the responsibilities of elected members, Governance, Risk and Best Value Committee, and for LPF Group and Fund matters the Pensions Committee and Pensions Audit Sub-Committee, management and staff for the identification and management of risks to corporate and service related priorities;
    - The Resources and Chief Executive's Risk Register and Council Risk Register all identify risks and proposed treatment and actions. These registers are regularly reviewed, updated and reported to the Corporate Leadership Team, which reviews Council-wide risk and reports to the Governance, Risk and Best Value Committee for scrutiny and challenge.
    - Resilience and business continuity plans are in place for all essential Council services. These set out arrangements for continuing to deliver essential services in the event of an emergency or other disruption.
    - Senior management and Heads of Service have formal objectives, with performance reviewed by the appropriate chief officer. Officers have personal work objectives and receive feedback on their performance through the Council-wide performance review and development process.
    - An Elected Members remuneration and expenses scheme is in place and is consistent with the Scottish Government's 'Councillors Remuneration: allowances and expenses – Guidance'. Information on the amounts and composition of elected members salaries, allowances and expenses is published on the Council's website.
    - The Council's Democracy, Governance and Resilience Senior Manager ensures that induction training on roles and responsibilities, and ongoing development opportunities, are provided for Elected Members. A separate policy on Pensions Committee and Pension Board member training has been adopted and is overseen by the LPF Group's officers.

- Mandatory training for Councillors newly appointed to the Pensions Committee is programmed within the Induction and Training programme for Elected Members. This focuses on governance, investment management and strategy and how the LPF Group and Fund work. Committee members are reminded of the requirement to undertake a minimum of 21 hours of training per financial year to fulfil their role on the Pensions Committee.
- Codes of Conduct, that set out the standards of behaviour expected from Elected Members and officers, are in place.
- The Employee Code of Conduct, Anti Bribery Policy and Policy on Fraud Prevention set out the responsibilities of officers and Elected Members in relation to fraud and corruption, and are reinforced by the Councillors' Code of Conduct, the Code of Ethical Standards and the Financial Regulations. The LPF Group has adapted policies to take into account the specific nature of its business and regulation.
- The Whistleblowing policy provides a process for disclosure in the public interest about the Council and its activities by officers, Elected Members and others. The LPF Group has an adapted policy to take into account the specific nature of its business and regulation.
- A Register of Members' Interests and Registers of Officers' interests are maintained and available for public inspection.

A significant element of the governance framework is the system of internal controls, which is based on an ongoing process to identify and prioritise risks to the achievement of the Council's objectives, including those relevant to the LPG Group and Fund. Following the establishment of the wholly-owned subsidiary companies, LPFE and LPFI, the Council continues to have appropriate assurance processes and procedures in relation to the responsible officers involved in the administration of those companies and so the wider LPF Group administering the Fund.

Review of Effectiveness

The Local Code of Governance details the Council's arrangements for monitoring each element of the framework and providing evidence of compliance. The Council's Governance and Democratic Services Manager has reviewed the effectiveness of the Code.

The Chief Internal Auditor has also provided an assurance statement on the effectiveness of the system of internal control. The opinion in the assurance statement states: "Internal Audit considers that significant enhancements are required to the LPF control environment and governance and risk management frameworks, and is raising a 'red' rated opinion, with our assessment towards the middle of this category."

In compliance with standard accounting practice, the Head of Finance, of the City of Edinburgh Council has provided the Chief Executive Officer with a statement of the effectiveness of the Group's internal financial control system for the year ended 31st March 2019. It is the Head of Finance's opinion that "… that although a degree of assurance can be placed upon the adequacy and effectiveness of the Group's systems of internal financial control, further improvements, including embedding of actions taken in response to previous recommendations, are still required.

In this context, I would particularly highlight improvements in train to address a number of systemic weaknesses in respect of payroll-related controls, including those to address historic, and prevent recurring, overpayments."

The Chief Finance Officer of the LPF Group has provided a statement of the effectiveness of the internal financial control system for the year ended 31st March 2019 for the Fund. It is the Chief Finance Officer's opinion "that reasonable assurance can be placed upon the adequacy and effectiveness of the system of internal financial control for the LPF Group in administering the Lothian Pension Fund and Scottish Homes Pension Fund".

Certification

It is our opinion, in light of the foregoing, that reasonable assurance can be placed upon the adequacy and effectiveness of the systems of governance that operate within the LPF Group in its administration of the Fund. We consider the governance and internal control environment operating during the financial year from 1 April 2017 to 31 March 2019 to provide reasonable and objective assurance that any significant risks impacting on the LPF Group and its ability to achieve its objectives in properly administering the Fund have and will continue to be identified and suitably proportionate actions have and will be taken to avoid or mitigate the impact of any such risks.

The LPF Group has identified certain key areas for improvement, summarised as follows:

- ICT: Continuing to engage with ICT service provider and the City of Edinburgh Council to monitor and drive improvements in the ICT services which the LPF Group receives, whilst in tandem continuing to assess the position around the LPF Group procuring a separate ICT provider to solely and independently service its specific ICT requirements in support of its strategic business plan.
- Human resources: To continue to implement the new human resources strategy specific to LPF Group's requirements.
- Pension Board: To ensure that vacancies in the Pension Board are filled timeously and by suitable candidates and that this body of external stakeholder representatives receives the training and support that it requires on an ongoing basis.
- Business continuity: To continue to assess and refresh the business continuity plan on an ongoing basis ensuring sufficient engagement with staff.
- Information governance: Having completed a full information governance compliance project prior to the implementation of new data protection laws on 25 May 2018, to continue to implement ongoing actions to ensure continuing best practice information governance and security within the LPF Group, including monitoring and engaging with third party suppliers where appropriate.
- Financial services regulatory compliance: To continue to instruct external compliance audits on the operations and governance of LPFI in order to ensure best practice compliance and assurance around its existing operations (and in preparation for its extended collaborative business model) and take action to address the recommendations from those audits on an ongoing basis.

- Wider governance: To continue to maintain and reinforce separate governance and controls specific to the needs of the LPF Group, the pensions funds it administers and its distinct duties to employer and member stakeholders; consistently throughout the LPF Group's governance structures. To ensure that oversight by the City of Edinburgh Council is supported in a manner consistent with these duties.

The LPF Group will continue to ensure that these are treated as a priority and that progress towards implementation will be reviewed through the governance structures and processes established for the LPF Group and summarised herein.

ANDREW KERR
Chief Executive Officer
The City of Edinburgh Council
26 June 2019

DR STEPHEN S MOIR
Executive Director of Resources
The City of Edinburgh Council
26 June 2019

DOUG HERON
Chief Executive Officer
Lothian Pension Fund
26 June 2019

Governance Compliance Statement

The Regulations that govern the management of Local Government Pension Scheme in Scotland require that a Governance Compliance Statement is published. This statement sets out the extent to which governance arrangements comply with best practice.

The statement below describes arrangements at 31 March 2019 and over the financial year.

Principle		Full Compliance	Comments
Structure	The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing Council.	Yes	The City of Edinburgh Council acts as administering authority and delegates all pension scheme matters to a committee of seven members (Pensions Committee) made up as follows: - Five City of Edinburgh Council elected members - Two external members, one drawn from the membership of the Fund and one drawn from the employers that participate in the Fund.
	That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	Yes	The Pensions Committee includes two external places for pension fund stakeholders i.e. one each from the employer and member representatives. Fund members and employers are also represented within the Fund's Pension Board. Membership includes five employer representatives and five member representatives. All members of the Pension Board are invited to attend the meeting of the Pensions Committee and receive the relevant papers prior to those meetings. Two members of the Pension Board attend the Pensions Audit Sub-Committee.

Principle		Full Compliance	Comments
Structure	That where a secondary committee or board has been established, the structure ensures effective communication across both levels.	Yes	The Pensions Audit Sub-Committee, consisting of three members of the Pensions Committee, report to the Pensions Committee on their findings and recommendations. Two members of the Pension Board attend the Pensions Audit Sub-Committee in a non-voting capacity. The Pension Board attends the Pensions Committee meetings and takes part in training events. Implementation of investment strategy is delegated to the Executive Director of Resources who then delegates to the Head of Finance, who takes advice from the Joint Investment Strategy Panel. The Panel meets quarterly and reports to the Pensions Committee annually. The advisers on the Joint Investment Strategy Panel consists of the Chief Investment Officer and on other portfolio manager of LPFI plus two experienced independent external industry advisers. The Pensions Committee receives annual updates from LPFE and LPFI.
Representation	That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include employing authorities (including non-scheme employers, e.g. admitted bodies) and scheme members (including deferred and pensioner scheme members).	Yes	The Pension Board consists of a mix of representatives: - Five employer representatives from non-administering authority employers; - Five member representatives appointed by the Trade Unions in accordance with the approach required under Scottish statute.
	Where appropriate, independent professional observers, and expert advisers (on an ad-hoc basis).	Yes	An Independent Professional Observer was appointed in March 2013 to help Committee scrutinise advice. This contract expired in February 2018 and a new Observer was appointed in September 2018.

Principle		Full Compliance	Comments
Representation	Where appropriate, independent professional observers, and expert advisers (on an ad-hoc basis).	Yes	As mentioned previously, external investment advisers sit on the Joint Investment Strategy Panel. A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the funds. A non-executive director was appointed to the board of LPFI on 7 February 2017 and LPFE on 19 March 2018. An external compliance consultant supports the LPF Group on its ongoing compliance with the Financial Conduct Authority rules, regulations and guidance.
	That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision-making process, with or without voting rights.	Yes	The Pension Board attends the Pensions Committee meetings to help ensure that the operation of the pension funds is in accordance with the applicable law and regulation. The Pension Board takes part in all Committee training events. The Pensions Committee takes account of the views of the Pension Board when making decisions.
Selection and Role of Lay Members	That committee or board members are made fully aware of the status, role and function that they are required to perform on either a main or secondary committee.	Yes	A comprehensive training programme including induction is in place. Members of the Pensions Committee and Pension Board are expected to attend no less than three days of training (21 hours) per year. The non-elected members confirm that they have read, signed and will abide by a Code of Conduct (specifically tailored for the Pensions Committee and Pension Board) prior to their appointment to those bodies. The elected members are required to read, sign and abide by the Councillors' Code of Conduct.

Principle		Full Compliance	Comments
Selection and Role of Lay Members	That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes	The declaration of members' interests is a standard item on the agenda for meetings of the Pensions Committee, Pensions Audit Sub-Committee and Pension Board. A Code of Conduct also applies to all members of the Pensions Committee and the Pension Board. The declaration of board members interest is a standard item on the agenda for the meetings for the LPFE and LPFI board meetings.
Voting	The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes	Five of the seven places of the Pensions Committee are held by elected members of the City of Edinburgh Council, which is required to retain a 2/3 majority in line with the Local Government (Scotland) Act 1973. The LPF Group's Nomination and Appointments Policy clearly documents how employer and member representatives will be elected to the Pensions Committee and Pension Board. LPFI and LPFE board members conduct meetings and other matters in accordance with their respective articles of association and shareholders' agreements.
Training / Facility Time / Expenses	a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	Yes	A Training and Attendance Policy is in place covering training requirements and reimbursement of expenses. The policy is available on the LPF Group's website www.lpf.org.uk. Board members and staff working for LPFI and LPFE also attend separate training for the purposes of their knowledge, understanding and (where appropriate) compliance with Financial Conduct Authority regulations.
	b) That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	Yes	The Training and Attendance Policy applies to both the Pensions Committee and the Pension Board. Advisers have their own professional development obligations.

Principle		Full Compliance	Comments
Training / Facility Time / Expenses	c) That the administering authority considers the adoption of annual training plans for committee and board members and maintains a log of all such training.	Yes	Each Pensions Committee and Pension Board member is expected to attend no less than three days training per year (21 hours) per year. Attendance at meetings and training is monitored and reported.
Meetings frequency	a) That an administering authority's main committee or committees meet at least quarterly.	Yes	The Pensions Committee meets at least four times a year.
	b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committees sits.	Yes	The Pensions Audit Sub-Committee is held before the Pensions Committee at least three times a year with further meetings held if necessary. The Joint Investment Strategy Panel meets quarterly or more frequently as required. The Pension Board attends all the Pensions Committee meetings and separately meets in advance of such meetings. Further meetings are held if necessary. The LPFE board now meet five time a year (in February, May, August, October and December) and the LPFI board at least quarterly.
	c) That an administering authority who does not include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Not applicable	
Access	That subject to any rules in the council's constitution, all members of main and secondary committees or boards have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	Pensions Committee papers and minutes are publicly available on the Council's website and all Pensions Committee and Pension Board members have equal access. Members of the Pensions Committee and Pension Board have equal access to the Independent Professional Observer who holds surgeries ahead of Committee meetings.

Principle		Full Compliance	Comments
Scope	That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The Pensions Committee deals with all matters relating to both the administration and investment of the Fund and the LPF Group. A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the Fund.
Publicity	That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes	Governance documents, policies and details of Pension Board membership are on the LPF Group's website. The LPF Group also communicates regularly with employers and scheme members.

ANDREW KERR
Chief Executive Officer
The City of Edinburgh Council
26 June 2019

DR STEPHEN S MOIR
Executive Director of Resources
The City of Edinburgh Council
26 June 2019

DOUG HERON
Chief Executive Officer
Lothian Pension Fund
26 June 2019

REMUNERATION REPORT

Remuneration Policy for Employees

Officers and employees of Lothian Pension Fund are employed by LPFE, an arms-length organisation owned by the City of Edinburgh Council, the administering authority for the Lothian Pension Fund. In recent years LPFE has been incorporated as a standalone entity to allow the Fund to compete with private sector investment management firms for recruitment and retention of skilled and experienced investment managers and analysts.

Operating this model allows Lothian Pension Fund to achieve significantly lower costs, and therefore improved net returns or lower investment risk, than would be possible by appointing private sector asset managers to invest the Fund's assets. The LPFE Board acts as a Remuneration Committee for officers and employees determining pay arrangements based on comparison to well-researched market benchmarks and performance against pre-agreed performance targets, and always linked to the principle of delivering value-for-money for the members of the Fund and their sponsoring employers.

Each year the Fund participates in a range of benchmarking exercises to measure operating costs and net investment returns against peers and indices relevant to the investment strategy, and this information is reported to the oversight bodies who review pay arrangements and terms of appointments of officers. Pay arrangements in LPFE reflect the market for investment expertise and recognise the qualifications and experience levels required to perform the roles and, more fundamentally, represent value-for-money for employee members and their sponsoring employers who bear the costs of operating the pension fund and securing retirement benefits.

Number of Employees by Pay Band

The numbers of employees whose remuneration during the year exceeded £50,000 were as follows:

Remuneration Bands	2017/18	2018/19	Remuneration Bands	2017/18	2018/19
£50,000 - £54,999	1	1	£95,000 - £99,999	1	1
£55,000 - £59,999	3	3	£100,000 - £104,999	1	2
£60,000 - £64,999	1	1	£105,000 - £109,999	-	2
£65,000 - £69,999	1	-	£110,000 - £114,999	-	-
£70,000 - £74,999	2	-	£115,000 - £119,999	-	-
£75,000 - £79,999	2	1	£120,000 - £124,999	-	-
£80,000 - £84,999	1	1	£125,000 - £129,999	-	1
£85,000 - £89,999	3	-	£130,000 - £134,999	-	4
£90,000 - £94,999	-	-			
			Total No. of Employees	16	17

During the year, the company introduced three variable pay schemes, two of which have vesting periods. The Portfolio Manager and Senior Management schemes entitle staff to receive an assessed percentage of their salary as an additional variable pay award if they meet certain objectives during the year. The assessment year runs from 1 February 2018 to 31 January 2019. The award then vests over three years.

The first part is payable at the end of the first year if the objectives are met and the remaining two parts are payable in the following two years if the requirement that the employee is still employed by the company at such time is met. Payment one has been made in January 2019. A liability has been raised at 31 March 2019 for the 2 months of service which the employees have delivered with regards to the second and third payments in the scheme.

Senior Employees Remuneration

The remuneration paid to the Fund's senior employees is as follows:

	Total Remuneration 2017/18	Salary, Fees and Allowances	Variable Remuneration	Total Remuneration 2018/19
Name and Post Title	**£000**	**£000**	**£000**	**£000**
Doug Heron, Chief Executive Officer (from February 2019)*	-	18	-	18
Clare Scott, Chief Executive Officer (to December 2018)**	101	80	-	80
Bruce Miller, Chief Investment Officer	96	106	26	132
John Burns, Chief Finance Officer	76	82	20	102
Struan Fairbairn, Chief Risk Officer (Head of Legal, Risk and Compliance)	76	81	19	100
	349	**367**	**65**	**432**

* Full time equivalent for 2018/19 £108,000

** Full time equivalent for 2018/19 £108,000

The senior employees detailed above have responsibility for management of the LPF group to the extent that they have power to direct or control the major activities of the group (including activities involving the expenditure of money), during the year to which the Remuneration Report relates, whether solely or collectively with other persons.

Senior officers of the City of Edinburgh Council are also fully remunerated via the Council and no additional remuneration is paid by the Fund. This remuneration is disclosed in the Financial Statements of the City of Edinburgh Council.

Senior Employees Pension Entitlement

Pension benefits for employees are provided through the Local Government Pension Scheme.
For employees the Local Government Pension Scheme became a career average pay scheme on 1 April 2015. Benefits built up to 31 March 2015 are protected and based on final salary. Accrued benefits from 1 April 2015 will be based on career average salary.

The Scheme's normal retirement age for employees is linked to the State Pension Age (with a minimum of age 65).

From 1 April 2009, a five-tier contribution system was introduced with contributions from Scheme members being based on how much pay falls into each tier. This is designed to give more equality between the cost and benefits of scheme membership. Prior to 2009, contributions rates were set at 6% for all non-manual employees.

The tiers and members' contribution rates for 2018/19 were as follows:

Pensionable Pay (2018/2019)	Rate (%)
On earnings up to and including £21,300 (2017/2018 £20,700)	5.5%
On earnings above £21,300 and up to £26,100 (2017/2018 £20,700 to £25,300)	7.25%
On earnings above £26,100 and up to £35,700 (2017/2018 £25,300 to £34,700)	8.5%
On earnings above £35,700 and up to £47,600 (2017/2018 £34,700 to £46,300)	9.5%
On earnings of £47,600 and above (2017/2018 £46,300)	12%

If a person works part-time, their contribution rate is worked out on the whole-time pay rate for the job, with actual contributions paid on actual pay earned.

There is no automatic entitlement to a lump sum. Members may opt to give up (commute) pension for lump sum up to the limit set by the Finance Act 2004.

The value of the accrued benefits has been calculated on the basis of the age at which the person will first become entitled to receive a pension on retirement without reduction on account of its payment at that age; without exercising any option to commute pension entitlement into a lump sum; and without any adjustment for the effects of future inflation.

The pension figures shown relate to the benefits that the person has accrued as consequence of their total local government service, and not just their current appointment.

The pension entitlement of the LPF Group's senior employees is as follows:

	In-year Pension Contributions			Accrued Pension Benefits	
	2017/18	2018/19		As at 31 March 2019	Increase from 31 March 2018
Name and post title	**£000**	**£000**		**£000**	**£000**
Doug Heron, Chief Executive Officer (from February 2019)	-	4	Pension	-	-
			Lump Sum	-	-
Clare Scott, Chief Executive Officer (to December 2018)	21	19	Pension	23	3
			Lump Sum	14	1
Bruce Miller, Chief Investment Officer	20	27	Pension	29	7
			Lump Sum	28	7
John Burns, Chief Finance Officer	16	21	Pension	41	7
			Lump Sum	78	12
Struan Fairbairn, Chief Risk Officer (Head of Legal, Risk and Compliance)	16	21	Pension	10	2
			Lump Sum	-	-
Total	**73**	**92**			

Exit Packages

Exit packages include compulsory and voluntary redundancy costs, pension contributions in respect of added years, ex-gratia payments and other departure costs. There was no payment of any exit packages in 2018/19 or in the previous year.

All information disclosed in the above tables at paragraphs in this Remuneration Report has been audited. The other sections of the Remuneration Report have been reviewed by the appointed auditor to ensure that they are consistent with the annual accounts.

Remuneration for Councillors on the Pensions Committee

Councillors on the Pensions Committee are remunerated by the City of Edinburgh Council, no additional remuneration is paid by the Fund.

ANDREW KERR
Chief Executive Officer
The City of Edinburgh Council
26 June 2019

DR STEPHEN S MOIR
Executive Director of Resources
The City of Edinburgh Council
26 June 2019

JOHN BURNS
Chief Finance Officer
Lothian Pension Fund
26 June 2019

Additional information

Key documents online

You can find further information on what we do and how we do it, on our website at www.lpf.org.uk. To view individual policy documents, click on the links below if viewing online or visit www.lpf.org.uk/publications.

- Actuarial Valuation reports
- Pension Board constitution
- Annual Report and Accounts
- Statement of Investment Principles
- Pension Administration Strategy
- Communications strategy
- Funding Strategy Statement
- Service Plan
- Training and attendance policy

Fund advisers

Actuaries:	Hymans Robertson LLP, Exchange Place One, 1 Semple Street, Edinburgh, EH3 8BL
Bankers:	Royal Bank of Scotland, 36 St Andrew Square, Edinburgh, EH2 2YB
Investment consultancy:	Gordon Bagot and Scott Jamieson
Investment custodians:	The Northern Trust Company, 50 Bank Street, Canary Wharf, London, E14 5NT
Investment managers:	Details can be found in the notes to the accounts.
Additional Voluntary Contributions (AVC) managers:	Standard Life, Standard Life House, 30 Lothian Road, Edinburgh, EH1 2DH Prudential plc, 1 Angel Court, London, EC2R 7AG
Property valuations:	CB Richard Ellis Limited, St Martin's Court, 10 Paternoster Row, London, EC4M 7HP
Solicitors:	Lothian Pension Fund In-house

Comments and suggestions

We appreciate your comments and suggestions on this report. Please let us know which sections you found useful and if you have any suggestions for items to be included in the future. Please email your comments to pensions@lpf.org.uk.

Accessibility

You can get this document on tape, in Braille, large print and various computer formats on request. Please contact the Interpretation and Translation Service (ITS) on 0131 242 8181 and quote reference number 00819. The ITS can also give information on community language translations.

Contact details

If you would like further information about Lothian Pension Fund and Scottish Home Pension Fund, please contact us the details on the back page if this report.

LOTHIAN PENSION FUND

pensions@lpf.org.uk

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Lothian Pension Fund, Atria One, 144 Morrison Street, Edinburgh EH3 8EX

The City of Edinburgh Council

Statement on the system of internal financial control

1. This statement is given in respect of the internal financial controls operated by The City of Edinburgh Council. As the Council's designated section 95 officer as defined under the provisions of the Local Government (Scotland) Act 1973, I acknowledge my responsibility for ensuring that an appropriate system of internal financial control is in place and its on-going effectiveness regularly reviewed.

2. The system of control can provide reasonable, but not absolute, assurance that material control weaknesses or irregularities do not exist, and that there is no unacceptable risk of material error, loss, fraud or breach of legislation. Consequently, the Council continually seeks to improve the effectiveness of its systems of internal control so that irregularities are either prevented or detected within an acceptable period of time. Tracking of agreed internal audit actions forms a standing item on Corporate Leadership and Senior Management Team agendas, with progress in implementation also regularly reported to the Governance, Risk and Best Value Committee.

3. In view of recent staffing reductions and various resulting changes in responsibilities, the self-attestation exercise undertaken early in 2018 was helpful in assessing the extent to which previous improvements had been embedded within service areas, highlighting a need for further action in some areas to implement and sustain the required controls. This exercise has subsequently been complemented, within the Resources Directorate, by quarterly Service Performance and Assurance meetings at which progress in implementation of agreed actions is also considered.

4. The effectiveness of the Council's internal financial control framework as a whole is subject to annual review by its external auditors, with the principal findings of the most recent annual assessment reported to the Governance, Risk and Best Value Committee in August 2018. While noting some opportunities for improvement and a need, in some cases, to embed previously-agreed actions, this assessment concluded that the system of internal financial control was well-designed.

5. The Internal Audit section operates in accordance with the Chartered Institute of Public Finance and Accountancy's United Kingdom Public Sector Internal Audit Standards. The Section undertakes an annual programme based on an agreed audit strategy. The plan is based on formal assessments of risk and audit needs which are reviewed regularly to reflect evolving risks and changes within the Council. During 2018/19, the section reported to the Head of Legal and Risk. It also has, however, unfettered access to the Chief Executive, Executive Directors, Heads of Service (including the Head of Finance) and elected members of the Council when required.

6. The Chief Internal Auditor will present her annual audit opinion on the adequacy and effectiveness of the system of internal control (including financial controls) to the Governance, Risk and Best Value Committee in August 2019. While showing a degree of improvement on the equivalent assessment for 2017/18, this opinion, based on internal audit work undertaken during the year, is expected to highlight an on-going need for enhancements to the control environment and associated governance and risk management frameworks. The required control improvements

implicit in this opinion will be examined and any corresponding required actions (as they relate to financial systems) implemented as a matter of urgency.

7. The existing system of internal financial control is based on a framework of regular management information, financial rules and regulations, administrative procedures (including segregation of duties), management supervision and a scheme of delegation and accountability. The system is maintained and developed by Council management and includes:

- comprehensive budgeting systems;
- preparation and regular review of periodic reports that measure actual financial performance against budgeted net expenditure. An internal audit review of the Council's savings development and monitoring processes undertaken in 2016/17 noted a number of areas of good practice, with no recommendations for improvement made. I am conscious, nonetheless, of a significant subsequent reduction in the proportion of service-specific savings delivered and have put in place arrangements both to provide additional project management resource for more material and/or transformational savings projects and strengthen more general officer and elected member scrutiny at the proposal inception, development and implementation stages;
- agreement of targets against which financial and operational performance can be assessed. Key amongst these financial targets is the achievement of a balanced Council-wide outturn, with the provisional year-end position for 2018/19 showing that net expenditure has been maintained within budgeted levels for the twelfth successive year;
- clearly-defined capital and other expenditure guidelines communicated to services and set out in the Finance Rules which were refreshed in July 2018. The Financial Regulations were also reviewed and minor amendments to their content approved in June 2018;
- an approved long-term financial strategy and plan, updates in respect of which are regularly discussed at CLT and reported to the Finance and Resources Committee, with the next such update planned for consideration on 15 August 2019;
- formal project management disciplines as supported and promoted through the Strategy and Communications section, including senior Finance representation on all major project boards and assurance review panels; and
- formal governance arrangements operated within both subsidiary and associated companies, complemented by a strengthened Council observer role and consolidation and active consideration by senior Council officers of a consistent suite of key operational documentation for its principal companies. Service Level Agreements are also in place for finance-related services provided to a range of external bodies.

8. My review of the effectiveness of the internal financial control system is informed by:

- assurance certificates on internal control received from all Executive Directors of Council, service areas and relevant service heads;
- regular senior management-level consideration of progress in implementing internal audit recommendations, including self-attestation of previous actions where relevant;
- governance arrangements in place for subsidiary and associated companies and an ongoing assessment of the effectiveness of these arrangements;
- the work of managers within the Council;

- the work of internal audit; and
- external audit reports, in particular the independent annual report on the Council's financial statements and internal control framework.

9. The Council's financial management arrangements conform with the governance requirements of the CIPFA Statement on the Role of the Chief Financial Officer (2014) as set out in the Application Note to Delivering Good Governance in Local Government Framework, an opinion confirmed as part of recent external audit scrutiny. Having reviewed the framework, it is therefore my opinion that although a degree of assurance can be placed upon the adequacy and effectiveness of the Group's systems of internal financial control, further improvements, including embedding of actions taken in response to previous recommendations, are still required. In this context, I would particularly highlight improvements in train to address a number of systemic weaknesses in respect of payroll-related controls, including those to address historic, and prevent recurring, overpayments.

10. I have overseen the improvements put in place in response to Finance-specific recommendations made by internal and external audit work during the year, with none outstanding at this time. This said, the extent of change and reduction in overall resources underpinning the Council's Transformation Programme has reinforced the importance of robust, documented and well-understood procedures for key system controls and, in light of the follow-up audits undertaken by both internal and external audit, a priority continues be to consolidate these improvements, identify any further required actions and gain necessary assurance by regularly assessing their effectiveness.

11. As noted in Paragraph 7 above, a combination of anticipated shortfalls in approved savings delivery and residual unmitigated pressures within services threaten to compromise the stability of the budget framework. To this end and in recognition of the seriousness of the situation without the taking of further urgent action, I reported to the Finance and Resources Committee on 23 May 2019, highlighting the extent of further required savings in the current year and more fundamentally emphasising the need for service transformation, improved demand management and ultimately service prioritisation if the Council’s financial sustainability is to be secured. I will therefore bring back to the Committee’s next meeting on 15 August potential measures to address this position.

Hugh Dunn
Head of Finance
13 June 2019

Annual Report 2019
of
Lothian Pension Fund
and
Scottish Homes Pension Fund

"Statement on the system of internal financial control

for the year ended 31 March 2019"

Section 95 of the Local Government (Scotland) Act 1973 states that "every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the authority has responsibility for the administration of those affairs". The Head of Finance serves as the Section 95 Officer for all of the Council's accounting arrangements, including those of the Lothian Pension Fund and Scottish Homes Pension Fund. For the Pension Funds, however, this Section 95 responsibility has been delegated to the Chief Finance Officer, Lothian Pension Fund.

In compliance with standard accounting practice, the Chief Finance Officer, Lothian Pension Fund, is required to provide the Chief Executive with a statement of the effectiveness of the internal financial control system of the Funds for the year ended 31 March 2019.

The Funds place reliance upon the internal financial controls within the City of Edinburgh Council's financial systems and the monitoring in place to ensure the effectiveness of these controls. Accordingly, the "Statement on the system of internal financial control" by Hugh Dunn, Head of Finance, City of Edinburgh Council, dated 13 June 2019, refers.

Within this overall control framework, specific arrangements for the Lothian Pension Fund and Scottish Homes Pension Fund are detailed in the Annual Governance Statement. These include:

- identifying the objectives of the Funds in Funding Strategy Statement, Statement of Investment Principles and Service Plan;
- a systematic approach to monitoring service performance by the Pensions Committee, Pensions Audit Sub-Committee, senior officers and stakeholders, including the Pension Board and Independent Professional Observer;
- a structured programme to ensure that Pension Committee members have the required standard of knowledge and understanding of Local Government Pension Scheme matters;
- operating within clearly established investment guidelines defined by the Local Government Pension Scheme Investment Regulations and the Funds' Statements of Investment Principles;
- compliance with the CIPFA Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme;
- with the exception of managed funds, unlisted investments and property, all investments are held under custody by a global custodian. The Funds benefit from the custodian's extensive internal control framework;
- benchmarking of services in terms of standards and cost against other Local Government Pension Scheme funds;
- LPFE and LPFI operating within their respective constitutional documentation and the relevant company regulations;

- LPFI operating within the relevant governance policies and procedures to ensure compliance with the Financial Conduct Authority regulations

The Chief Internal Auditor has provided an "Internal Audit Annual Report and Opinion for the year ended 31 March 2019", in accordance with the requirement set out in the Public Sector Internal Audit Standards. This opinion, based on internal audit work undertaken during the year, concludes that "the LPF control environment and governance and risk management frameworks are generally adequate but with enhancements required." Requisite actions are being progressed to secure such control improvements, including affirmation as to the ongoing integrity of supplier systems.

It is my opinion, therefore, that reasonable assurance can be placed upon the adequacy and effectiveness of the system of internal financial control for the LPF Group in administering the Lothian Pension Fund and Scottish Homes Pension Fund.

John Burns, FCMA CGMA, PgC
Chief Finance Officer,
Lothian Pension Fund

13 June 2019