

Pensions Committee

11.00am, Wednesday, 27 September 2017

Statement of Investment Principles

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Executive/routine	
Wards	All
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Executive Summary

This report introduces the revised Statement of Investment Principles (SIP) for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund (the Funds). It replaces the SIP agreed by Committee in June 2016.

Statement of Investment Principles

1. Recommendations

Committee is requested to:

- 1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider; and
- 1.2 Adopt the revised Statement of Investment Principles.

2. Background

- 2.1 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 require administering authorities to prepare, maintain and publish a written Statement of Investment Principles.

3. Main report

- 3.1 The Statement of Investment Principles (SIP) is formally reviewed annually whether there are policy changes or not. The amendments described in this paper are reflected in the draft SIP in Appendix 1, which the Pensions Committee is recommended to adopt.
- 3.2 Several changes have been made. Most notably, the strategic allocations and investment management structures of the three Funds have been updated and are shown in Appendix A of the SIP.
- 3.3 Another material change is the addition of paragraph 4.7 which relates to internal management and collaboration. This clarifies the Pensions Committee's focus on achieving value for money for the Funds' stakeholders and is discussed separately below under "Investment Management Structure and Collaboration".
- 3.4 The draft SIP also incorporates expanded wording on the Funds' approach to incorporating environmental, social and governance (ESG) issues into the Funds' investment processes (paragraphs 5.7 and 6.1- 6.7).
- 3.5 Additional wording setting out the Funds' fiduciary duty to members and employers has also been included in paragraphs 3.1 and 6.1 (and the removal of reference to taxpayers in paragraph 6.2) following legal opinion on fiduciary duty, prepared by Pinsent Masons and issued as guidance to Scottish Local Government Pensions Scheme (LGPS) Funds by the Scottish LGPS Advisory Board in June 2016.

- 3.6 Expanded wording on management and monitoring of investment risks has also been included in paragraphs 5.5 and 5.6.
- 3.7 Other revisions to the SIP are minor and are proposed to clarify pre-existing text.

Strategic Allocations

- 3.8 Lothian Pension Fund manages two investment strategies which provide employers with access to a level of risk appropriate to their individual circumstances. Most employer liabilities are funded by Investment Strategy 2012-17 (Strategy 1). The strategy is diversified across a range of assets but the majority of investments are in growth assets, including equities. Employer liabilities accounting for less than 1% of the Fund are funded by a gilts-only strategy (Strategy 2), which invests entirely in UK index-linked gilts to reduce risk for these employers.
- 3.9 As part of the 2017 actuarial valuation, the Fund is assessing the feasibility of introducing further strategy options and will be consulting with employers on potential changes to the Funding Strategy Statement. The potential introduction of further strategies will be reported to Pensions Committee as part of the actuarial valuation results later in 2017 or early 2018.
- 3.10 The Long-Term Strategy 2012-17 (Strategy 1) for Lothian Pension Fund, initially approved by Pensions Committee in October 2012 and reaffirmed in December 2015 remained unchanged since the last review of the SIP. There were small adjustments to the interim strategy allocations as the Fund gradually implements the long-term strategy over the five years from 2012-2017. Strategy 2 has remained unchanged since the last review of the SIP.
- 3.11 For Scottish Homes Pension Fund, the strategic allocation has been updated in line with its strategy, which adjusts the Fund asset allocation as the funding level changes. As the funding level improved over the year, the equity allocation was progressively reduced in stages to end the year at 17.5% as of 31 March 2017 compared to 30.0% at the previous year-end.
- 3.12 Implementation of the Scottish Homes Pension Fund strategy was also changed over the year. During March 2017, assets previously managed by State Street were transferred to be managed internally. The bond portfolios were re-structured to improve cash-flow matching of the pension assets with future liability payments, and the equity assets were re-invested to improve income generation.
- 3.13 For Lothian Buses Pension Fund, the long-term strategic allocation (approved by Pensions Committee in March 2016) remains unchanged since the last review of the SIP. There have been small adjustments to the interim strategy allocations as the Fund gradually implements the long-term strategy over the five years from 2016 to 2021.

Investment Management Structure and Collaboration

- 3.14 On 1 November 2016, new regulations took effect for the Local Government Pension Scheme (LGPS) in England and Wales, replacing the requirement for a Statement of Investment Principles (SIP) with a new Investment Strategy Statement (ISS).

- 3.15 The ISS requirements, which are not applicable to the LGPS in Scotland, largely replicate the previous SIP requirements in England and Wales, with one significant exception: there is an additional requirement to include details of each Fund's approach to pooling investments.
- 3.16 Official guidance issued by the Department of Communities and Local Government (DCLG) on the new pooling requirement states that "authorities must commit to a suitable pool to achieve benefits of scale". By increasing scale through the pooling of assets and resources, the UK Government assumes that the LGPS will be able to negotiate reduced investment fees on *externally managed* assets, resulting in lower investment management costs, and access investment opportunities unavailable to small funds and/or those funds without relevant expertise.
- 3.17 The majority of the investments of the Funds administered by the City of Edinburgh Council are managed internally by an experienced in-house investment team, which delivers significant ongoing cost savings relative to external management, but external managers are used where in-house options are not available.
- 3.18 The Pensions Committee has long recognised that there are benefits from scale and benefits from the alignment of interests of an in-house team. Its collaboration with Falkirk Council Pension Fund has been mutually beneficial and the recent creation of the Joint Investment Strategy Panel for the two funds should bring further benefits. Further collaboration with other LGPS funds, particularly in infrastructure and other private market investment, should enable the Lothian Funds to benefit from increased scale and cost-sharing arrangements.
- 3.19 While a specific statement on pooling is not required for Scottish LGPS funds, the underlying drivers behind the requirement - value for money, cost benefits through shared resourcing and access to investment opportunities – are. The additional wording in section 4 of the draft SIP is therefore included to reflect the Committee's ongoing focus on value for money for the Funds' stakeholders, which manifests itself in the Funds' investment structure.

4. Measures of success

- 4.1 Success of the investment strategies will, among other things, be measured by the achievement of the investment and funding objectives of the Funds.

5. Financial impact

- 5.1 There is no financial impact arising from this report. However, the investment strategy of the pension funds has a material influence on the financial cost of the pension fund to the participating employers.
- 5.2 The revisions to the SIP (on investment risks, ESG issues, and internal management and collaboration) reflect the approaches and investment structures currently in place.

6. Risk, policy, compliance and governance impact

- 6.1 The Statement of Investment Principles details how the risks, compliance and governance aspects of the Funds are managed. Such a statement is required under the Local Government Pension Scheme Regulations. Appendix D of the Statement sets out how the Funds comply with the CIPFA principles.

7. Equalities impact

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

8. Sustainability impact

- 8.1 The Statement sets out the Funds' approach to responsible ownership and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with the Statement is expected to contribute to the sustainability of the Funds' investments.

9. Consultation and engagement

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

10. Background reading/external references

- 10.1 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010

<http://www.lgpsregs.org/timelineregs/scot/maninvst/SSI20100233/20100233.htm>

Scottish LGPS Advisory Board – Guidance on Fiduciary Duty, June 2016

<http://lgpsab.scot/fiduciary-duty-guidance/>

LGPS Regulations and Guidance, including The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Amendment Regulations 2016

<http://www.lgpsregs.org/index.php/scotland/sppa-circulars>

The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Amendment Regulations 2016 – SPPA Policy Note

http://www.legislation.gov.uk/ssi/2016/74/pdfs/ssipn_20160074_en.pdf

LGPS in Scotland, Government Compliance Statements Guidance – November 2010

<http://www.sppa.gov.uk/Documents/Local%20Government/Useful%20Resources/Consultations/2010/Draft%20Governance%20Compliance%20Guidance%2001.11.10.pdf>

Stephen S. Moir

Executive Director of Resources

Contact: Bruce Miller, Chief Investment Officer, Lothian Pension Fund

E-mail: bruce.miller@edinburgh.gov.uk | Tel: 0131 469 3866

11. Appendices

Appendix 1 – Statement of Investment Principles, which includes:

Appendix A – Investment Strategies

Appendix B – Statement of Compliance with UK Stewardship Code

Appendix C – Compliance with the CIPFA Principles for Investment Decision Making in the Local Governance Pension Scheme

LOTHIAN PENSION FUND, LOTHIAN BUSES PENSION FUND and SCOTTISH HOMES PENSION FUND (“the Funds”)

STATEMENT OF INVESTMENT PRINCIPLES (September 2017)

1. Introduction

- 1.1 This Statement of Investment Principles was agreed by the Pensions Committee of the City of Edinburgh Council on 27 September 2017.
- 1.2 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 require administering authorities to prepare, maintain and publish a written Statement of Investment Principles (SIP). The SIP must be reviewed from time to time and revised within six months of any material changes in the Policy. In preparing this statement, the Committee has taken professional advice from the Investment Strategy Panel, which includes external advisers.

2. Governance

- 2.1 The City of Edinburgh Council (CEC) is the administering authority for the Lothian Pension Fund, the Lothian Buses Pension Fund and Scottish Homes Pension Fund (“the Funds”).
- 2.2 The Pensions Committee (“the Committee”) of the City of Edinburgh Council has delegated responsibility for the supervision of the Funds.
- 2.3 This SIP sets out the principles governing decisions about the investments of the Funds. The Committee recognises the importance of environmental, social and corporate governance (“ESG”) issues and that these can materially impact the financial performance of the companies and investments in which the Funds invest.
- 2.4 The SIP forms part of a framework that includes
- The Statutory Regulations
 - The Pensions Committee
 - The Pension Board
 - The Investment Strategy Panel
 - The Funds’ Advisors
 - The Funds’ Funding Strategy Statement.

3. Investment Objectives & Benchmarks

- 3.1 The Funds' fiduciary duty is to its members and employers.
- 3.2 The primary aim of the Funds is to ensure that all members and their dependants receive their benefits when they become payable.
- 3.3 The funding objectives for each Fund are documented in the Committee's Funding Strategy Statement.
- 3.4 The Committee sets the investment strategies for each Fund, taking into account the funding status and liabilities. The strategies are subject to regular review. Details of each Fund's strategic asset allocations are provided in Appendix A.
- 3.5 In order to provide suitable investment strategies for differing requirements of employers, Lothian Pension Fund currently operates two investment strategies. Most employer liabilities are funded in Strategy 1, which invests in a diversified portfolio of assets. Employers (with the exception of Transferee Admitted Bodies) that are close to leaving the Fund are funded in Strategy 2, which invests in a portfolio of UK index linked gilts to reduce investment risk for these employers. These employers account for less than 1% of the Fund's liabilities.
- 3.6 There may also be demand from individual employers for other investment strategies for their section of the Fund. The Fund will consider such requests subject to practical implementation of such strategies and, if appropriate, a review of employer contribution rates. It is not practical for the Fund to offer individual employers full flexibility on asset allocation.
- 3.7 The Lothian Pension Fund **Strategy 1** adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer.
- 3.8 The Lothian Pension Fund **Strategy 2** adopts a lower risk approach for some employers (typically those which have a short expected duration in the Fund) and invests in index-linked government bonds to reduce the degree of short-term change in funding level and employer contribution rates.
- 3.9 The investments in Lothian Pension Fund Strategy 1, Lothian Buses Pension Fund and Scottish Homes Pension Funds are assessed relative to a benchmark, but success is also measured in terms of income generation and the volatility of absolute performance. The investment objectives of the Lothian Pension Fund Strategy 1, Lothian Buses Pension Fund and Scottish Homes Pension Funds are to achieve the same return as the strategic allocation over the long term economic cycle (typically five years or more). Over shorter periods, the Funds should perform better than the strategic allocation if markets fall significantly. The investment objective of Lothian Pension Fund Strategy 2 is to invest in low risk assets that reduce the funding level fluctuations to a very low level.

4. Investment Management Structure

- 4.1 The Funds employ a combination of managers and mandates with the aim of delivering, in aggregate, the objectives of each Fund. Each Fund employs different types of managers and mandates depending on the requirements of the Fund.
- 4.2 The Fund recognises that there are cost and alignment advantages from investing the majority of the Funds' assets via its in-house investment team. The internal investment team also manage transitions and specialist transition managers can be employed to manage more complex changes in investment strategy and/or manager(s) if required.
- 4.3 To reduce the risk that a Fund does not deliver its objective, performance and risk targets and controls are set for each manager relative to its benchmark. For external managers, the details are included in formal Investment Management Agreements; similarly, internal mandates have formal objectives and constraints. Both external and internal managers' risk and return are measured by an independent performance measurement specialist. Performance and mandate implementation is also monitored by the Investment Strategy Panel on a regular basis.
- 4.4 The investment managers are responsible for the selection of individual holdings within each type of investment category within the parameters set out in their agreement.
- 4.5 The selection of external investment managers complies fully with European Union directives on competitive tendering.
- 4.6 Details of the Funds' investment managers are provided in Appendix A.
- 4.7 Collaborating with other investors also provides opportunities for further cost benefits for the Funds and other investors, benefiting from increased scale and cost sharing arrangements. Financial Conduct Authority approval has been obtained to enable the Funds to more effectively collaborate with other investors, while supporting other institutional pension funds in accessing investment markets on a more cost-effective basis.

5. Underlying Investments

Types of Investment

5.1 The Committee has approved the use of the following different types of investment and income generating mechanisms to achieve their overall investment objectives:

- Listed and Unlisted Equities (including Managed Funds, Unit Trusts, Investment Trusts, Open Ended Investment Companies and Exchange Traded Funds);
- Bonds (including Index-Linked and Fixed Interest Bonds, issued by governments, government-related entities and corporations);
- Alternative investments (including Infrastructure, Property, Timber, Agriculture, Currency, Private Debt and other asset classes as agreed by the Investment Strategy Panel);
- Cash (including Treasury Bills, Money Market Funds and Secured Investments);
- Derivatives;
- Stock lending;
- Commission recapture;
- Underwriting.

The Balance between Different Types of Investments & Risks

5.2 The Committee sets investment strategy for each Fund, taking into account funding status and liabilities. The strategies are subject to regular review. The Executive Director of Resources, with advice from the Investment Strategy Panel, implements the investment strategy, including mandate design and investment manager appointments.

5.3 Asset liability modelling techniques, which aim to measure the funding level risk of the Funds relative to their liabilities, are used to assist in the strategy reviews, as appropriate.

5.4 The Funds seek to manage risk by investing in a diverse range of investments, within and across asset classes, or in assets that will reduce funding level fluctuations to a low level when liabilities are mature.

5.5 The risk of the Funds performing differently to their objectives and benchmarks is monitored using an independent performance and risk specialist. The Investment Strategy Panel and Committee also monitors the Funds' investment risk on a quarterly basis.

5.6 Specific investment risks, including (but not limited to) price/volatility, interest rate, currency, concentration, liquidity and credit risks, are reviewed and managed, at Fund, portfolio and individual mandate level, as appropriate, by the internal investment team and the Funds' external managers on an ongoing basis. The Investment Strategy Panel and Committee also consider and review these risks as part of regular monitoring.

- 5.7 Consideration of environmental, social and governance (“ESG”) risks is also integrated into the investment process, as the Committee recognises that these can materially impact financial risk and the prospective returns for the Funds. Further detail on the management and monitoring of ESG risks is provided under section 6 on Responsible Investment.

Expected return on investments

- 5.8 Each Fund expects its investments to produce a return over the long term above that of the investment return assumed in the actuarial valuation.

Realisation of investments

- 5.9 The majority of the Funds’ investments are in liquid markets and can be expected to be realised relatively quickly if required. A proportion of the Funds’ investments (such as property, private equity, private debt and infrastructure) have less or limited liquidity and would therefore take longer to be realised. The overall liquidity of each Fund’s assets is considered in the light of potential demands for cash.

Stock Lending

- 5.10 The Funds lend a proportion of their investments in order to maximise additional income. Stock lending is conducted within the parameters prescribed in the regulations. Stock lending does not prevent any investments from being sold. Safeguards are in place to reduce the risk of financial loss in the event of default. These safeguards include receiving liquid collateral in excess of the value of the loan, indemnity agreement with the lending agent and regular reviews of credit-worthiness of potential borrowers.

Safekeeping of Assets

- 5.11 The services of a global custodian are employed to ensure the safekeeping of investments.

Performance measurement

- 5.12 An independent provider is employed to calculate performance for the Funds. Each quarter, the Investment Strategy Panel considers the performance of the combined assets and each manager’s portfolio against their respective benchmarks and objectives.

6. Responsible Investment

- 6.1 The Funds’ policy on responsible investment stems from its fiduciary duty to its members and employers, which is clarified by a legal opinion on the responsibilities of Scottish Pension Funds (available at the Scottish Local Government Pension Scheme’s Advisory Board website¹).

- 6.2 The Committee believes that it has a responsibility to take environmental, social and governance (“ESG”) issues and risks seriously and where appropriate, to act upon them in a manner which is consistent with the paramount fiduciary duty to provide the highest standards of stewardship of the Funds’ investments.

Integration of ESG factors into investment process

- 6.3 As a signatory to the United Nations Principles for Responsible Investment, the Funds are obliged to incorporate ESG issues into investment analysis and decision-making processes.
- 6.4 A specialist third party is used for dedicated research to identify ESG risks and opportunities (including, but not limited to, climate change risk) at individual company level. These measures aim to enhance the integration of ESG factors into the Funds' investment process.
- 6.5 The Funds' external managers are also selected and appointed after due consideration of their approach to integrating ESG considerations into their investment processes. Their activities, including scrutiny of how ESG considerations are incorporated into investment decisions, are monitored on a regular basis.

Voting and Engagement

- 6.6 The Committee also believes that responsible investment involves exercising its right to vote the shares that it owns, and that it should also involve active engagement with companies. Consequently, the Funds do not follow a policy of exclusion or automatic divestment, as such a policy has the potential to transfer ownership rights to investors without responsible investment policies.
- 6.7 To ensure that these issues are addressed appropriately, the Funds use a specialist third party to assist with voting and engagement activities for the shares that the Fund holds. The Funds are also active members of the Local Authority Pension Fund Forum (LAPFF), which engages with companies on behalf of the majority of Local Government Pension Schemes across the UK.
- 6.8 The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting. As long term investors, the Funds recognise the importance of promoting responsible stewardship and long term decision making. The Funds seek to adhere to the FRC'S UK Stewardship Code, and encourage our appointed asset managers to do so too. Details of adherence to the Code are provided in Appendix B.

1 <http://lgpsab.scot/wp-content/uploads/2016/06/Letter-to-Funds-on-Fiduciary-Duty.pdf/>

7. Compliance

Regulations and Investment Limits

- 7.1 The Funds are compliant with the statutory restrictions set out in the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 and the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Amendment Regulations 2016.

The Regulations contain limits on the percentage of a pension fund that may be invested in certain asset types and provide for the limits to be raised, subject to certain requirements being met. The Committee have agreed the limits applicable to the Funds' investments in partnerships be raised in order to accommodate the allocation to unlisted investments, including infrastructure, timber, property, equity and debt. The limits agreed by Committee are:

- All contributions to any single partnership 5% (which compares with the statutory maximum of 5%)
- Contributions to all partnerships be raised from 15% to 20% (which compares with the statutory maximum of 30%)

The Committee took proper advice in respect of these limits from the Investment Strategy Panel and from officers. The limits will apply for the period during which the Funds' strategic allocations include investments in partnerships, unless investment considerations require an earlier review. This decision is compliant with the Regulations.

CIPFA Principles for Investment Decision Making

- 7.2 Regulations require administering authorities to publish the extent to which they comply with guidance issued by the Scottish Ministers, which in turn refer to guidance issued by Chartered Institute of Public Finance and Accountancy ("CIPFA"). The Funds' compliance statement is provided in Appendix C.

8. Review

- 8.1 The Committee will review this statement annually or more frequently if appropriate. The Committee will consult with such persons as it considers appropriate and take proper advice when revising the statement.

Lothian Pension Fund

Investment Strategy 1

	Interim Strategy 1 April 2017 (%)	Long Term Strategy 2012-2017 (%)	Permitted Range (%)
Total Equities	66	65	50 – 75
Index-Linked Assets	7	7	0 – 20
Alternatives	26.5	28	20 – 35
Cash	0.5	0	0 – 10
TOTAL	100	100	

There were small changes to the Interim Strategy over the year to 1 April 2016 with a small reduction in Equities (-1%) and Cash (-0.5%) and an increase in Alternatives (+1.5%). The Long Term Strategy, initially agreed by Committee in October 2012 and reaffirmed in December 2015, is being implemented gradually, subject to financial market developments. The Long Term Strategy is expected to be reviewed in 2018 post the 2017 Actuarial Valuation.

Investment Management Structure at 1 April 2017

- 5 Global Equity Mandates (external: Nordea, Harris; internal: Global Low Volatility, Global Value, Global High Dividend Yield)
- 4 Regional Equity Mandates (internal: UK All Cap, UK Mid Cap, US and Europe ex-UK)
- 1 Private Equity Mandate (internal: invests in a range of direct funds, fund-of-funds and listed vehicles)
- 1 Index-Linked Asset Mandate (internal: UK Index-Linked Gilts)
- 1 Property Mandate (external: Standard Life)
- 1 Real Assets Mandate (internal: invests in a range of direct funds, fund-of-funds and listed vehicles invested in infrastructure and timber)
- 1 Other Bonds Mandate (internal: invests in a range of direct debt funds and listed sovereign and corporate bonds)
- 1 Currency Mandate (internal: hedges currency exposure of overseas equities to reduce volatility of returns)
- 1 Cash Mandate (managed alongside City of Edinburgh Council cash)

Investment Strategy 2

A lower-risk, gilts-only strategy with a 100% allocation to UK index linked gilts (internally managed). This is primarily to reduce the degree of short-term change in funding level and employer contribution rates in the period prior to an employer leaving the Fund.

The breakdown of assets by manager is provided in the Fund's Annual Report & Accounts which can be found at www.lpf.org.uk.

Lothian Buses Pension Fund

Investment Strategy

	Interim Strategy 1 April 2017 (%)	Long Term Strategy 2016-2021 (%)	Permitted Range (%)
Equities	57	40	+/- 10 Interim Strategy
Index-Linked Assets	15	20	+/- 10 Interim Strategy
Other Real Assets	18	18	+/- 10 Interim Strategy
Other Debt Assets	10	22	+/- 10 Interim Strategy
Cash	0	0	0 – 15
TOTAL	100	100	

Long Term Strategy agreed by Committee in March 2016 will be implemented gradually, subject to financial market developments.

Investment Management Structure at 1 April 2017

- 2 Global Equity Mandates (internal: Global High Dividend Yield; external: Baillie Gifford Global Alpha)
- 1 Listed Private Equity Mandate (internal: listed funds)
- 1 Index Linked Gilts Mandate (internal: UK Index-Linked Gilts)
- 1 Property Mandate (external: Standard Life pooled fund)
- 1 Real Assets Mandate (internal: invests in a range of direct funds, fund-of-funds and listed vehicles invested in infrastructure and timber)
- 2 Fixed Income Assets Mandates (external: Baillie Gifford corporate bond pooled fund; and internal: invests in a range of direct debt funds and listed sovereign and corporate bonds)
- 1 Cash Mandate (managed alongside City of Edinburgh cash)

The breakdown of assets by manager is provided in the Fund’s Annual Report & Accounts which can be found at www.lpf.org.uk.

Scottish Homes Pension Fund

Investment Strategy

Committee approved a change to the investment strategy in December 2014 whereby the equity and bond allocations will be adjusted depending on the funding level in accordance with the following table, subject to review and consideration of market conditions and other factors.

Equity Allocation %	Funding level	Note [1]
35	89.5%	2011 TFL
30	91.5%	2014 TFL
25	93.0%	2017 TFL
20	94.5%	2020 TFL
15	95.5%	2023 TFL
10	96.5%	2026 TFL

[1] Target Funding Level as per the Guarantee

The strategy at 1 April 2017 is shown in the table below.

	Strategy at 1 April 2017 %
Equities	17.5
Bonds	77.5
Property	5.0
Cash	0.0
TOTAL	100.0

Investment Manager Arrangements at 1 April 2017

- 1 Global Equity Mandate (internal: Global High Dividend Yield)
- 1 Bond Mandate (internal: UK Index-Linked Gilts)
- 1 Property Mandate (external: Schroders pooled fund)

The breakdown of assets by manager is provided in the Fund's Annual Report & Accounts which can be found at www.lpf.org.uk.

Statement of Compliance with UK Stewardship Code

<p>Principle 1 Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.</p>	<p>We acknowledge our role as an asset owner under the Stewardship Code and therefore seek to hold to account our fund managers and service providers in respect of their commitments to the Code.</p> <p>In practice our policy is to apply the Code through</p> <p>a) The appointment of Hermes Equity Ownership Services (EOS) to assist in fulfilling our fiduciary responsibilities as long term shareholders. We believe that the monitoring of shareholdings by Hermes EOS enables us to provide the highest standards of stewardship on behalf of the beneficiaries of the pension funds.</p> <p>Hermes EOS has the expertise in corporate engagement to carry forward this work on an international basis. Their aim is to bring about positive long-term change at companies through a focussed and value-oriented approach.</p> <p>Engagements undertaken by Hermes EOS on our behalf are guided by the Hermes Responsible Ownership Principles http://www.hermes.co.uk/Portals/8/The_Hermes_Ownership_Principles_UK.pdf</p> <p>Besides engagement on an individual company level, through Hermes EOS, we also work to establish effective regulatory regimes in the various markets in which we invest to encourage governance structures that facilitate accountability of companies to their owners, give companies the certainty they need to plan for the future and to level the playing field to ensure companies are not disadvantaged for prioritising long-term profitability.</p> <p>b) As well as Hermes EOS, Baillie Gifford takes direct responsibility for stewardship issues, including voting and engagement, in the funds which it manages on our behalf. Baillie Gifford has published its own Statement of Compliance with the Stewardship code.</p> <p>Details are available at:- https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code/UK-Stewardship-Code-statements.aspx</p> <p>c) Through our membership of the Local Authority Pension Fund Forum (LAPFF), we keep informed of potential issues of concern at both individual companies and across the market as a whole, which leads to collaborative engagement.</p>
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Statement of Compliance with UK Stewardship Code

<p>Principle 2 Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.</p>	<p>Our relationship with Hermes EOS enables us to manage conflicts of interest effectively in relation to our stewardship work. Hermes EOS conflicts of interest policy, which explains how it manages conflicts on our behalf, can be found at http://hermes.yellowtailcms.co.uk/Portals/8/Conflicts_of_interest_policy.pdf.</p> <p>We also encourage the asset managers employed by the Funds to have effective policies addressing potential conflicts of interest.</p> <p>In respect of conflicts of interest within the Funds, Pensions Committee members are required to make declarations of interest prior to Committee meetings.</p> <p>Our policy of constructive engagement with companies is consistent with the Funds' fiduciary responsibilities.</p>
<p>Principle 3 Institutional investors should monitor their investee companies.</p>	<p>Day-to-day responsibility for monitoring our equity holdings is delegated to Hermes EOS and Baillie Gifford. We expect them to monitor companies, intervene where necessary, and report back regularly on activity. Details are provided quarterly on the Funds' website. This includes both the total number of company meetings where the Funds have voted and details of individual companies where we have voted against company management.</p> <p>The internal team also monitors its investee companies regularly, on an ongoing basis.</p> <p>LAPFF also monitors and engages with companies and provides an 'Alerts' service which highlights concerns over corporate governance issues.</p> <p>The internal investment management team adhere to the Funds' compliance policy on insider information. In order to foster a positive working relationship with an individual company and to build trust, Hermes EOS may be willing to become an insider. In such circumstances, the relevant information will not be passed to the internal team until after it is no longer inside information.</p>

Statement of Compliance with UK Stewardship Code

<p>Principle 4 Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.</p>	<p>As highlighted above, responsibility for day-to-day interaction with companies is delegated, including the escalation of engagement when necessary.</p> <p>We expect the approach to engagement on our behalf to be value orientated and focussed on long term sustainable profitability. We expect Hermes EOS and Baillie Gifford to disclose their guidelines for such activities in their own statements of adherence to the Code.</p> <p>The internal team also monitors investee companies and escalates engagement activity directly with investee companies as required.</p> <p>We may also propose escalation of activity through the Local Authority Pension Fund Forum.</p> <p>Consistent with our fiduciary duty to beneficiaries and in order to encourage improved conduct in future, we consider participating in shareholder litigation where it appears likely that the Fund will recover losses (net of costs) sustained because of inappropriate actions by company directors.</p>
<p>Principle 5 Institutional investors should be willing to act collectively with other investors where appropriate</p>	<p>We seek to work collaboratively with other institutional shareholders in order to maximise the influence that we can have on individual companies. We do this through:</p> <ul style="list-style-type: none"> - membership of the Local Authority Pension Fund Forum, which engages with companies over environmental, social and governance issues on behalf of its members. - the appointment of Hermes EOS also signals our commitment to the benefits of collective shareholder engagement. Hermes EOS pools together investors' resources to create an engagement service which aims to protect and enhance shareholder value. Hermes EOS represents us at many national, regional and global conferences through which we seek to enhance our effectiveness by working collaboratively with other institutions, including legislators, regulators and industry bodies. Hermes EOS seeks to work with institutions and alongside other individual investors to effect change most efficiently. - being a signatory of the PRI in our own right. - being a signatory since 2009 to the Carbon Disclosure Project (CDP) Information Request. The information gathered by CDP forms the largest database of corporate climate change information in the world.

Statement of Compliance with UK Stewardship Code

<p>Principle 6 Institutional investors should have a clear policy on voting and disclosure of voting activity.</p>	<p>The emphasis of our voting policy is to promote best practice. We seek to vote on all shares held. The Funds have an active stock lending programme but consider recalling stock from a loan where it appears that this would be an appropriate way to safeguard the Funds' financial interests.</p> <p>Our preference is for managers to vote on the Funds' behalf and for responsible stewardship to be integral to the investment decision making process.</p> <p>We are comfortable with delegation of voting to Baillie Gifford for the funds they manage. The managers' voting policies can be found at the websites mentioned above.</p> <p>For the remaining funds, Hermes EOS votes consistently, across the portfolios it covers, and makes voting decisions based on a thorough analysis of publicly available information and always take account of a company's individual circumstances. Hermes EOS informs companies where it has concerns and seeks a resolution prior to taking the decision to vote against management. In this way, it uses our votes as a lever for positive change at companies.</p> <p>Underpinning voting decisions are Hermes EOS Regional Corporate Governance policies which can be found at the "How we invest" section of our website.</p> <p>We disclose our historic voting information on our website. This includes the total number of companies where the Funds voted and details of individual companies where we have voted against company management.</p> <p>We disclose in arrears so that we are transparent and accountable but dialogue with companies in our portfolios is not compromised.</p>
<p>Principle 7 Institutional investors should report periodically on their stewardship and voting activities.</p>	<p>We report annually on stewardship activity through a specific section in the Funds' annual report and accounts and on our website.</p> <p>We also report annually on stewardship issues to the Pensions Committee.</p> <p>We have reviewed this Statement in June 2017. We will review the Statement annually.</p>
	<p>For further information please contact albert.chen@edinburgh.gov.uk</p>

Compliance with the CIPFA Principles for Investment Decision Making in the Local Government Pension Scheme

The Funds comply with the six CIPFA Principles. Details of the principles and the Funds' compliance are described below.

Principle 1 – Effective decision making

Administering authorities should ensure that decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and monitor their implementation; and Those persons or organisations should have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

- The Funds' Trustee Training Policy (comprising a compulsory training seminar for all new trustees and ongoing training of at least three days per year for all members of the Pensions Committee and Pension Board) provides the knowledge to enable them to evaluate and challenge the advice they receive. Standards relating to the administration of the Committee's business are strictly up-held.
- The Fund has appointed an Independent Professional Observer to strengthen governance. The role of the Observer is to provide the Committee with an impartial, additional source of experience and technical knowledge.
- The Pensions Committee focuses on setting the strategy for the Funds and monitoring performance. The Pension Board also attends Committee meetings and is responsible for assisting the Committee in securing compliance with relevant regulations and other legislation.
- The Committee delegates the day-to-day running of the Funds to the Executive Director of Resources. The Executive Director of Resources is responsible for the provision of the training plan for Committee to help them to make effective decisions to ensure that they are fully aware of their statutory and fiduciary responsibilities, and to regularly remind them of their stewardship role.
- The Investment Strategy Panel advises the Executive Director of Resources on the implementation of the agreed strategies, reviewing structure, funding monitoring, performance and risk and asset allocation. The Investment Strategy Panel meets quarterly and is made up of experienced investment professionals, including independent advisers.
- The in-house team undertakes day-to-day monitoring of the Funds. The team includes personnel with suitable professional qualifications and experience to provide the necessary skills, knowledge, advice and resources to support the Investment Strategy Panel and the Pensions Committee.

- Conflicts of interest are managed actively. At each Committee meeting, elected members of the Pensions Committee and Pensions Board are asked to highlight conflicts of interest. A Code of Conduct applies to members of the Committee and the Pension Board. The Funds have a Compliance Policy which ensures conflicts of interest are highlighted and managed appropriately.

Principle 2 – Clear Objectives

Overall investment objectives should be set out for the fund that take account of the scheme's liabilities, the potential impact on local council tax payers, the strength of the covenant of the participating employers, and the attitude to risk of both the administering authority and the scheme employers, and these should be clearly communicated to advisers and investment managers.

- The Statement of Investment Principles and the Funding Strategy Statement define the Funds' primary funding objectives.
- Asset-liability modelling is undertaken with the help of external advisers to aid the setting of investment strategy in order to understand risks. Each Fund has a scheme-specific investment strategy.
- The attitude to risk of employers is specifically taken into account in the setting of strategy.
- Reviews of investment strategy focus on the split between broad asset classes (equities, bonds and alternative investments).
- Investment Management Agreements set clear benchmarks and risk parameters to achieve and include the requirement to comply with the Funds' Statement of Investment Principles.
- Appointments of advisers are reviewed regularly. Investment and actuarial advisers are appointed under separate contract. Procurement of advisers is conducted within European Union procurement regulations.
- The setting of the Funding Strategy included specific consideration of the need to maintain stability in employer contribution rates.

Principle 3 – Risk and liabilities

In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.

These include the implications for council tax payers; the strength of the covenant of participating authorities; the risk of their default, and longevity risk.

- The Funds take advice from the scheme's actuary regarding the nature of its liabilities. Asset-liability modelling is undertaken periodically to aid the setting of investment strategy, and these exercises specifically take account of covenant strength and longevity risk.
- It is recognised that within Lothian Pension Fund, employers' circumstances vary and a lower-risk investment strategy for their section(s) of the Fund may be deemed suitable. The Fund will also consider such requests subject to practical implementation of such strategies and if appropriate, a review of employer contribution rates. It is not practical for the Fund to offer individual employers full flexibility on asset allocation.
- The Funding objectives for the Funds are expressed in relation to the solvency and employer contribution rates. The Funds regularly assess the covenants of participating employers.
- The Executive Director of Resources is responsible for ensuring appropriate controls of the Funds. Controls are subject to internal audit and results of audits are submitted to the Pensions Audit Sub Committee and/or the Pensions Committee.
- The Funds maintain a risk register, which is reviewed on a quarterly basis.

Principle 4 – Performance assessment

Arrangements should be in place for the formal measurement of the performance of the investments, investment managers and advisers.

Administering authorities should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members.

- The Funds' performance and risk analysis is produced by an independent external provider.
- The internal investment team assesses the external investment managers' performance and risk on a regular basis. The Investment Strategy Panel assesses the performance and risk of the internal and external investment managers on a regular basis.
- The Funds' contracts with its advisers are regularly market tested.

- The Investment Strategy Panel assesses its own performance on a regular basis and reports to Committee on its activities, typically annually.
- Training and attendance of members of the Pensions Committee and the Pensions Board are monitored and reported on a regular basis. The composition of the Committee and Pension Board is reviewed on a regular basis.

Principle 5 – Responsible ownership

Administering authorities should adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.

A statement of the authority's policy on responsible ownership should be included in the Statement of Investment Principles.

Administering authorities should report periodically to members on the discharge of such responsibilities.

- The Funds' policy on responsible ownership is included in the statement on the FRC's Stewardship Code (see Appendix B of the Statement of Investment Principles).
- Details of the Funds' voting and engagements are available on the Funds' website. The Funds' annual report and accounts includes a summary of the Funds' approach to responsible investment. A summary of the report and accounts is sent to members. The full report is available on the website and is sent to members on request.

Principle 6 – Transparency and reporting

Administering authorities should act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives; and Provide regular communication to members in the form they consider most appropriate.

- Meetings of the Pensions Committee are open to the public. Members of the public are allowed to provide deputations at Committee meetings. Committee papers are available on the City of Edinburgh Council's website. The Pension Board joins the Committee at all meetings.
- The Committee's remit covers wider pension scheme issues, other than the management and investment of funds.
- The Funds' policy statements, including the Communications Strategy, Statement of Investment Principles and Funding Strategy Statement are maintained regularly. Stakeholders are consulted on changes. Documents are available on the Funds' website.
- The Funds produce an Annual Report & Accounts. The full report is available on the website, and is sent to members on request. The Funds also produce regular newsletters for members as well as an annual benefit statement. Regular briefings are provided to employers. The Funds' website is updated regularly.