Public Document Pack

Notice of meeting and agenda

Pensions Committee

2.00 pm Wednesday, 11th December, 2019

Dunedin Room - City Chambers

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

The law allows the Council to consider some issues in private. Any items under "Private Business" will not be published, although the decisions will be recorded in the minute.

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1. Order of Business

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

2. Declaration of Interests

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

3. Deputations

3.1 If any

4. Minutes

4.1	Minute of Pensions Committee of 25 September 2019 – submitted for approval as a correct record	7 - 12

5. Reports

5.1	Referrals and Recommendations from Pensions Audit Sub-Committee	
5.2	Agenda Planning – Report by the Executive Director of Resources	13 - 18
5.3	Pension Fund Cost Benchmarking – Report by the Executive Director of Resources	19 - 26

5.4	Contribution Stability Mechanism Review 2019 – Report by the Executive Director of Resources	27 - 98
5.5	Statement of Investment Principles – Report by the Executive Director of Resources	99 - 122
5.6	Stewardship and Engagement – Report by the Executive Director of Resources	123 - 132
5.7	Service Plan Update – Report by the Executive Director of Resources	133 - 142
5.8	Lothian Pension Fund Branding Review – Report by the Executive Director of Resources	143 - 150
5.9	Risk Management Summary – Report by the Executive Director of Resources	151 - 166

6. Motions

6.1 If any

7. Resolution to Consider in Private

7.1 The Committee, is requested under Section 50(A)(4) of the Local Government (Scotland) Act 1973, to exclude the public from the meeting for the following items of business on the grounds that they would involve the disclosure of exempt information as defined in Paragraphs 6 and 9 of Part 1 of Schedule 7A of the Act.

8. Private Reports

8.1	Governance Update – Report by the Executive Director of Resources	167 - 308
8.2	Investment Collaboration Update - Shared Service Cost Apportionment – Report by the Executive Director of Resources	309 - 314
8.3	Lothian Pension Fund ICT Update – Report by the Executive	315 - 320

Director of Resources

Laurence Rockey

Head of Strategy and Communications

Committee Members

Councillor Alasdair Rankin (Convener), Councillor Steve Burgess, Councillor Maureen Child, Councillor Cameron Rose and Councillor Neil Ross; John Anzani and Richard Lamont.

Information about the Pensions Committee

The Pensions Committee consists of 5 Councillors and 2 external members and is appointed by the City of Edinburgh Council. The Pensions Committee usually meets every twelve weeks. The Pensions Committee usually meets in the City Chambers on the High Street in Edinburgh. The meeting is open to all members of the public.

Further information

If you have any questions about the agenda or meeting arrangements, please contact Lesley Birrell or Natalie Le Couteur, Committee Services, City of Edinburgh Council, Business Centre 2.1, Waverley Court, 4 East Market Street, Edinburgh EH8 8BG, Tel 0131 529 4240 / 0131 529 6160, email lesley.birrell@edinburgh.gov.uk / natalie.le.couteur@edinburgh.gov.uk.

A copy of the agenda and papers for this meeting will be available for inspection prior to the meeting at the main reception office, City Chambers, High Street, Edinburgh.

The agenda, minutes and public reports for this meeting and all the main Council committees can be viewed online by going to www.edinburgh.gov.uk/cpol.

Minutes

Pensions Committee

2.00pm, Wednesday 25 September 2019

Present

Councillors Rankin (Convener), Burgess, Child, Rose and Neil Ross; John Anzani and Richard Lamont.

Pension Board Members

Jim Anderson, Sharon Cowle, Darren May, Thomas Carr-Pollock and Brian Robertson.

Independent Professional Observer

Andy McKinnell

1. Minutes

Decision

To approve the minute of the Pensions Committee of 26 June 2019 as a correct record.

2. Referrals/Recommendations from Pensions Audit Sub-Committee

Councillor Rose advised the Committee of the discussion and decisions taken at the Pensions Audit Sub-Committee on 24 September 2019.

Decision

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

(Reference – Pensions Audit Sub-Committee 25 June 2019)

3. Agenda Planning

Details were provided of proposed potential reports for future meetings of the Pensions Committee and Pensions Audit Sub-Committee including meetings in December 2019 and March 2020.

Decision

1) To note the agenda planning document.

2) To agree to an investment activity update in December 2019.

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

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4. Audited Annual Report 2019 of the Lothian Pension Fund and Scottish Homes Pension Fund, including Annual Report by External Auditor

The audited Annual Report for the year ended 31 March 2019 for the Lothian Pension Fund (LPF) and Scottish Homes Pension Fund (SHPF) was considered by the external auditor, Scott-Moncrieff, and their findings presented.

It was concluded that that there were no matters which Scott-Moncrieff were required to report by exception.

Decision

1) To note the report by Scott-Moncrieff "Lothian Pension Funds 2018/19 Annual Audit Report to Members and the Controller of Audit" (Appendix 1).

2) To note the audited Annual Report for the year ended 31 March 2019 for the LPF and the SHPF (Appendix 2).

3) To note that the audited financial statements, for the year ended 31 March 2019, of both the wholly-owned companies, LPFE Limited and LPFI Limited, were approved by the respective Board of Directors in May 2019. These statements were shown in full at Appendices 3 and 4.

4) To agree to refer the report to Council for noting.

5) To thank Scott-Moncrieff for their work to the report.

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

5. Lothian Pension Fund - Contract Awards (Period 1 January to 30 June 2019)

An update was provided on the scope of contracts awarded by Lothian Pension Fund in the period 1 January to 30 June 2019. This provided visibility of contracts awarded under the Scheme of Delegation to Officers, inclusive of direct contract awards not openly tendered due to specific circumstances permitted in regulation and those awarded following a waiver of the Council's Contract Standing Orders (CSOs).

Decision

1) To note the contents of the report and the authorisations made under the Scheme of Delegation to Officers.

2) To note that a further report would be submitted to the Committee in approximately six months' time.

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

6. Overpayments of Pension

In July 2019, an error had been identified whereby the Lothian Pension Fund had been paying a pension for a dependent child into an incorrect bank account since September 2015, totalling £13,373.30. The circumstances through which this had arisen and the steps taken to rectify the error were detailed.

Members discussed the issue and the costs to the Fund as it was unlikely that the full sum could be recovered from the individual.

Decision

1) To note that the Fund was currently pursing recovery of an overpayment of pension totalling £13,373.30.

2) To agree that the overpayment should be written off to the extent that the Fund's pursuit of recovery proved unsuccessful.

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

7. Service Plan Update

An update was provided on the progress against the 2018–2020 Service Plan, performance indicators and the actions taken to enable the fund to meet its key objectives.

Overall progress was being made against the service plan objectives for 2019/20. An underspend was projected for the financial year.

Decision

1) To note progress of the fund against the 2018-2020 Service Plan, together with the regulatory update.

2) To note an update on performance indicators and the Local Government Pension Scheme (Scotland) Regulations.

2) To agree to include context on the Staff Engagement Survey in a future Service Plan Update.

3) To thank officers for their work to the report.

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

8. Risk Management Summary

The Lothian Pension Fund's risk management procedures required the fund to maintain a detailed operational risk register which set out all the risks identified and assessed by the officers on an ongoing basis, the degree of risk associated in each case and the action taken to mitigate these risks

In line with the Fund's ongoing risk management procedures, an overview was provided of the Fund's risk analysis for consideration by the Committee.

Decision

To note the Quarterly Risk Overview.

(References – Pensions Committee 26 June 2019 (item 10); report by the Executive Director of Resources, submitted.)

9. LPFE Limited and LPFI Limited Annual Report

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

An update was provided on the business and operation of the LPFE Limited (LPFE) and LPFI Limited (LPFI).

Councillor Rose advised that there had been discussion around the operation of the LPF group's governance structure at the Pensions Audit Sub-Committee and that the Sub-Committee had produced a recommendation on this for the Pensions Committee.

Decision

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

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

10. Employer Covenant Review 2019

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

An overview was provided of the recent employer covenant analysis undertaken by the Fund.

Decision

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

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

Declaration of Interests

Sharon Cowle declared a non-financial interest in this item as her friend was Chair of Barony Housing.

11. Employers Participating in Lothian Pension Fund

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

An update was provided on current matters affecting employers participating in the LPF.

Decision

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

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

Declaration of Interests

Councillor Child declared a non-financial interest in this item as a Board Member of Edinburgh World Heritage.

Sharon Cowle declared a non-financial interest in this item as her friend was Chair of Barony Housing.

12. Lothian Pension Fund ICT Update

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

Following approval by the Committee on 26 June 2019, an update was provided on the implementation of the Fund's ICT pathway.

Decision

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

(Reference – Pensions Committee 26 June 2019 (item 12); report by the Executive Director of Resources, submitted.)

13. Governance Update

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

An update was provided on implementing the recommendations of the Fund Governance Review 2019.

Decision

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

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

14. Office Relocation

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

The business case was presented for leaving Atria One, including the context of the challenges of the current office provision and the review undertaken in response.

Decision

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

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

15. Employers Participating in Lothian Pension Fund – Visit Scotland

The Convener ruled that the following item, notice of which had been given at the start of the meeting, be considered as a matter of urgency to allow the Council to give early consideration to this matter.

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

Approval was sought to transfer all active, deferred and pensioner liabilities of VisitScotland from all their other Local Government Pension Scheme (LFPS) funds in Scotland to the LPF.

Decision

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

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

Declaration of Interests

Richard Lamont declared a non-financial interest in this item as an employee of VisitScotland and took no part in the decision on this item.

Pensions Committee

2.00pm, Wednesday, 11 December 2019

Agenda Planning

Item number	**5.2**
Executive/routine	
Wards	**All**
Council Commitments	

1. Recommendations

The Pensions Committee is requested to:

1.1 note the agenda planning document; and

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

Stephen S. Moir

Executive Director of Resources

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Report

Agenda Planning

2. Executive Summary

2.1 This report and the scheme of committee document (appendix 1 of this report) provides the Committee with an overview of the proposed agendas for future meetings of the Pensions Committee and Pensions Audit Sub Committee. It also provides a more general overview of the current cycle of papers for those committees.

2.2 There will, of course, be specific matters and papers which need to be brought to attention of the committees in addition to those set out herein.

3. Background

3.1 In order for the Committee and Pension Board to gain an overview of the content of future meetings, it was agreed that an agenda planning document be submitted each quarter.

3.2 Committee meetings are held on a quarterly basis and the Audit Sub Committee meetings are generally held three times a year.

4. Main report

4.1 The proposed agendas for the next two meetings are therefore set out below, based on the usual Committee cycle plus any additional and intra-cycle requests.

4.2 An additional Audit Sub committee meeting may be held in March 2020 as agreed with the Convenor of the Audit Sub Committee, Councillor Cameron Rose to review and approve the Internal Audit Reports (should those be available at that time).

4.3 The scheme of committee schedule (appendix 1) has been updated with the following amendments:

- LPFE Limited (LPFE) and LPFI Limited (LPFI) Loan Financing Requirement paper, (which reports on the review and extension of the intra-group loan

- arrangements from LPF to LPFI/E) has been included in the schedule and will be presented to the Pension Committee every three years.
- Investment Controls and Compliance will now be called LPF Group Controls and Compliance and will be presented annually to Committee in June instead of December.
- The Governance update will now be called Annual LPF Group Governance Update and will be presented in June. The report will include a strategic review of all LPF Group matters and will combine the LPFI and LPFE annual report which will be removed from September.

4.3 The additional quarterly Governance Updates, that provide updates on the LPF Group Governance review, will continue until all material outcomes of the review have been implemented.

March 2020

Pensions Committee

- Referrals / recommendations from Pensions Audit-Sub Committee
- Audit plans and reports (internal and external) *
- Policies and Strategies Update
- Actuarial Valuation: Lothian Pension Fund/Scottish Homes Pension
- Employers Participating in Lothian Pension Fund
- Service Plan Update and Budget for 2020/21
- LPFI and LPFE Loan Financing Requirement
- Risk management summary
- LPF Group Governance Review Update

*Draft audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee and the Independent Professional Observer.

June 2020

Pensions Committee	**Audit Sub Committee**
• Referrals / recommendations from Pensions Audit-Sub Committee • LPF Annual Report and Accounts (Unaudited) • Statement of Investment Principles • Joint Investment Strategy Panel Activity • Annual Investment Updates - Lothian Pension Fund and Scottish Homes Pension Fund • Annual LPF Group Governance Update • Risk management summary	• LPF Annual Report and Accounts (Unaudited) • Annual LPF Group Governance Update • LPF Group Controls and Compliance • Risk Management summary

Future Pensions Committee and Audit Sub Committee dates:

Pensions Committee	Pensions Audit Sub Committee
• Wednesday, 25 March 2020, 2.00pm, Dunedin Room, City Chambers. • Wednesday, 24 June 2020, 2.00pm, Dunedin Room, City Chambers.	• Tuesday, 23 June 2020, 2.00pm, Dunedin Room, City Chambers.

5. Next Steps

5.1 None.

6. Financial impact

6.1 None.

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 – Scheme of Committee Papers

Frequency	Pensions Committee	Audit Sub Committee	Month
Annually	Audit plans and reports (internal and external)	N/A - *Draft audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee.*	March
	Policies and Strategies Update (including revised Pension Administration Strategy biennial from March 2016)	N/A	March
	Service Plan (every 2 years)	N/A	March
	Budget	N/A	March
	LPF Annual Report and Accounts (Unaudited)	LPF Annual Report & Accounts (Unaudited)	June
	Statement of Investment Principles	N/A	June
	Joint Investment Strategy Panel Activity	N/A	June
	Annual Investment Updates - Lothian Pension Fund and Scottish Homes Pension Fund	N/A	June
	Annual LPF Group Governance Update	Annual LPF Group Governance Update	June
		LPF Group Controls and Compliance	June
	Employer Covenant Review	N/A	September
			September
	Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund, including the Annual Report by External Auditor.	Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund, including the Annual Report by External Auditor.	September
	N/A	Pensions Data Quality	September
	N/A	Irrecoverable overpayment of pensions – decisions made under delegated authority	September
	N/A	Fraud Prevention	September
	Annual Report by External Auditor	Annual Report by External Auditor	December (or September if available)
	Benchmarking	N/A	December
	N/A	EU Tax Claims and Other Income Tax Recoveries	December
	N/A	Investment Income Review-Cross-Border Withholding Tax	December
	Stewardship and Engagement	N/A	December
	N/A	Global Custody Services Performance	December
		Risk Management: In-depth review	December

Frequency	Pensions Committee	Audit Sub Committee	Month
Semi Annually	Employers Participating in Lothian Pension Fund	N/A	March & September
	Lothian Pension Fund Contract Awards Report	N/A	March & September
3 Times per year	Service Plan Update	N/A	March, September & December
	Referrals / recommendations from Pensions Audit-Sub	N/A	June, September & December
Quarterly	Risk management summary	Risk management summary	March, June, September and December
Every 3 years	Actuarial Valuation: LPF SHPF		December or March
	Funding Strategy Statement		
	LPFI and LPFE Loan Financing Requirement		December or March
As required	Delegated authorities (provider appointments)	N/A	
	Discretions (death grants etc.)	N/A	
	N/A	Internal Audit Reports	
	Regulatory Update	N/A	
	Investment Strategy Reviews (at least every 3 years)	N/A	
	N/A	Particular items of risk management for greater scrutiny (as requested).	
	Contribution Stability Mechanism Review	N/A	

Pensions Committee

2.00pm, Wednesday, 11 December 2019

Pension Fund Cost Benchmarking

Item number	**5.3**
Executive/routine	
Wards	**All**
Council Commitments	

1. Recommendations

The Pensions Committee is requested to:

1.1 note the report; and

1.2 note that:

- the interim CEM Investment Cost Effectiveness Analysis (to 31 March 2019);
- the CIPFA Pensions Administration Benchmarking 2019; and
- the interim CEM Pension administration benchmarking report 2019, have been provided, on a confidential basis, to the Conveners of the Committee and Audit Sub-Committee and the Independent Professional Observer.

Stephen S. Moir

Executive Director of Resources

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Report

Pension Fund Cost Benchmarking

2. Executive Summary

2.1 The purpose of this report is to inform Committee about the benchmarking of investment costs for the Lothian Pension Fund and of pension administration costs for Lothian Pension Fund and Scottish Homes Pension Fund (and collectively known as LPF).

2.2 *Analysis of investment costs* was carried out by an independent provider, CEM Benchmarking Inc. Its database now includes 37 LGPS funds (with £193 billion of assets), and a wider global universe of 325 funds, including half of the world's top 300 funds (with £7.1 trillion of assets).

2.3 Lothian Pension Fund's actual investment cost of 0.39% of average assets was below the benchmark cost of 0.48%. The majority of LPF's investment cost relates to external management. The 0.09% difference with the benchmark is equivalent to a saving of approximately £6.3m per year. The main contributing factor to this difference is the fact that LPF manages a high percentage of assets on an internal basis compared to the benchmark peer group.

2.4 *Analysis of pension administration costs* was undertaken by the Chartered Institute of Public Finance & Accountancy (**CIPFA**). Pension administration cost per member of £22.09 for LPFs fell within a very wide range for local authority funds and was slightly higher than the average of £21.34. Qualitative measures, however, indicate, that the overall service provision exceeds the average.

2.5 In order to obtain further insight into pension administration cost and also quality of service, for the first time LPF has also participated in the pension administration benchmarking survey carried out by CEM. Whilst CIPFA is exclusive to the LGPS, CEM also includes UK private sector schemes. Participating funds, both private and public, are of a significantly larger size than LPF. Interim results show LPF's pension administration service to be categorised as "low cost; high service standard".

3. Background

3.1 LPF's annual report for 2018/19 identifies £38.6 million of expenses, with investment costs (£36.1 million) representing by far the largest proportion of the total, as expected.

3.2 Benchmarking is undertaken to help identify areas where improvements can be made to deliver better value for money. The exercise should facilitate:

- 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.

3.3 LPF has contributed to CEM's database for the past five years to better understand its investment expense base and how it compares with other pension funds.

3.3.1 The CEM 2019 global database comprises 325 funds representing £7.1 trillion in assets, including 241 North American funds with assets of £3.9 trillion and 74 European funds with assets of £2.4 trillion.

3.3.2 The global database also includes 37 LGPS funds with total assets of £193 billion.

3.3.3 The global funds range in size from £0.1 billion to £861 billion; the LGPS funds range from £0.6 billion to £22 billion.

3.3.4 The peer group for calculating LPF's benchmark cost contains 18 funds (including 10 LGPS funds). The peer group funds have been selected on the basis of fund size. The median fund size within the peer group is £7.8 billion, with half the funds in the range of £6.4 billion to £8.8 billion. This compares with Lothian Pension Fund's assets of £7.8 billion at 31 March 2019.

3.3.5 Care should be taken in deriving conclusions from the headline data. CEM itself states that "being high or low cost is neither good nor bad". What matters is whether a pension fund is receiving sufficient value for the costs incurred. This is reflected in the long term returns of pension funds, net of costs.

3.4 CIPFA's pensions administration benchmarking club has been used for a number of years to assess the costs of administration of the Funds. The outputs and analyses have served to supplement internal performance management information.

3.5 However, in recent years, the number of local authority pension funds participating in the CIPFA benchmarking club has declined, making meaningful comparison more difficult. In addition, the Fund's drive for continuous improvement in service delivery led to a desire to be able to measure and compare against other funds in order to identify areas of best practice which could be adopted.

3.6 CEM has been benchmarking pensions administration for around 10 years, primarily in the US, Canada and the Netherlands. In the UK, participants include some of the other public sector pension schemes and other large company pension Schemes. The fund was invited to join a group of other large LGPS funds to take part in the survey for the first time in 2019. Although many questions posed are similar to those in the CIPFA survey and a cost per member output is produced, the CEM survey also includes a score for service. The peer group used in the CEM benchmarking survey is made up of Local Authority funds and other comparable UK pension funds.

4. Main report

Investment Cost Benchmarking Analysis

4.1 The benchmarking analysis undertaken by CEM aims to provide comprehensive, like-for-like comparisons with similar funds, but they are unable to capture all investment costs from all funds. Improved transparency has been achieved with the inclusion of private asset performance fees, but investment transaction costs, including property operational costs, are excluded. In addition, the fund undertakes more detailed cost analysis than CEM for its listed private market funds as these cannot be compared with other funds in the database. Thus, the total actual costs reported by CEM differ from those reported in Lothian Pension Fund's annual report.

4.2 CEM calculates a benchmark cost for Lothian Pension Fund, which reflects the fund's asset class mix, based on the asset class costs of the peer group funds.

4.3 LPF's actual cost figure to 31 March 2019 of approximately 0.39% of average assets was below the benchmark cost of 0.48%. The 0.09% difference is equivalent to a saving of approximately £6.3m for the year to 31 March 2019. Previous CEM cost analyses are shown below (analyses prior to 31 March 2017 were calculated on a calendar year basis):

- 31 March 2018: 0.43% versus the benchmark cost of 0.55%
- 31 March 2017: 0.31% versus the benchmark cost of 0.48%
- 31 December 2015: 0.36% versus the benchmark cost of 0.45%
- 31 December 2014: 0.39% versus the benchmark cost of 0.50%

4.4 CEM concludes that the primary reason for cost being low compared with the benchmark is 'implementation style' – a relatively high percentage of assets are internally managed. External active management fees are significantly more expensive than internal management.

4.5 CEM analysis also shows that the Lothian Pension Fund cost of 0.39% is significantly lower than the median cost of the global peer group (0.63%) and also lower than the median cost of the LGPS universe (0.57%).

4.6 CEM highlights that investment costs should be taken in the context of a fund's long-term net returns.

4.7 CEM have compared Lothian Pension Fund's net value added (investment performance in excess of LPF's benchmark) over the medium-term (five years) with the net value added by CEM's global universe and its LGPS universe.

4.8 The analysis indicates that Lothian Pension Fund's net value added performance has been very strong - 85th percentile for the global universe and 81st percentile for the LGPS universe, meaning that Lothian has higher net value added than 85% of the funds in the global universe, and 81% of funds in the LGPS universe.

4.9 CEM has also conducted analysis on net total returns across its database. Over five years, Lothian Pension Fund's net total return is at the 100th percentile for the global universe, meaning that the fund has the highest five year return out of the 250 global funds for which CEM has five-year returns.

4.10 LPF's strong performance relative to peers is attributable to the outperformance of LPF relative to its benchmark in the years to 31 March 2015, 2016 and 2019. This was driven by the performance of LPF's internally managed equity portfolios that aim to deliver stronger returns in periods when equity markets are weaker/less buoyant, which occurred during those years.

CIPFA Pensions Administration Benchmarking Club

4.11 The CIPFA Pensions Administration Benchmarking Club aims to collect the transactional volumes and processing costs for administering members' LGPS benefits (i.e. excluding costs associated with administration and management of investments) using standard definitions. "Employing authority work" and any work associated with the administration of non-LGPS pensions are excluded.

4.12 Local authority pension funds subscribe to the CIPFA Benchmarking Club on a voluntary basis. The relative value to be gained from benchmarking analyses is obviously dependent on the scale of take-up of the service. The take-up of the CIPFA service has diminished in recent years and, as a consequence, the separate benchmarking report of funds of comparable size to Lothian Pension Fund is not reported this year.

4.13 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 use only within the authority....and for contacting and communicating with other members of the club*". Accordingly, the full report and executive summary report have been provided, on a confidential basis, to the Conveners of the Committee and Audit Sub-Committee and the Independent Professional Observer.

4.14 LPF is, however, able to report restricted summary findings and other relevant observations that affect the cost as follows:

- Lothian Pension Fund cost per member of £22.09 falls within the very wide range of local authority funds of c£13 to c£48. However, the cost is higher than the average of all funds of £21.34.

- The composition of a fund’s membership impacts costs. Active members represent 39.4% of Lothian Pension Fund membership compared with an average of 32.7%, and pensioners represent 29.9% compared with 25.5%, with the consequence that deferred members represent a lower proportion of membership (23.6%) than the typical fund (30.5%). 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 Lothian Pension Fund staff holding relevant pension administration qualifications is significantly higher than the average (more than double).
- Moreover, Lothian Penson Fund’s administration performance is above average for 10 of the 13 industry standard indicators, in certain instances by a considerable margin.

4.15 It is important to emphasise that care should be taken in interpreting the data purely on the basis of apportioned costs. This is of particular relevance given the scale of central support costs which are typically apportioned to the pension fund by the host Councils, the extent of co-provision of employer services and also the bases of overhead apportionment to the pension administration function.

4.16 Also, there appears to be potential inconsistency between the presentation of the benchmarking data and the allocation of costs in LGPS funds’ financial statements (using CIPFA Guidance) to ‘Administration’ and ‘Oversight and Governance’ expenses.

CEM Pensions Administration benchmarking

4.17 Whilst CIPFA is exclusively comprised of LGPS funds, CEM also includes UK private sector schemes, together with LGPS funds. Participating funds, both private and public, are of a significantly large size than Lothian Pension Fund.

4.18 As noted above, the CEM survey poses similar questions around cost as the CIPFA survey. Additional questions, however, focus on delivery of service, particularly on the channels used to communicate with customers and how different customer groups, including employers are served.

4.19 Final results are being compiled. However, at the time of writing the report, the interim results show that cost per member of £25.56 is lower than the adjusted average of £42.64. Results are adjusted to take into account differences in the number of members within the peer group. LPF’s third-party fees and other direct costs, which include IT and accommodation, were lower than the peer group average.

4.20 The definition of functions encompassed by the term “pensions administration” does vary between the CIPFA and CEM benchmarking analyses, this explaining the higher cost per member disclosed by the latter. The CEM definition includes some additional areas such as relevant legal and trustee costs and other costs related to governance.

4.21 CEM believes that looking at cost in isolation is unhelpful, and, in order to provide context and measure value for money, a service score is also calculated. Service is defined from a member’s perspective and higher service ‘means more channels, faster turnaround times, more availability, more choice, better content and higher quality. The interim results show a service score of 68 out of 100, which is higher than the peer median of 64. This score is calculated by weighting the service scores for three customer groups (active members, deferred members and pensioners) based on the membership mix. Reasons for the higher score compared to the peer group include:

- meeting more members one to one;
- paying retirement lump sums more quickly;
- having a strong social media presence across a number of platforms; and
- carrying out more transactional customer surveys.

Although employer service does not feed into the overall service score, compared the peer group, LPF scored well for meeting employers, training employer staff and for employer website and online services.

4.22 Participation in the CEM benchmarking pensions administration survey also allows access to additional research and workshops in order to meet with the peer group and other pension funds in order to identify areas of best practice which could be adopted for future service delivery.

4.23 The benchmarking information provides a useful snapshot of costs compared with funds that are prepared to share their data, but care should be taken in interpreting the information as the output relies on the accuracy of the data supplied.

5. Next Steps

5.1 LPF will use the benchmarking information to identify areas for improvement to ensure best value for money across its operations in investment administration and management and in pensions administration.

6. Financial impact

6.1 There are no financial implications arising directly from this report. Out of LPF's total costs of £38.6 million for 2018/19, investment costs amounted to £36.1 million and pension administration costs amounted to £2.5 million. Continuous improvement initiatives will be met from the approved budget 2019/20.

7. Stakeholder/Community Impact

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

7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.

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

8. Background reading/external references

8.1 None.

9. Appendices

None.

Pensions Committee

2.00pm, Wednesday, 11 December 2019

Contribution Stability Mechanism Review 2019

Item number	**5.4**
Executive/routine	
Wards	**All**
Council Commitments	

1. Recommendations

The Pensions Committee is requested to:

1.1 Approve the Contribution Stability Mechanism (CSM), to the effect that, from 1 April 2021, for all employers currently offered stabilised rates, contributions will be frozen for four years, then increase or decrease (towards the underlying "market base" rate) by no more than 0.5% of payroll each year thereafter. In the application of this funding strategy, the Fund will aim to keep the total contribution rate for all stabilised employers between 18.0% and 25.0% of payroll. There may be specific employer circumstances, however, which will merit the actuary certifying a contribution rate that is outside this range, which will be applied at the discretion of the Fund. This strategy will apply to all employers currently offered stabilised rates with the following exceptions:

1.1.1 For two employers, West Lothian Leisure and Enjoy Leisure, whose current contributions rates are below the floor of 18%, from 1 April 2021 contributions will be increased (towards the underlying "market base" rate) by 0.5% of payroll each year, then increase or decrease by no more than 0.5% of payroll each year;

1.1.2 Children's Hearing Scotland, given its low funding level, should be excluded from CSM, unless its guarantor, the Scottish Government, is content that it should remain;

1.1.3 Newbattle College, as an "admitted body" without any guarantor, should be excluded from CSM;

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1.2 Retain the right to review or withdraw the CSM, from any or all employer(s), as protection against extreme adverse financial circumstances;

1.3 Note that the CSM, stipulating minimum contribution rates payable, will require to be certified by the Fund's actuary at each statutory actuarial valuation.

Stephen S. Moir

Executive Director of Resources

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Report

Contribution Stability Mechanism Review 2019

2. Executive Summary

2.1 Detailed financial modelling of asset and liability cashflows has been undertaken and advice from the Fund's actuary sought in order to inform recommendations as to the proposed extension of the Contribution Stability Mechanism (CSM).

3. Background

3.1 The Funding Strategy Statement (at paragraph 7.5) states "The policy of the Fund is to operate a Contribution Stability Mechanism (CSM) on an ongoing basis, subject to regular reviews, in order to provide certainty of pension contributions to Fund employers for future years, together with ensuring appropriate assurance of funding level to the Fund. Contribution stability will not be offered to all employers – each employer's particular circumstances will be considered, in particular the strength of the covenant offered and the extent of membership commitment to the Fund. Employers are not obliged to participate in the CSM, but if they wish to opt out, they must make an election at the outset. ….. However, contribution stability will be subject to ongoing review by the Fund, which reserves the right to remove an employer from the CSM should particular circumstances deem it prudent to do so, for example assessment of employer covenant, financial or demographic experience"

3.2 Employers which are open to new entrants and have contribution rates calculated based on their individual circumstances will be offered contribution stability subject to:

- satisfactory assessment of the employer covenant, and;
- agreement by their guarantor to inclusion of the employer in the contribution stability mechanism (where appropriate).

3.3 At its meeting on 28 September 2016, the Committee approved "the continued use of the CSM for long-term secure employers … for the 2017 actuarial valuation" and noted the advice from the Actuary to review the CSM prior to the next triennial valuation in 2020.

3.4 The Local Government Pension Scheme (LGPS) funding valuation cycle may increase to a four-yearly interval (from the current triennial) because of broader alignment of public sector schemes. This will be determined by the Scottish Government for the LGPS in Scotland.

4. Main report

Asset (and) Liability Modelling

4.1 Conscious of the desirability of providing certainty of budgetary parameters for its long-term secure employers, the Lothian Pension Fund (LPF) commissioned its actuary to undertake asset liability modelling to assist in setting the contribution strategy ahead of the statutory 2020 actuarial valuation. The intention, therefore, being that this modelling could be used to set minimum contributions payable under the CSM for a period from 1 April 2021, with the duration and thresholds of the CSM reflecting actuarial advice.

4.2 Prior to undertaking the modelling, from cashflows from the employer asset tracking system, the actuary confirmed that all of the CSM employers are cashflow positive, albeit some marginally so. This was noted as being fairly unusual compared to other LGPS funds where they tended to see some stabilised employers with negative positions. The actuary noted that, from a funding perspective, being cashflow positive was generally a good thing as assets are maintained to generate returns.

4.3 In order to minimise costs of the exercise, a pragmatic approach was adopted. Consequently, member data from City of Edinburgh Council was deemed to be representative of the CSM group and, owing to its low contribution rate relative to the majority of other employers in the group, modelling was also undertaken using data from West Lothian Leisure.

4.4 The asset liability model (comPASS) allows projections to be made of employers' assets and liabilities under 5,000 different economic scenarios. The output from the model includes metrics for prudence, affordability, stability and stewardship, which can be compared to assess how an employer may perform under different contribution and investment strategies.

4.5 The asset liability modelling report "Review of the Lothian Pension Fund's Stabilised Contribution Mechanism" by Hymans Robertson LLP, dated 08 November 2019, is provided in full at Appendix 1.

4.6 There are acknowledged limitations to the modelling, including anticipated adverse implications for liabilities arising from age discrimination legal cases and the equalisation of Guaranteed Minimum Pensions (GMP). Nor does the modelling address the potential impact of the employer cost cap (ceiling and floor), as pertaining to the LGPS in Scotland. The net impact on cost is unknown at present, but will be addressed in due course once these matters have been clarified on a national basis.

Conclusion

4.7 The actuary has undertaken detailed scenario analyses, including significant stress testing to assess potential downside risks. Notwithstanding the limitations of the asset liability modelling, the actuary is supportive of the recommendations for the CSM, as detailed above.

4.8 Appendix 2 details the list of employers, to which LPF currently offers CSM, together with the respective recommended position for each.

4.9 Prior to the Committee, the actuary will provide verbal commentary on the asset liability modelling and the proposed CSM to members of both Committee and Board at the training seminar, scheduled for 25 November 2019.

5. Next Steps

5.1 Following consideration by Committee, appropriate communication will be undertaken with LPF employers. The suitability of the CSM for any individual employer, or indeed all employers, will be subject to ongoing review.

6. Financial impact

6.1 The principal objective of LPF is to ensure its long-term solvency. LPF therefore targets full funding on an ongoing basis over the long-term.

6.2 The CSM provides long-term secure LPF employers with future budgetary certainty, within defined parameters, together with appropriate assurance of funding level.

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 - "Review of the Lothian Pension Fund's Stabilised Contribution Mechanism" by Hymans Robertson LLP, dated 08 November 2019

Appendix 2 – Employers Currently participating in the Contribution Stability Mechanism

Appendix 1

Lothian Pension Fund

Page 31

Review of the Lothian Pension Fund's Stabilised Contribution Mechanism

Richard Warden FFA
Laura McInroy FFA

8 November 2019

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Addressee

- This paper has been requested by, and is addressed to, City of Edinburgh Council **in its capacity as Administering Authority** to the Lothian Pension Fund ("the Fund").
- The results contained within are in respect of City of Edinburgh Council and West Lothian Leisure ("the Employers") **in their capacity as participating employers** in the Fund. This is intended to be part of an investigation to allow the officers to consider a long term funding strategy for the employers that participate in the Fund's contribution stability mechanism ("CSM employers"). It should not be used for any other purpose, for instance in determining investment strategy.
- This paper may be shared with the CSM employers for information purposes only. It does not constitute advice to any Fund employers.
- This paper should not be disclosed to any other third parties (e.g. separate advisers to the Fund or any other employers) without our prior written permission and then only in full. We accept no liability to any party for any other purpose than above, unless expressly accepted in writing.
- Any changes to the agreed funding strategy should be documented in the Funding Strategy Statement (FSS).

Decision making record

Decision	Reason for decision	By whom	Date
CEC Scenario 4 : Freeze for 4 years followed by +/- 0.5% p.a.	LPF comfortable with freezing the contribution rates based on the narrower range of cap & floor	LPF	28 October 2019
West Lothian Leisure Scenario 1 : Increase by 0.5% p.a. for 4 years followed by +/- 0.5% p.a.	LPF commented that a step-up in contribution rates appeared to be appropriate for WLL	LPF	28 October 2019

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General comments

- Since the last Asset Liability Modelling was carried out in 2013, asset returns have been positive and as such this has helped to improve the results.
- However the funding time horizon is long term and the temptation to cut rates too deeply should be avoided as that may increase the likelihood of requiring substantial increases in the future. The principle behind the CSM is to restrict both increases and reductions to relatively small amounts between valuations.
- The LGPS funding valuation cycle may change as a result of wider developments. Consequently, at the 2020 valuation the Fund may need to set contribution rates for the following 4 years i.e. 1 April 2021 to 31 March 2025.
- When agreeing the funding strategy, the decision making process should also take into account factors which the modelling cannot:
  - E.g. unmodelled risks (such as climate change, political, McCloud – see next bullet), affordability, fairness, precedents, past agreements etc.
- At present, there is significant uncertainty around the cost of LGPS benefits due to the ongoing “McCloud case”. The resolution of this case is likely to see the cost of LGPS benefits (both past and future) increase. The modelling results take no account of this, but the risk should be factored into decision making around funding strategies.

Contents

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Background

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Purpose

- In advance of the 2017 formal valuation of the Fund, the long term funding strategy for the CSM employers was reviewed. The results of this review were that the contribution strategy set at the previous formal valuation remained appropriate. This was formalised in the FSS at that time, together with a note that the contribution strategy would be formally reviewed as part of the 2020 valuation of the Fund.
- The purpose of this report is to carry out a full review of the funding strategy for the CSM employers to ensure it remains appropriate given the Fund's long term funding objectives and view of funding and investment risk.
- As contributions and investment returns are the sole sources of funding members' benefits, a long term funding strategy should be considered in tandem with a long term investment strategy.
- Note that this paper has not been prepared for the purpose of reviewing or advising on the Fund's long term investment strategy.

What’s happened since the last full review?

- The 2013 Asset Liability Modelling exercise considered how the assets and liabilities may evolve under 5,000 different projections for future market conditions.
- When a review takes place, we consider what has actually happened in the intervening period.
- Factors that can influence the results of a review include:
  - actual market performance in the period (which has been higher than expected);
  - changes in membership profile;
  - changes in future economic outlook;
  - risks that sit outside the modelling

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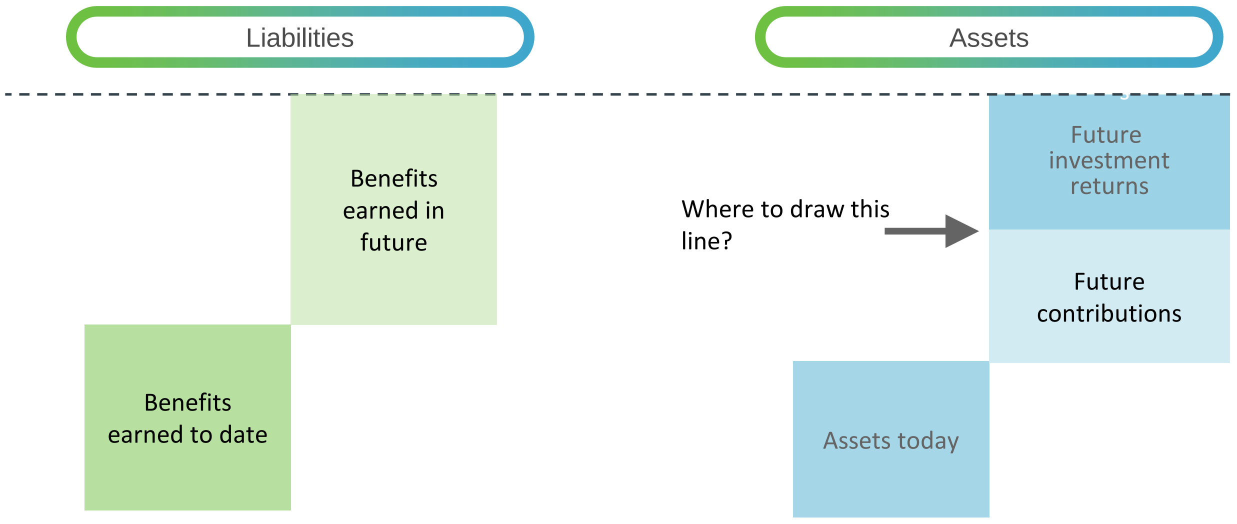
Methodology & inputs

Setting funding strategy



- The funding of members' benefits is achieved by a combination of contributions and investment returns.
- As such it is critical to consider how much a particular funding strategy (i.e. contribution rates) relies on future investment returns.
- This modelling considers 5,000 outcomes for future investment returns as these are unknown and volatile. It is important to understand how much reliance is being placed on investment returns, and therefore how much risk is involved in the funding strategy, as this may impact on future contribution requirements.
- This modelling looks at total contributions required (i.e. primary plus secondary) to meet the funding objective.

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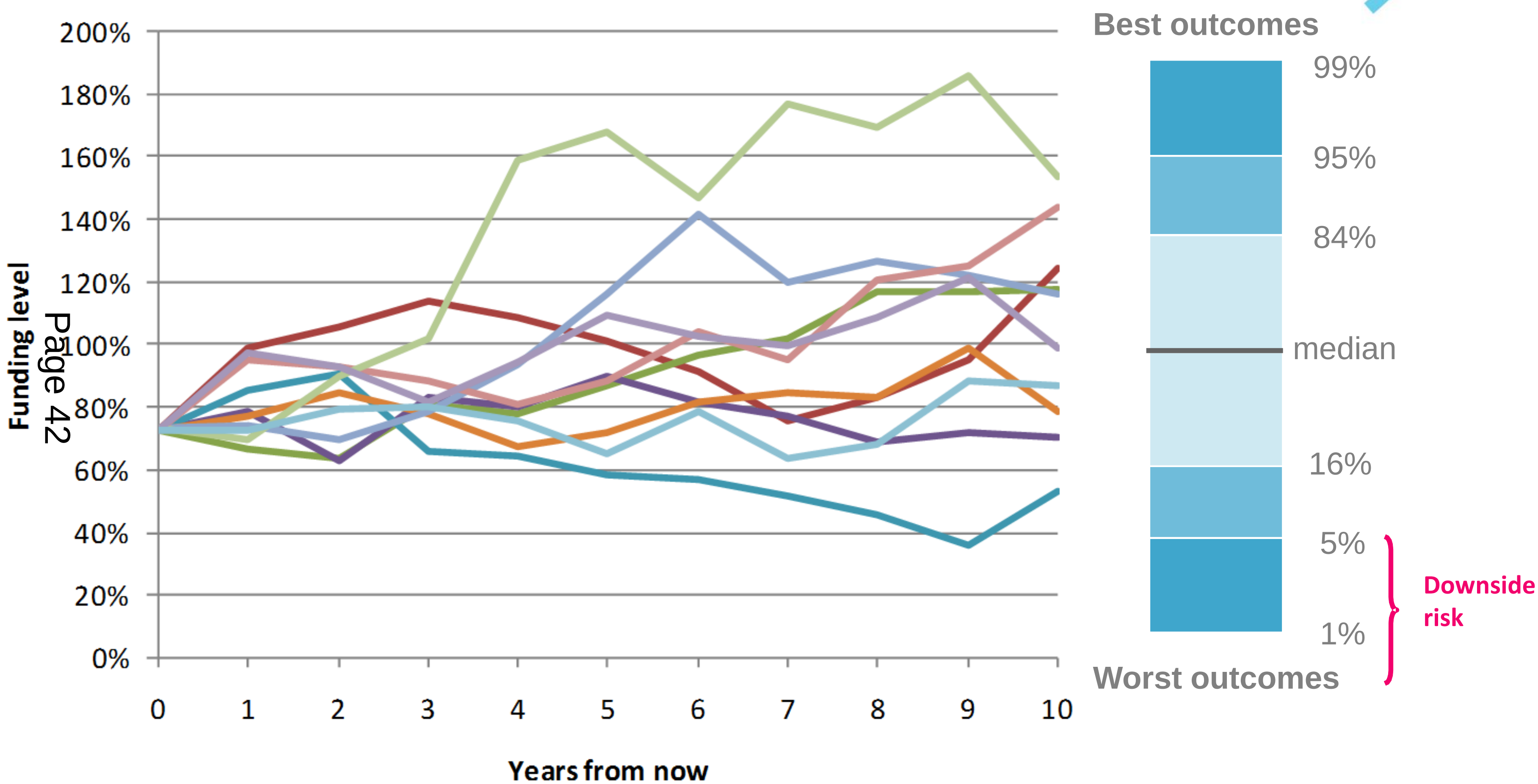
Methodology

- This modelling is a form of asset-liability modelling ("ALM").
- Assets and liabilities are projected forward from 2019 using membership data as at 31 March 2019 under 5,000 different outcomes for future market and economic conditions. See the "Reliances, limitations and additional details" appendix for details of the expected return on assets, economic conditions and the associated volatilities.
- For each outcome (5,000 per contribution scenario), we calculate the funding position annually throughout the projection period.
- The funding position uses the assumptions used for the 2017 valuation of the Fund. Further details are included in our 2017 valuation report dated March 2018.
- We then rank the 5,000 outcomes from best to worst and we plot the outcomes graphically (as shown in the following two pages).
- We can then compare the range of outcomes with other contribution scenarios.
- Please note the following likelihoods are adopted for each graph (please see the key on the following page for further details)
  - Lightest coloured ranges represent middle 2/3rds of the outcomes
  - The range above and below this shows 1 in 6 outcomes each
  - This range is further split into 1 in 10 for the next lightest range and 1 in 20 for the darkest range of outcomes
  - The best and worst 1% of outcomes are not shown on the graphs

Methodology



Each scenario has different inflation, investment returns, interest rates etc

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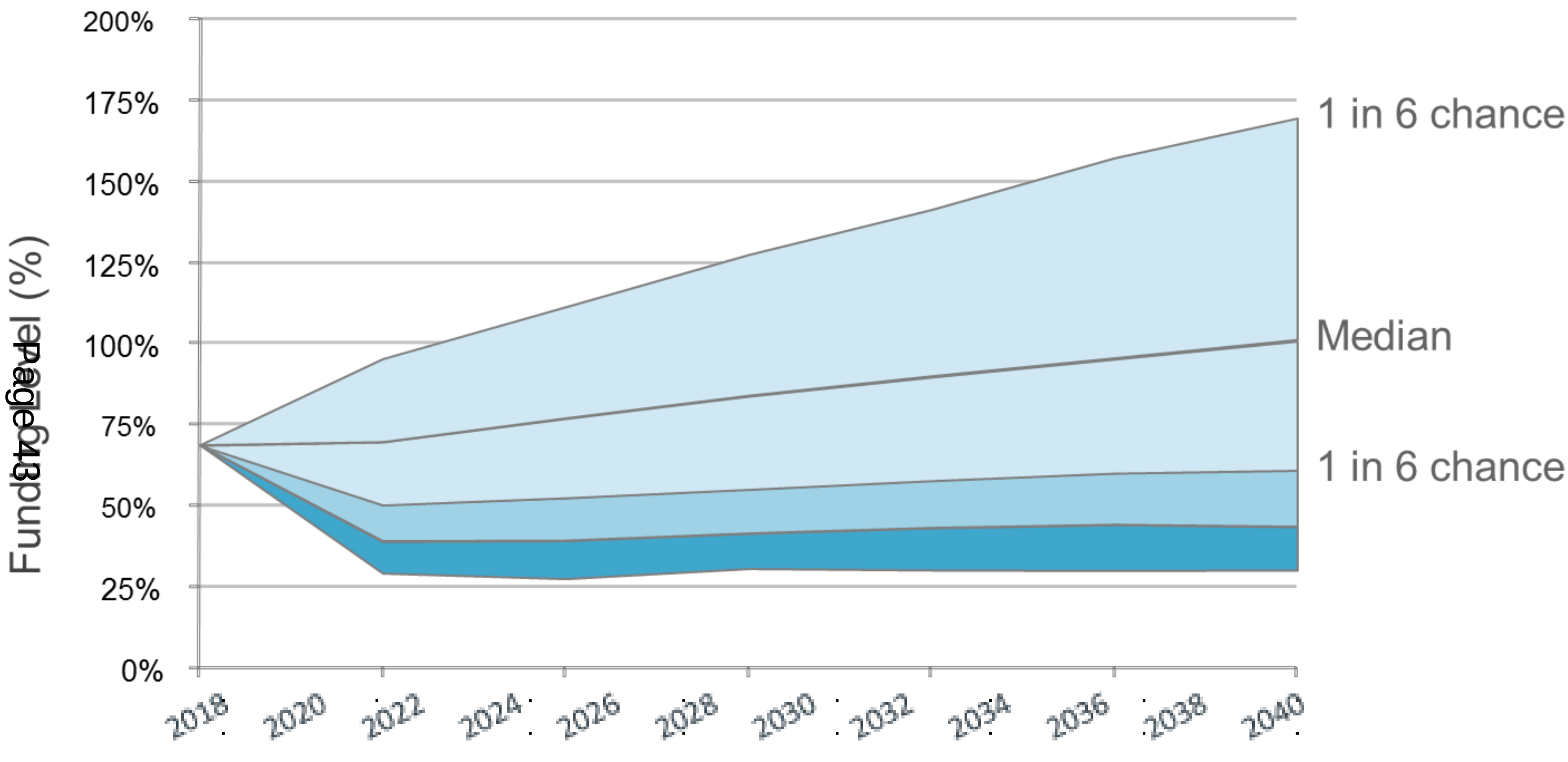
5,000 scenarios gives a distribution of outcomes



Measure likelihood of meeting funding objective

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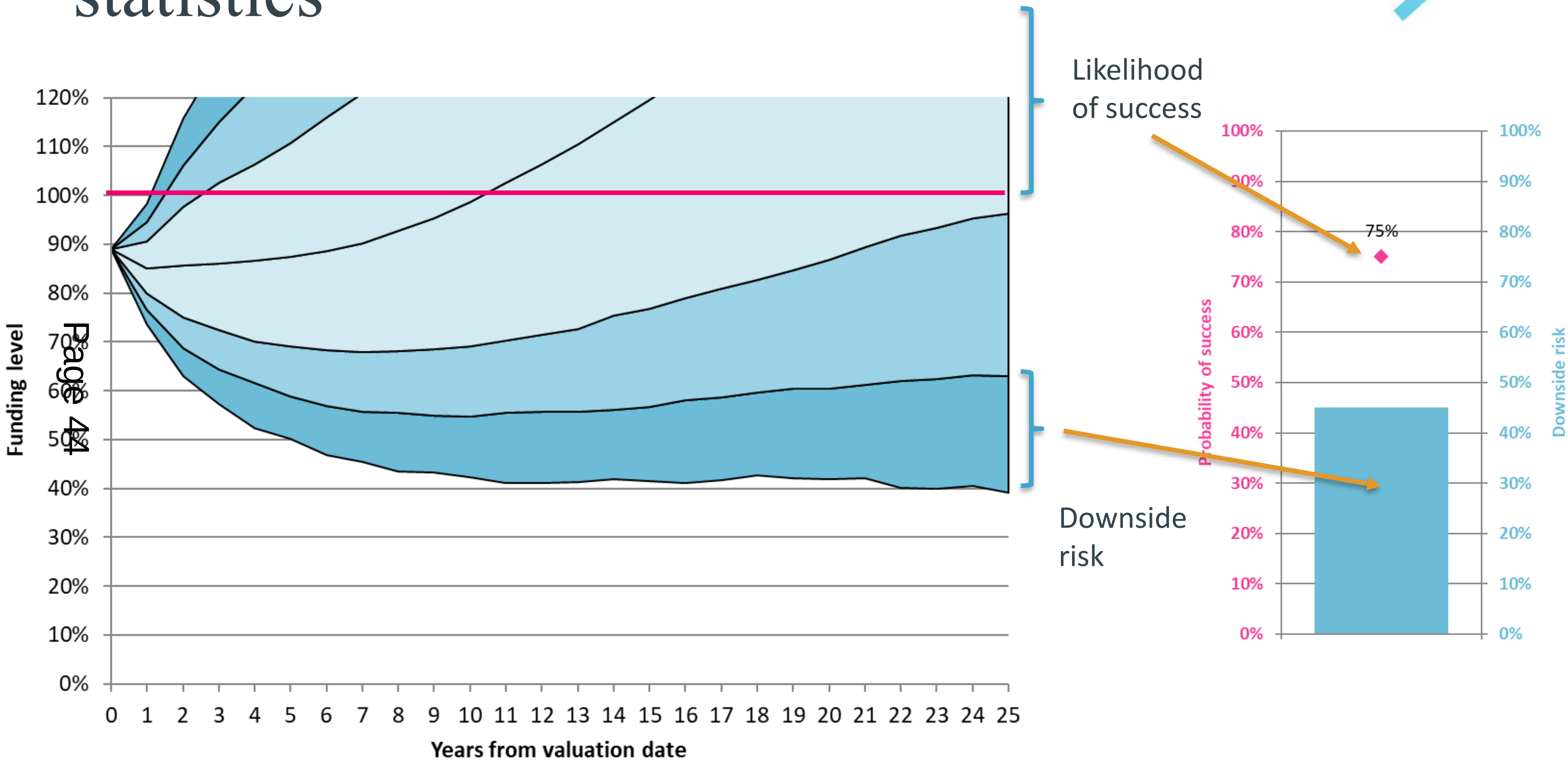
Source: Hymans Robertson LLP, comPASS, sample fund

From this distribution we can prepare summary statistics



Assess the likelihood of 'success' and the risk when things go wrong

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Model inputs - contributions

- For each scenario, we have modelled the contribution rate expressed solely as a percentage of pay.
- The CSM employer's certified contributions may be expressed as both a percentage of pay and a monetary amount. However, for the purpose of this modelling, we have converted the monetary element into % of pay terms.
- The contributions payable in 2019/20 and 2020/21 are based on the rates certified at the 2020 valuation.
- The contribution patterns modelled make no allowance for any changes to members benefits resulting from the Cost Cap mechanism or recent 'McCloud' court case ruling

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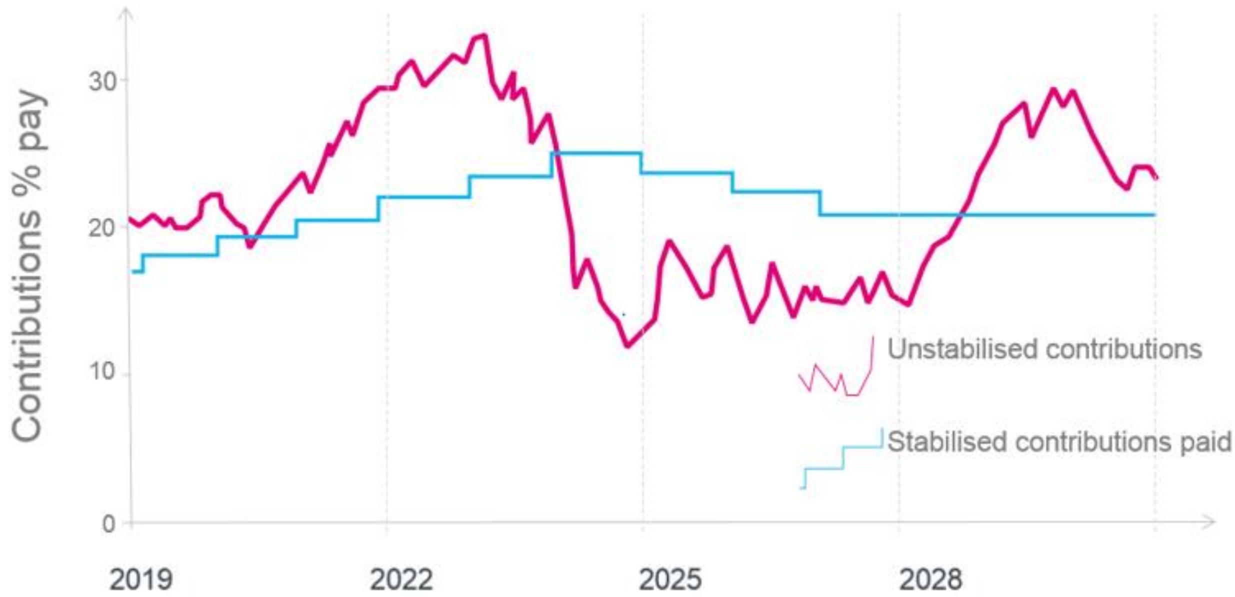
Model inputs - stabilised contributions



- The funding strategies considered in this modelling are stabilised
- The stabilisation mechanism limits contribution rate increases and decreases to a maximum amount each year, helping employers avoid sudden or large changes
- Stabilisation will aid budgeting, avoid surprises and help keep contribution rates affordable during periods of short term market volatility
- Stabilisation is primarily used for long-term, secure employers though it can be extended

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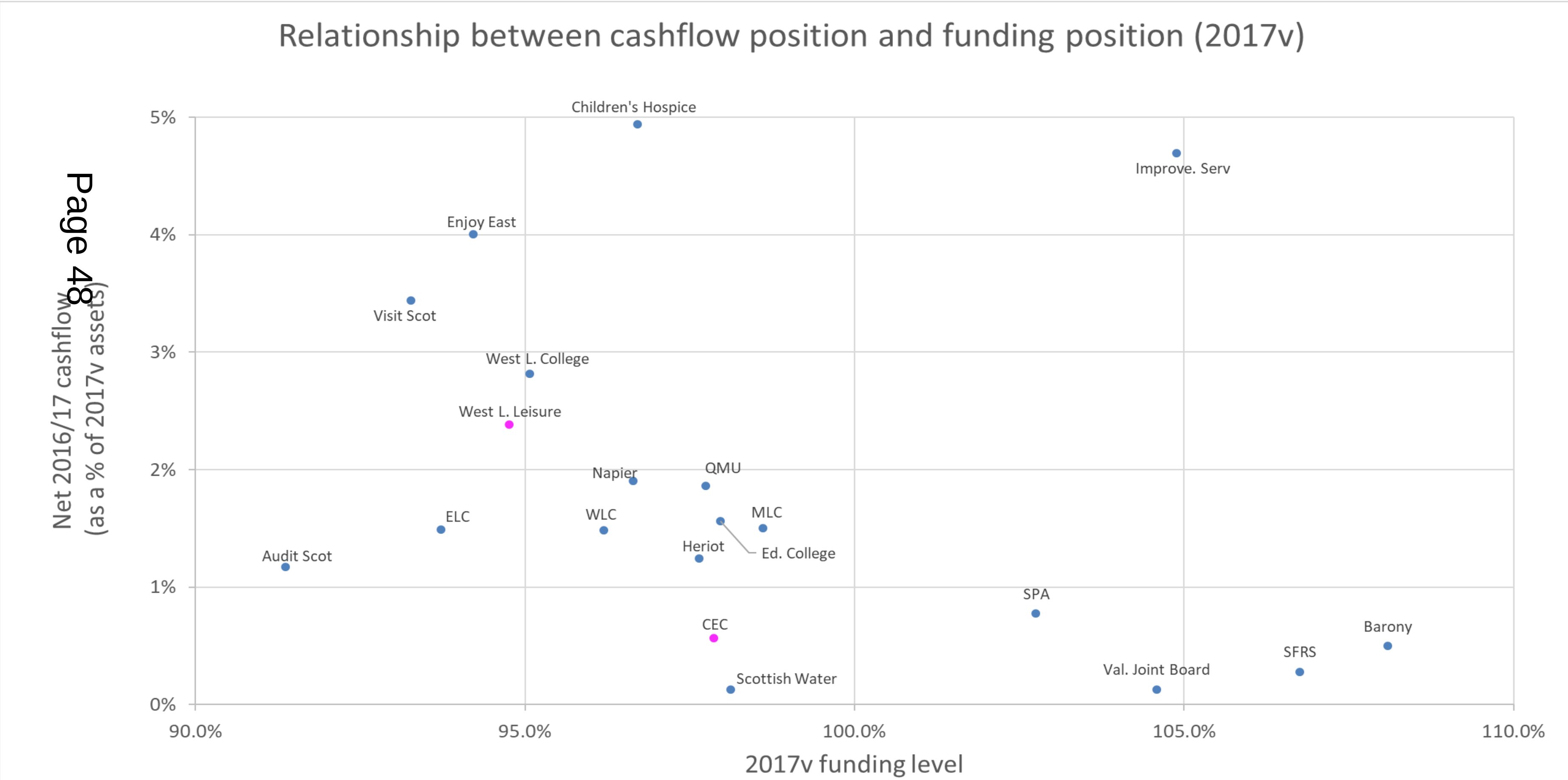
CSM employers to be modelled

- We have analysed the CSM employers in order to determine which employers are similar in characteristics and may therefore produce similar modelling results. As part of this analysis, we considered:
  - **Net cashflow position in 2016/17** – employer and employee contributions less pensions paid. The greater the extent to which an employer's contribution income exceeds its benefit outflow, the greater the extent to which its asset share is expected to grow over time. An employer that has a positive cashflow position will be a net investor (rather than a net disinvestor) and will benefit from investment returns to a greater extent than a cashflow negative employer.
  - **2017 valuation funding level**
  - **Actual contribution rate in payment in 2020/21**
- Based on the results of this analysis, the Administering Authority selected two employers to be modelled as representative examples from the CSM group.
- Please note that our analysis of the CSM employers is crude in its nature and has limitations which should be noted. For example, an employer's *future* cashflow profile will impact the future progression of its funding position. An employer's net cashflow position will change over time due to retirements, withdrawals and deaths – our analysis of the CSM employers does not capture this. However, the Asset Liability Modelling does allow for changes in the modelled employer's cashflow position over time.

CSM analysis

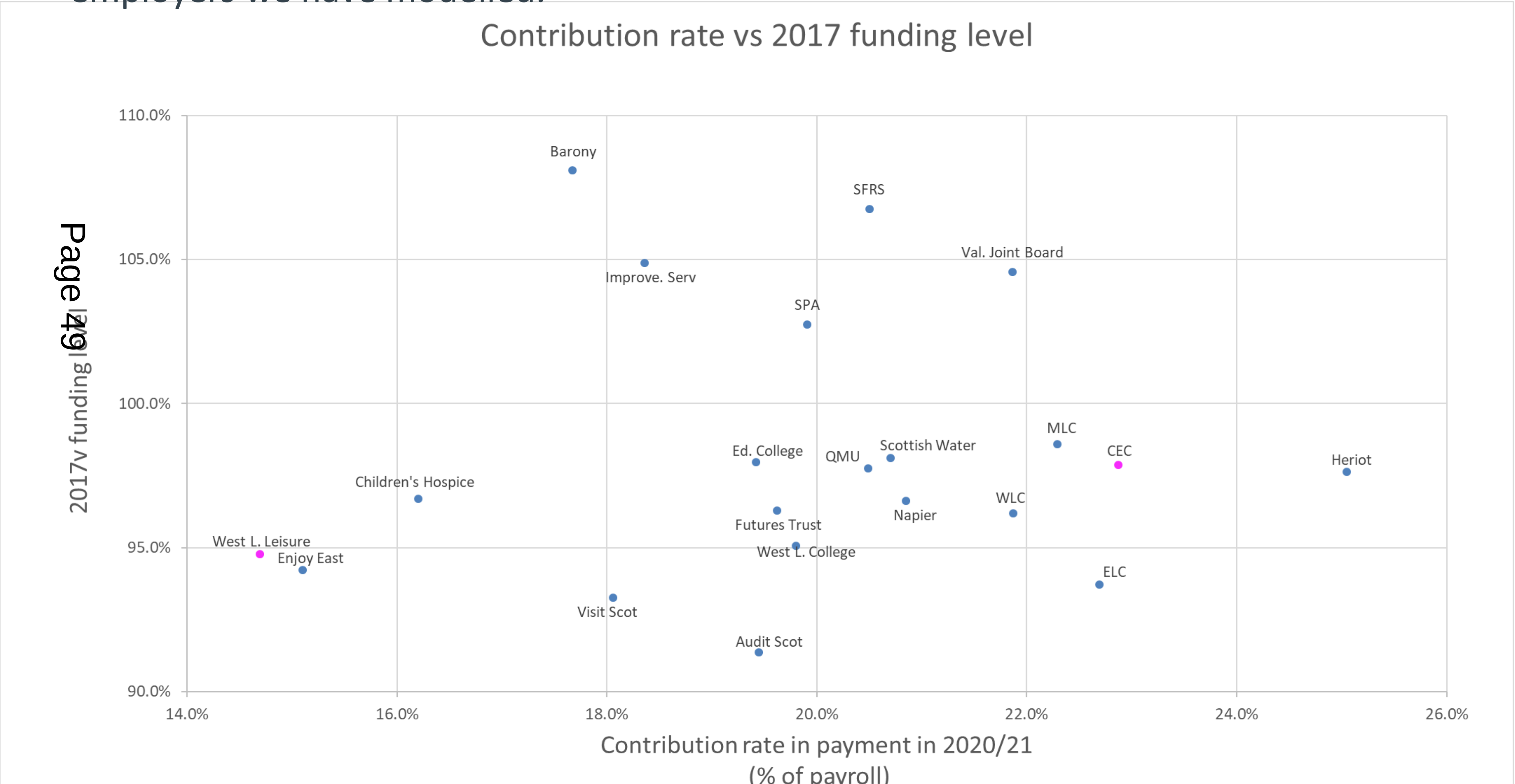
The employers shown in pink highlight are the representative examples of the CSM employers we have modelled.



All CSM employers are currently cashflow positive

CSM analysis (cont.)

The employers shown in pink highlight are the representative examples of the CSM employers we have modelled.



There is a wide range of contribution rates in payment

CSM employers to be modelled

- The Administering Authority elected to model:
  - West Lothian Leisure (WLL), due to its low contribution rate relative to other employers in the CSM group (Enjoy East Lothian has a similarly low contribution rate and should be considered alongside the modelling results for WLL)
  - The City of Edinburgh Council (CEC) to represent the other employers in the CSM group

Model inputs - contribution patterns (CEC)

Funding strategy	Currently certified in R&A		New R&A from 2020 valuation				
	YTE 2020	YTE 2021	YTE 2022	YTE 2023	YTE 2024	YTE 2025	Thereafter (stabilisation mechanism)
1) +0.5% for 4 years then +/-0.5% (floor: 15%, cap 30%)	22.2%	22.7%	23.2%	23.7%	24.2%	24.7%	From 1 April 2025, contributions will increase or decrease (towards the underlying “market based” rate) by no more than 0.5% of payroll each year (with a contribution rate floor of 15% and cap of 30%)
2) -0.5% for 4 years then +/-0.5% (floor: 15%, cap 30%)	22.2%	22.7%	22.2%	21.7%	21.2%	20.7%	Stabilisation in line with scenario 1 from 1 April 2025
3) Freeze for 4 years then +/-0.5% (floor: 15%, cap 30%)	22.2%	22.7%	22.7%	22.7%	22.7%	22.7%	Stabilisation in line with scenario 1 from 1 April 2025
4) Freeze for 4 years then +/-0.5% (floor: 18%, cap 25%)	22.2%	22.7%	22.7%	22.7%	22.7%	22.7%	Stabilisation in line with scenario 1 from 1 April 2025 but with a higher contribution rate floor of 18% and lower contribution rate cap of 25%
5) -1.5% for 4 years then +/-1.5% (floor: 15%, cap 30%)	22.2%	22.7%	21.2%	19.7%	18.2%	16.7%	From 1 April 2025, contributions will increase or decrease (towards the underlying “market based” rate) by no more than 1.5% of payroll each year (with a contribution rate floor of 15% and cap of 30%)

NB contribution rates include expenses of 0.3%

Model inputs - contribution patterns (WLL)

Funding strategy	Currently certified in R&A		New R&A from 2020 valuation				
	YTE 2020	YTE 2021	YTE 2022	YTE 2023	YTE 2024	YTE 2025	Thereafter
1) +0.5% for 4 years then +/-0.5% (floor 5%, cap 30%)	14.7%	14.7%	15.2%	15.7%	16.2%	16.7%	From 1 April 2025, contributions will increase or decrease (towards the underlying "market based" rate) by no more than 0.5% of payroll each year (with a contribution rate floor of 5% and cap of 30%)
2) -0.5% for 4 years then +/-0.5% (floor 5%, cap 30%)	14.7%	14.7%	14.2%	13.7%	13.2%	12.7%	Stabilisation in line with scenario 1 from 1 April 2025
3) Freeze for 4 years then +/-0.5% (floor 5%, cap 30%)	14.7%	14.7%	14.7%	14.7%	14.7%	14.7%	Stabilisation in line with scenario 1 from 1 April 2025
4) Freeze for 4 years then +/-0.5% (floor 10%, cap 25%)	14.7%	14.7%	14.7%	14.7%	14.7%	14.7%	Stabilisation in line with scenario 1 from 1 April 2025 but with a higher contribution rate floor of 10% and lower contribution rate cap of 25%
5) -1.5% for 4 years then +/-1.5% (floor 5%, cap 30%)	14.7%	14.7%	13.2%	11.7%	10.2%	8.7%	From 1 April 2025, contributions will increase or decrease (towards the underlying "market based" rate) by no more than 1.5% of payroll each year (with a contribution rate floor of 5% and cap of 30%)

NB contribution rates include expenses of 0.3%

Model inputs – liabilities and assets

- This initial modelling has been carried out for CEC and WLL
- Assets and liabilities are valued consistently
- Liability values are based on membership data provided as at 31 March 2019 by the Fund
- Liability values are assessed on the same methodology for assumptions as applied at the 2017 formal funding valuation, but updated for 31 March 2019 market conditions
- Asset values as at 31 March 2019 have been taken from the employers' HEAT schedules at this date

Model inputs – liabilities and assets

31 March 2019 (£m)	City of Edinburgh Council	West Lothian Leisure
Liabilities		
Active members	1,211	16
Deferred members	369	6
Pensioners	1,157	5
Total liabilities	**2,736**	**28**
Asset share	**2,828**	**27**
Surplus/(deficit)	91	(1)
Funding level	103%	97%

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Model inputs - investment strategy

Asset class	Current benchmark
UK equities	8%
Overseas equities	58%
Total Growth assets	**65%**
Infrastructure (equity)	11%
Senior Loans (sub inv. Grade)	2%
Commercial property	7%
Total other growth	**20%**
Index linked gilts	7%
Corporate bonds	8%
Total bonds	**15%**
Grand total	**100%**

The above asset split was provided by the Lothian Pension Fund for the purpose of this modelling exercise

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Decision making framework

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Decision making framework (1)

- Consider different funding strategies from 1 April 2021
  - The contribution patterns tested were agreed after correspondence with Fund officers
  - The contribution strategies described on slides 21 and 22 are a subset of the 9 contribution strategies modelled for the employers. This report focuses on the strategies that provide the most insight to help determine viable contribution strategies for the CSM employers. Results for the other strategies modelled can be provided on request.
- Time horizon
  - We have considered the position at 2040 i.e. 20 years from the 2020 valuation date. We have also considered the results at 2037 to give insight into how sensitive the results are to the time horizon.
- Likelihood of success
  - What is the “risk” tolerance? i.e. how likely is it the employer will be fully funded within the time horizon?
  - We have assumed use of a minimum 67% measure although this should not be viewed as a target

Decision making framework (2)

- Downside risk
  - How “bad” is the worst case scenario? i.e. how low could the funding level get by the end of the time horizon?
  - The averages of the worst 5% funding levels are shown for all future years.
- Combine all the above to reach a value judgement

Decision making framework (3)

- Wider factors than modelling results should also be considered
  - **Budgets**
    - What has been budgeted for the next few years?
    - If contributions are reduced now, will there be difficulty in increasing contributions in the future?
  - **Unmodelled risks**
    - Legal risks - McCloud, Cost Cap and GMP equalisation
    - Uncertainty around possible benefit changes
    - Ideally, contribution strategy should be flexible enough to absorb benefit changes
    - Other ‘big ticket’ risks include climate change and political.
    - **No allowance included in modelling**
  - **Time horizon – stay at 20 years?**
    - Some GAD pressure for this to reduce but not necessarily relevant in an open scheme
  - **Stand up to scrutiny?**
    - Results / proposed rates need to be justified to:
      - Pension Committee and Local Pension Board
      - External bodies e.g. Government Actuary’s Department (GAD)

City of Edinburgh Council

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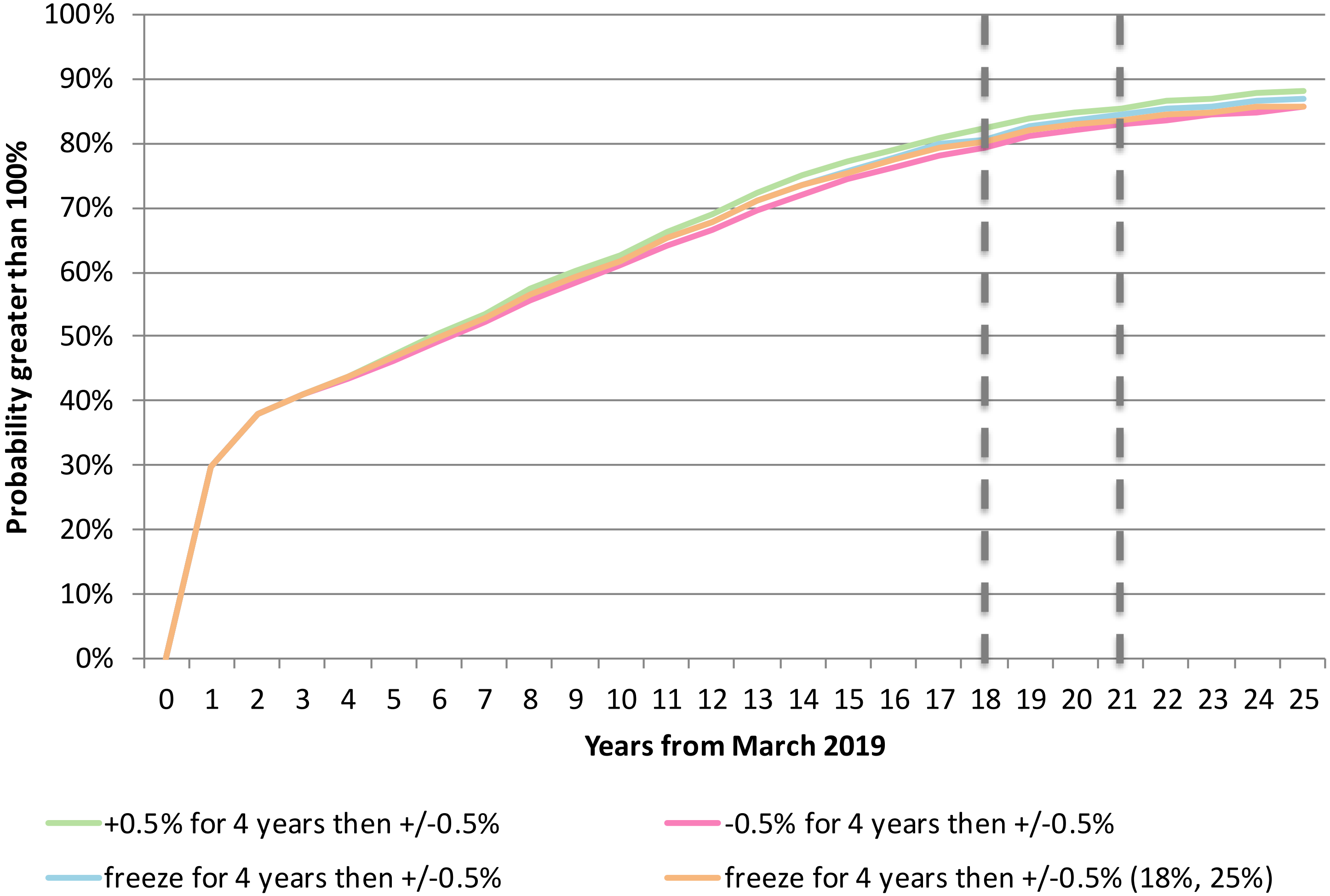
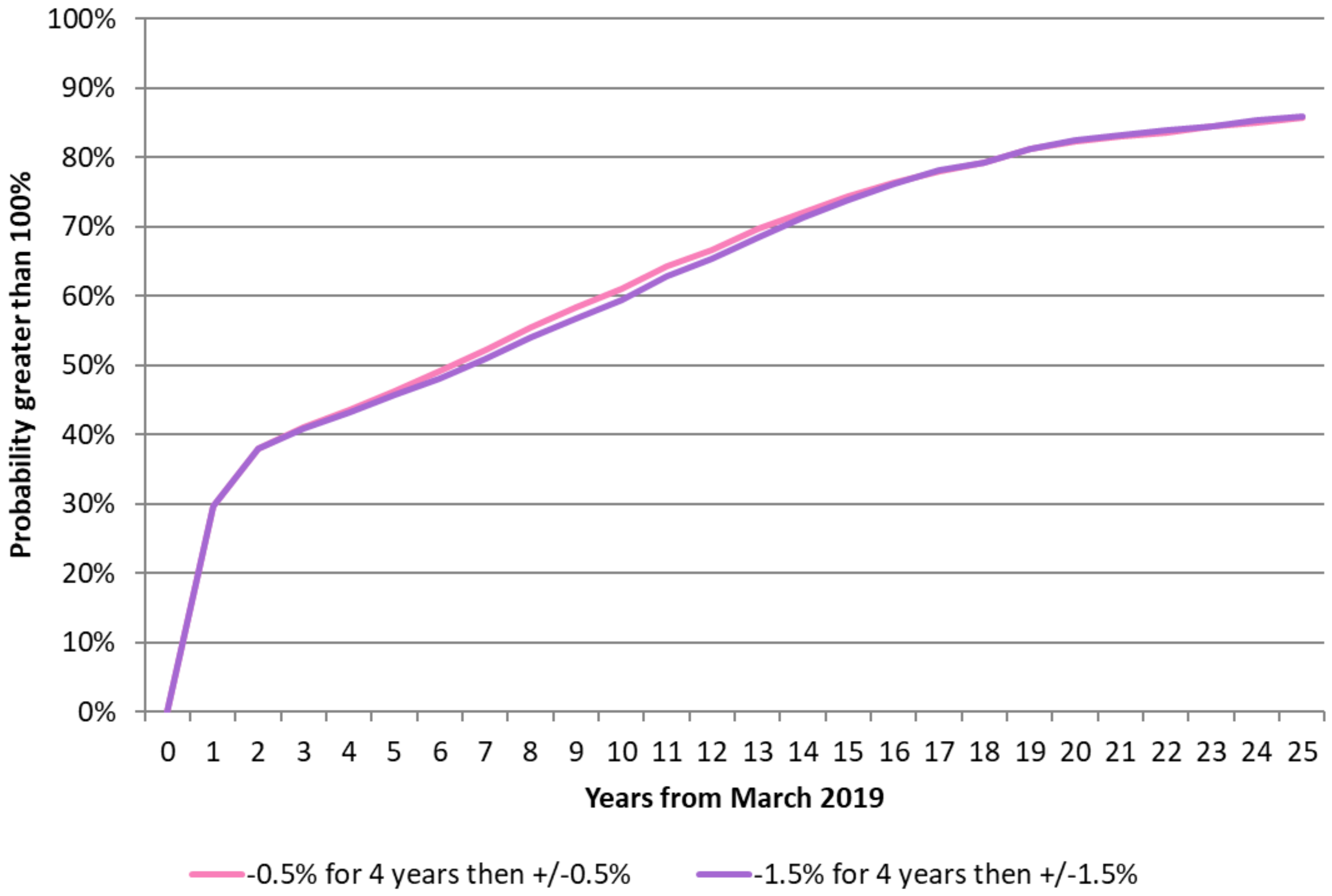
Likelihood of being above 100% funded (scenarios 1-4)



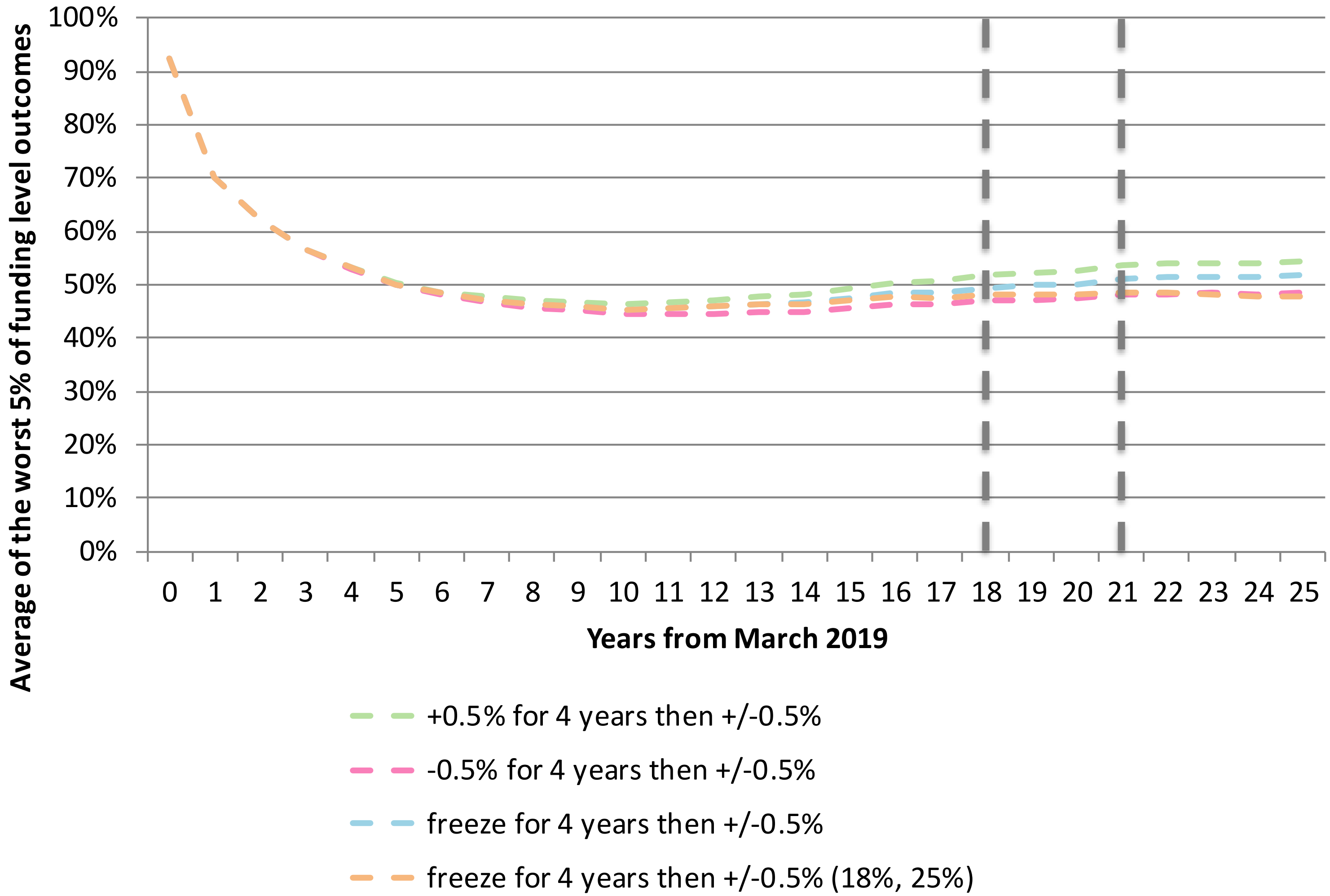
All scenarios modelled have >66% likelihood of success

Likelihood of being above 100% funded (scenarios 2 and 5)



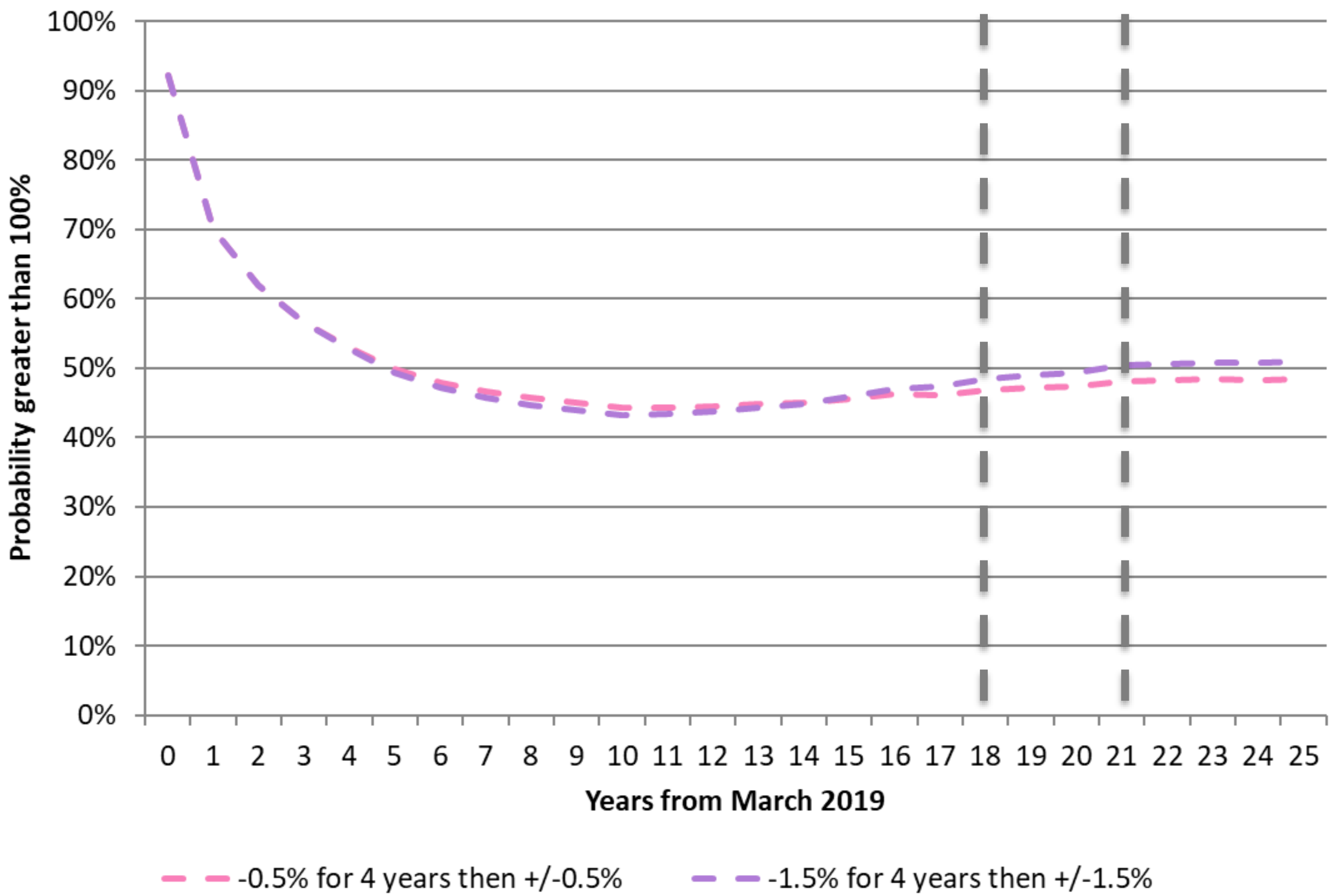
Long term outcomes similar as contribution rate bounces back quicker under +/-1.5% scenario

Average of the worst 5% of funding Levels (scenarios 1-4)



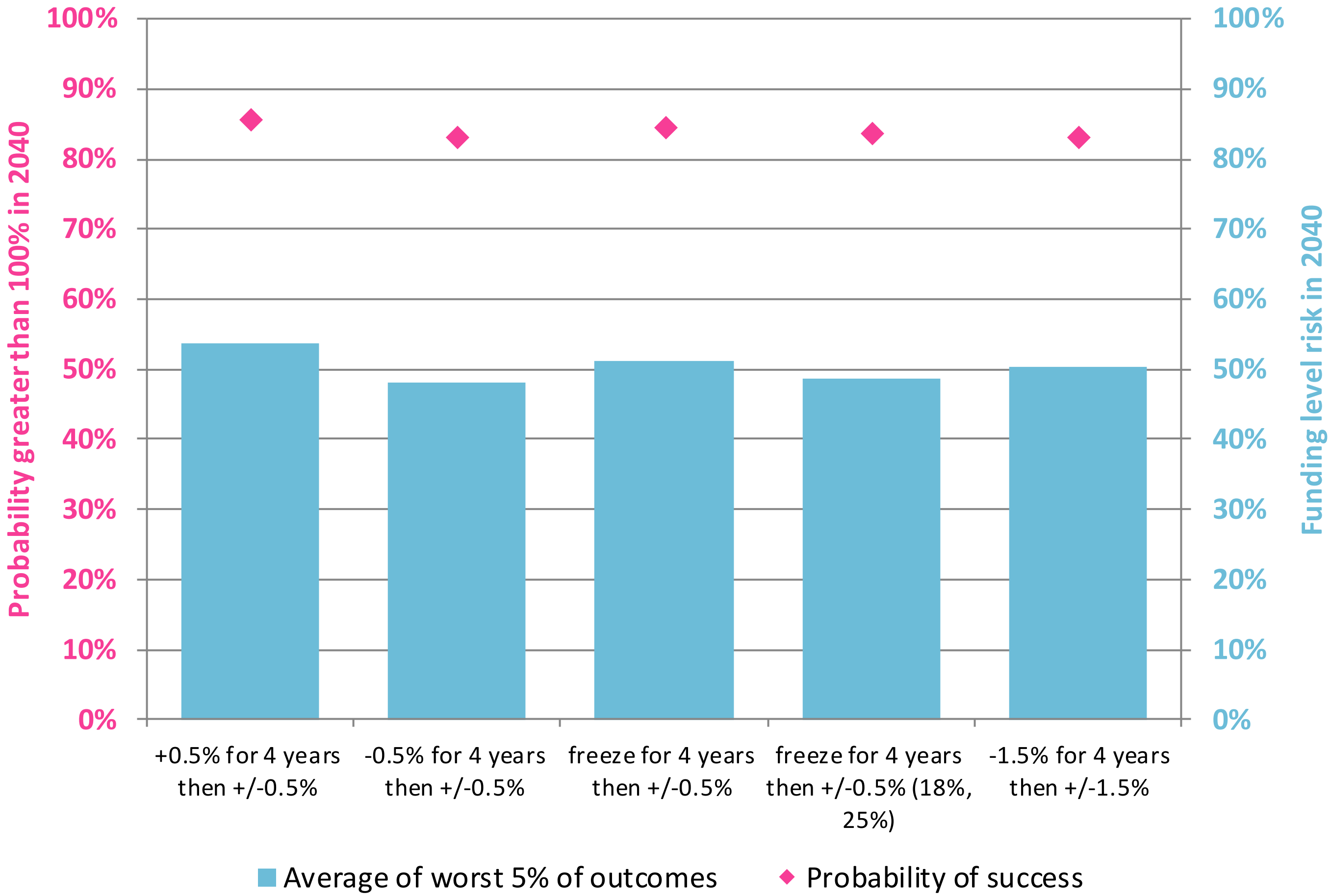
Higher contributions now lead to lower downside risk,
contribution rate cap reduces the ability to 'bounce back'

Average of the worst 5% of funding Levels (scenarios 2 and 5)



+/-1.5% scenario has lower downside risk as contributions increase faster in bad scenarios

Success vs risk in 2040



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Increasing contributions now has best funding outcomes, but freezing or short term reductions has acceptable downside risk

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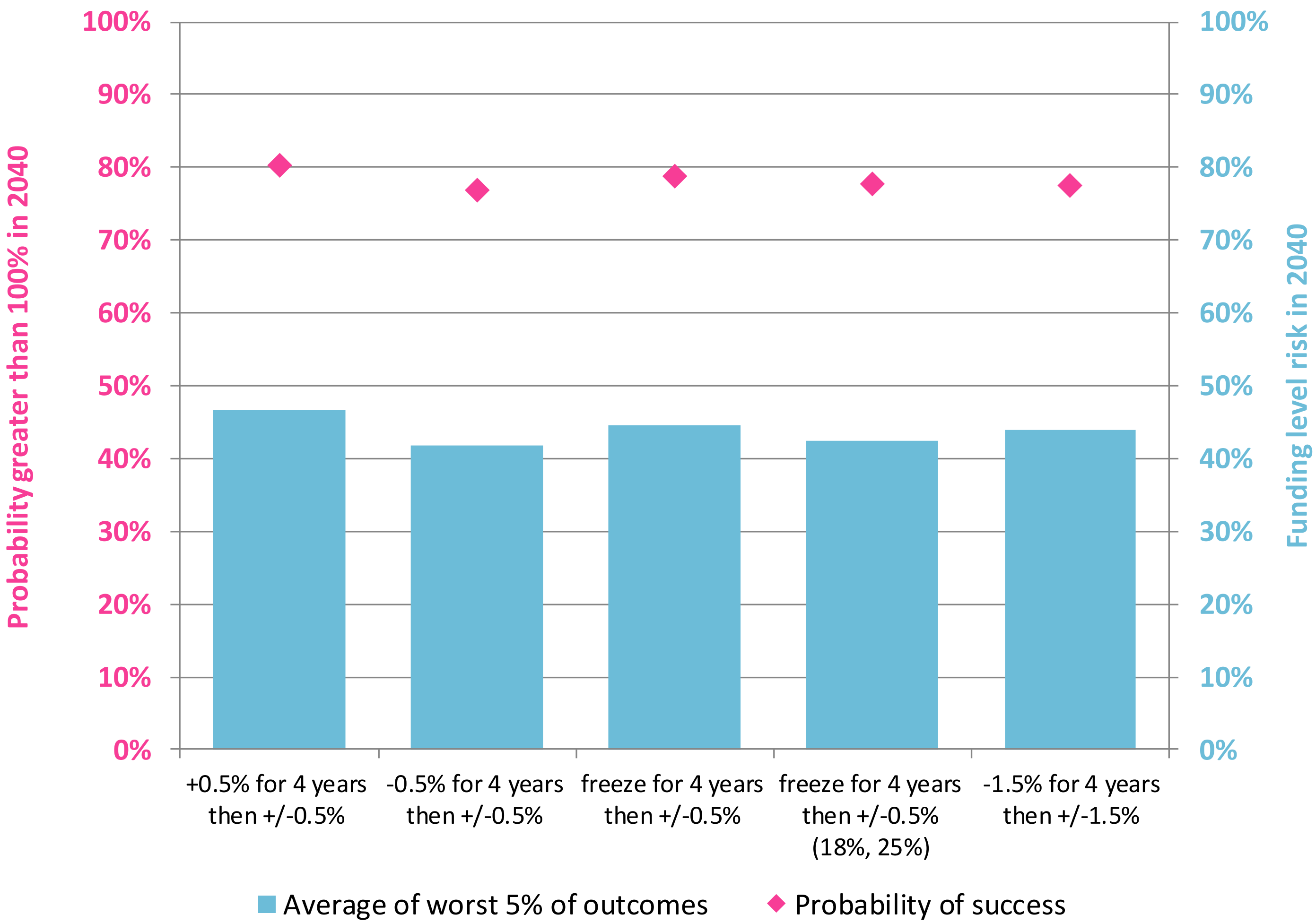
Success vs risk in 2040 – without mean reversion



The upside and downside risk measures reduce by around 6-7%.

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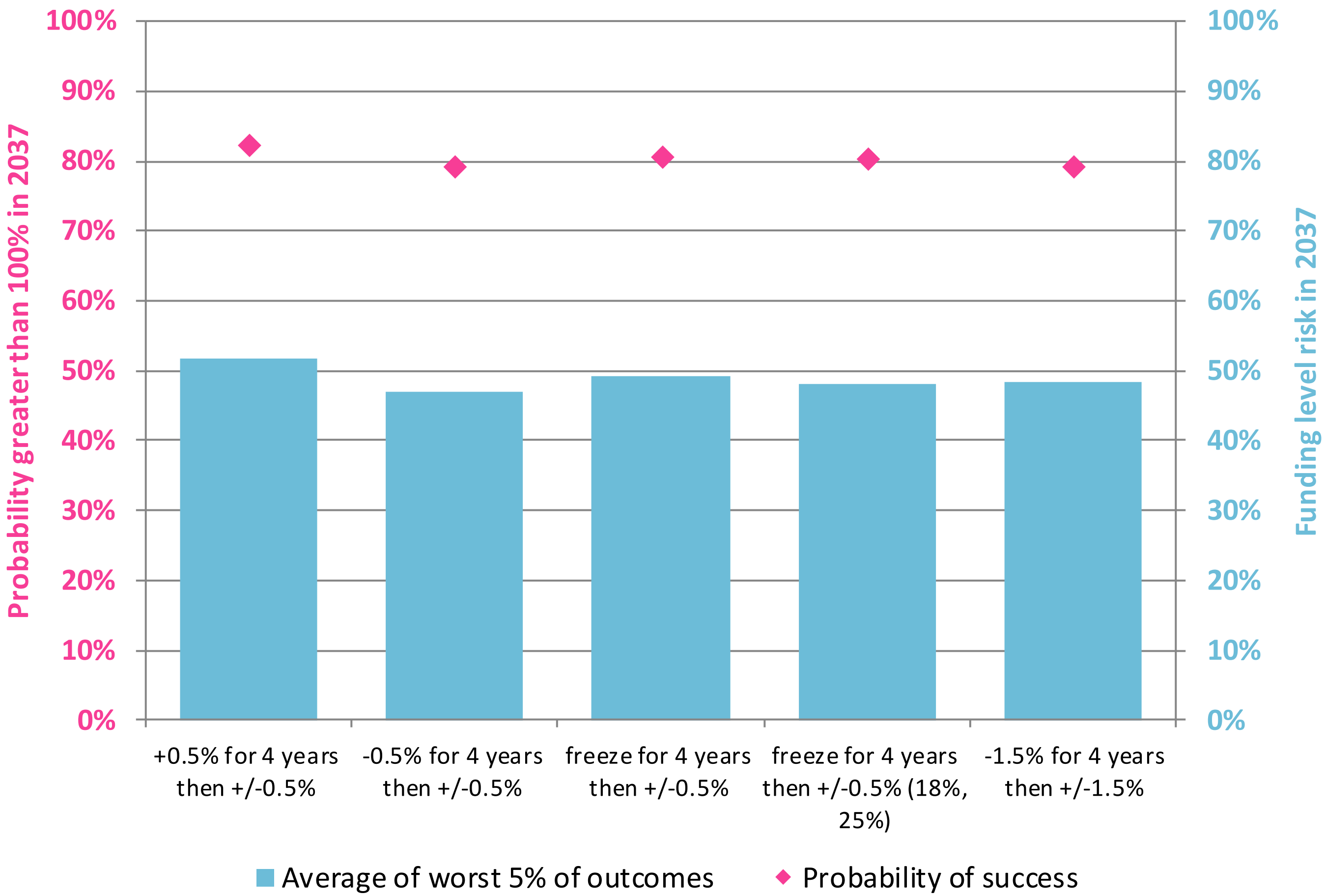
Success vs risk in 2037



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Time horizon could be reduced and funding target still met in >75% of outcomes

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Summary of results

Contribution strategy	Likelihood of meeting funding target in 2037	Likelihood of meeting funding target in 2040	Average of the worst 5% of funding levels in 2040
+0.5% for 4 years then +/-0.5% (floor: 15%, cap 30%)	82%	86%	54%
-0.5% for 4 years then +/-0.5% (floor: 15%, cap 30%)	79%	83%	48%
Freeze for 4 years then +/-0.5% (floor: 15%, cap 30%)	81%	84%	51%
Freeze for 4 years then +/-0.5% (floor: 18%, cap 25%)	80%	84%	49%
-1.5% for 4 years then +/-1.5% (floor: 15%, cap 30%)	79%	83%	50%

Contribution strategy should have a greater than 2/3rds (67%) likelihood of success
Downside risk FL- Red: <40%, Amber: between 40% and 49%, Green: >49%

HYMANS ROBERTSON

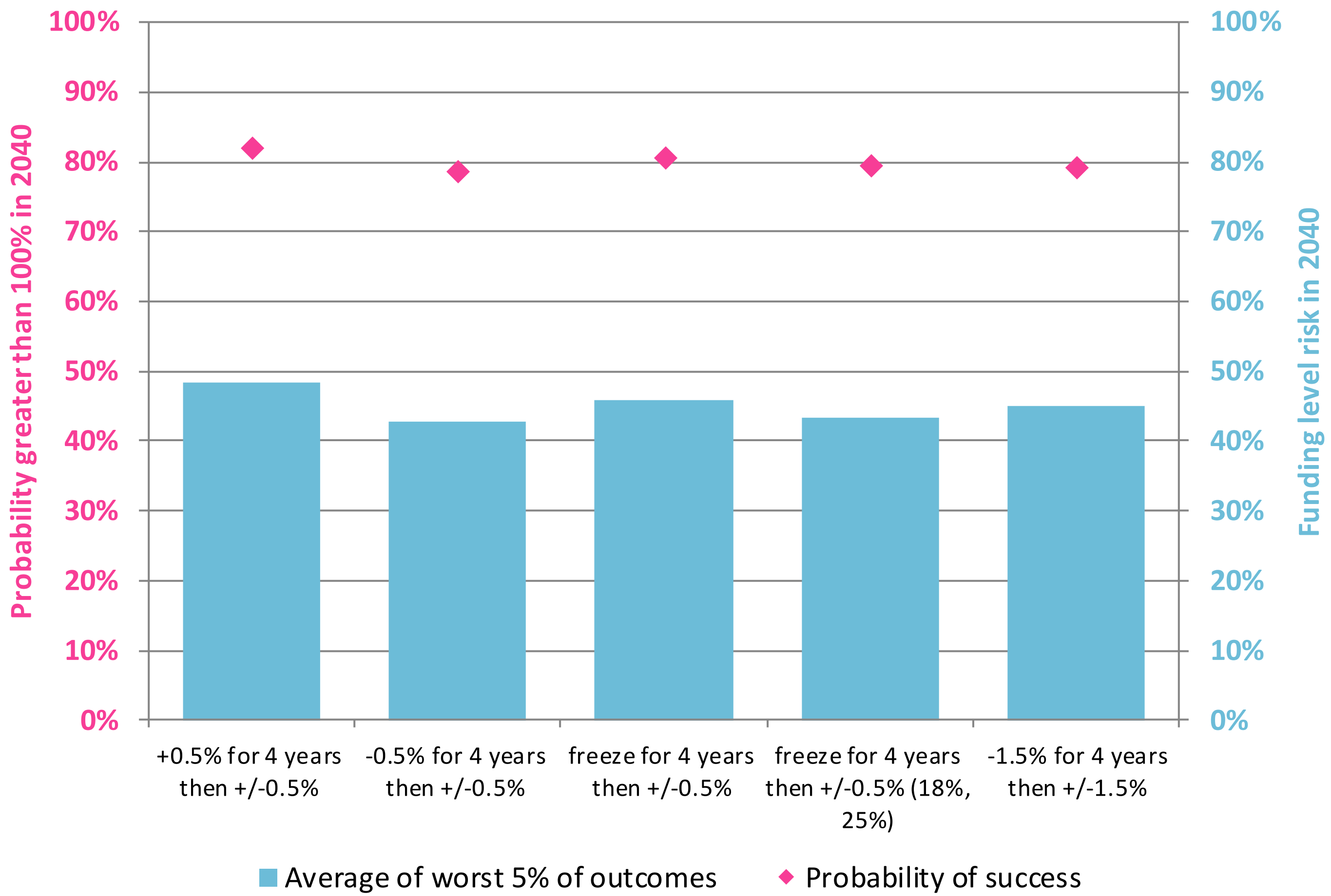
Comment on results

- At both time horizons (2037 and 2040), all strategies modelled comfortable exceed a 67% likelihood of success
- Increasing the contribution rate from 1 April 2021 leads to the most desirable outcomes
- Freezing or reducing the contribution rate for 4 years has a small but noticeable impact on the likelihood of success and downside risk
- Applying a narrower funnel of possible contribution rates (a floor of 18% and cap of 25% as opposed to a floor of 15% and cap of 30%) has a negligible impact on the likelihood of success and downside risk
- Setting funding strategy is striking a balance between affordability and prudence. The Fund will need to consider:
  - Will freezing/reducing the rate today result in difficulties increasing the rate in future? (e.g. if future investment performance is poor)
  - How much of a 'prudence buffer' should be held as cover against unmodelled risks e.g. McCloud, climate change, political?
  - Is there an opportunity to reduce the funding time horizon at this valuation?

What if asset values fall by 10% immediately?

HYMANS ROBERTSON

Success vs risk in 2040 – 10% less starting assets



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If assets were 10% lower today, likelihoods of success in 2040 would be 4-5% lower

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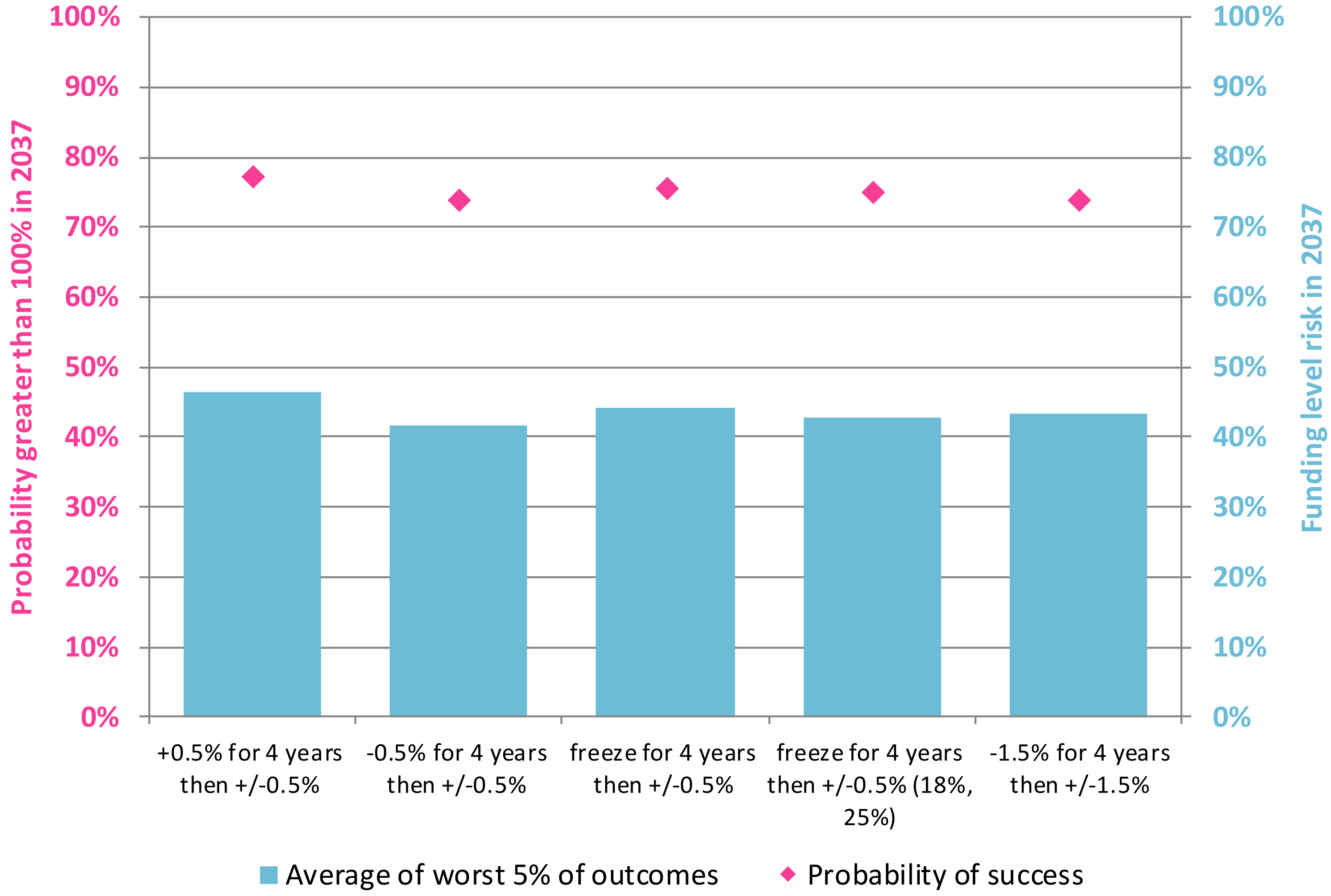
Success vs risk in 2037 – 10% less starting assets



If assets were 10% lower today, likelihoods of success in 2037 would be 5-6% lower

HYMANS ROBERTSON

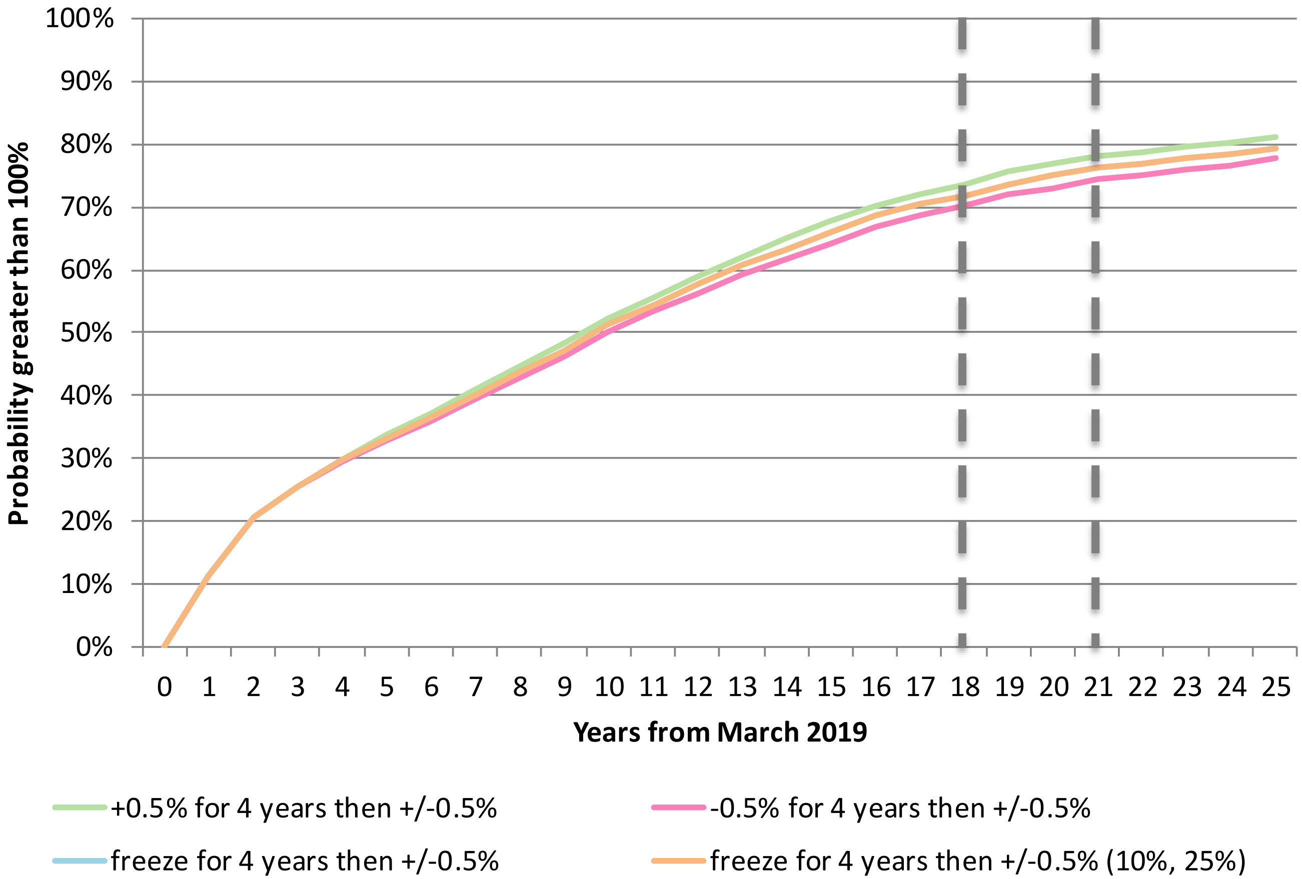
Comment on results

If assets were to fall by 10% today, the long term modelling shows that:

- All of the contribution strategies modelled have a likelihood of success greater than 67% and ‘worst case’ funding levels greater than 40%
- This supports the viewpoint that small contribution rate reductions in the short term are acceptable

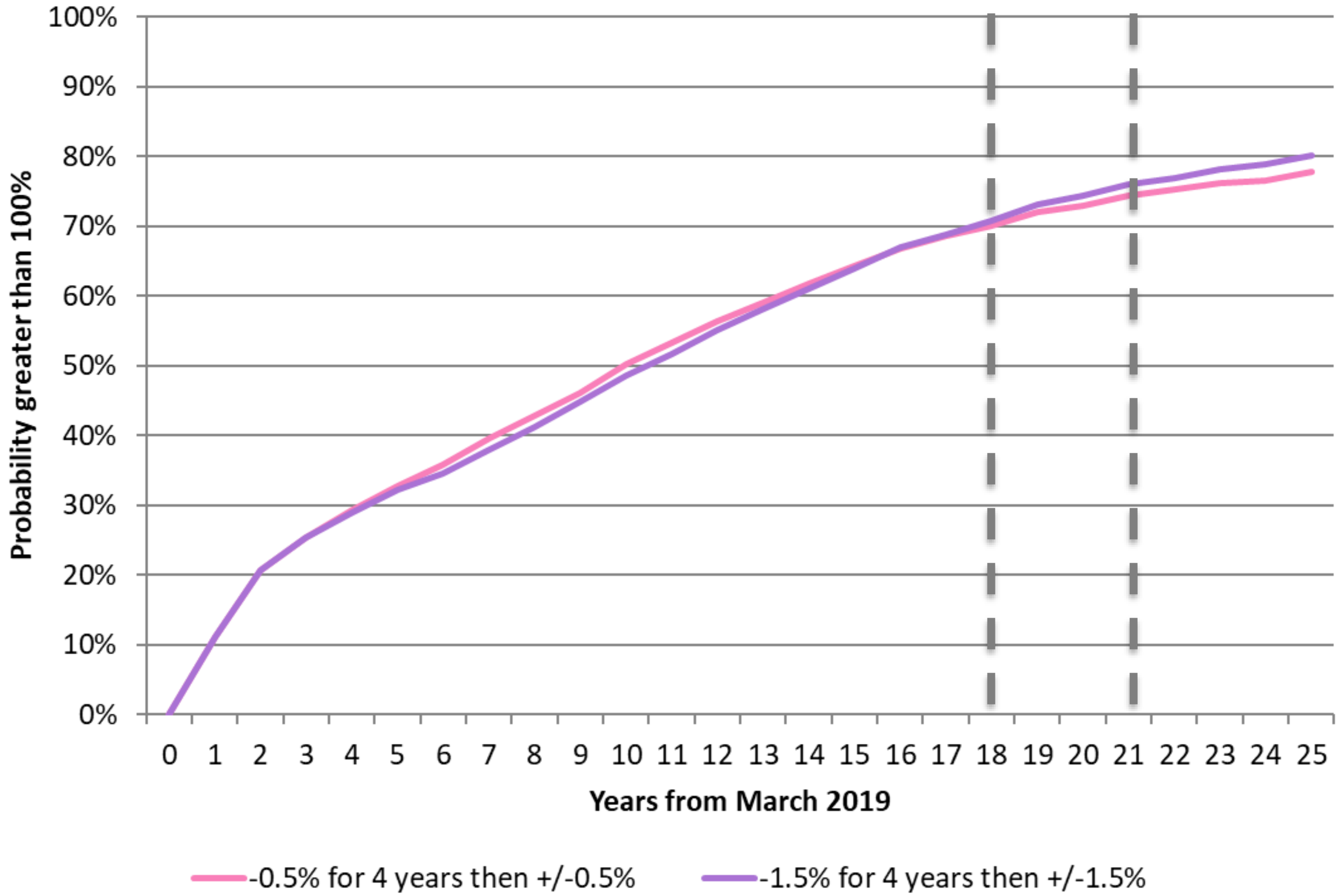
West Lothian Leisure

Likelihood of being above 100% funded (scenarios 1-4)



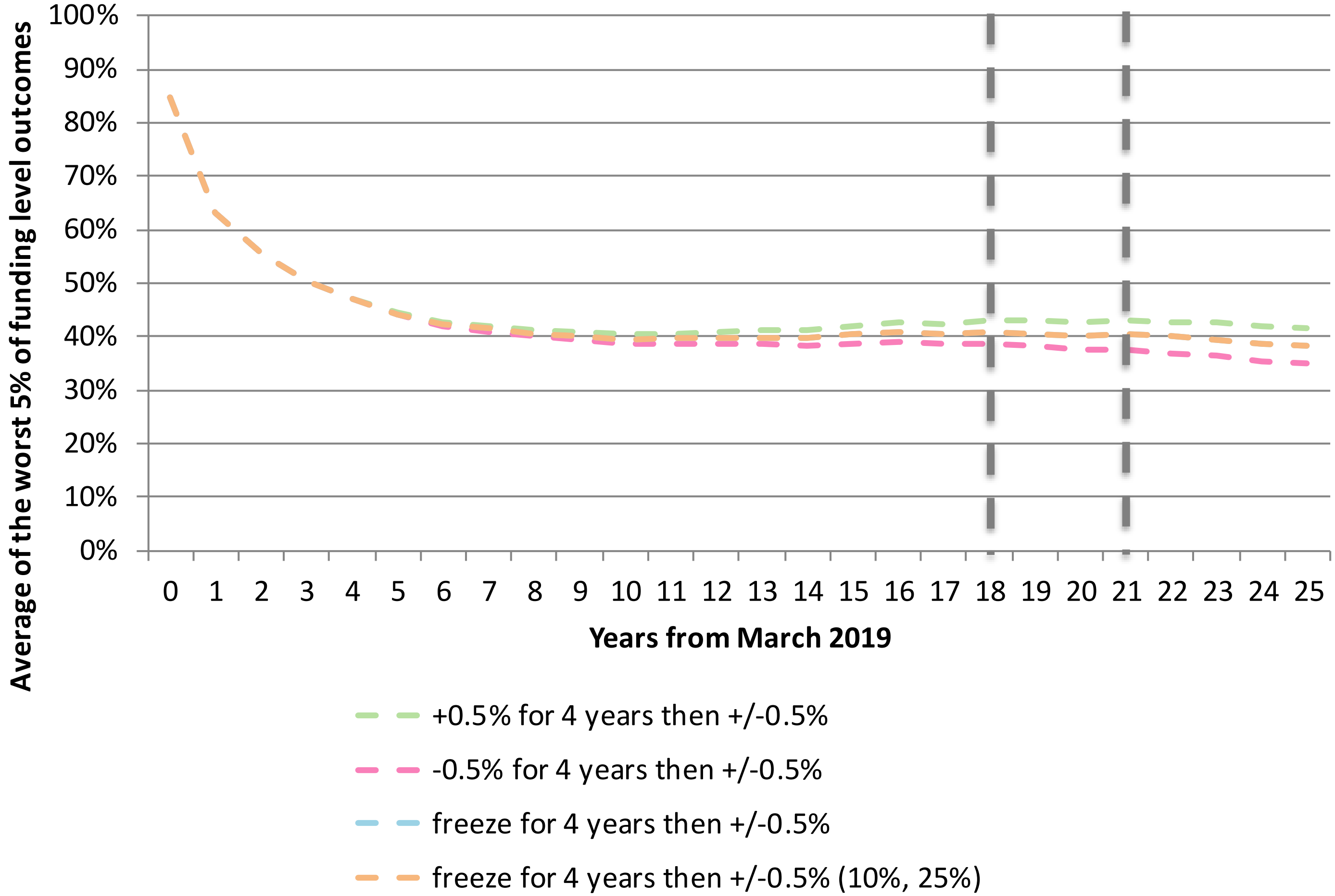
All scenarios modelled have >66% likelihood of success

Likelihood of being above 100% funded (scenarios 2 and 5)



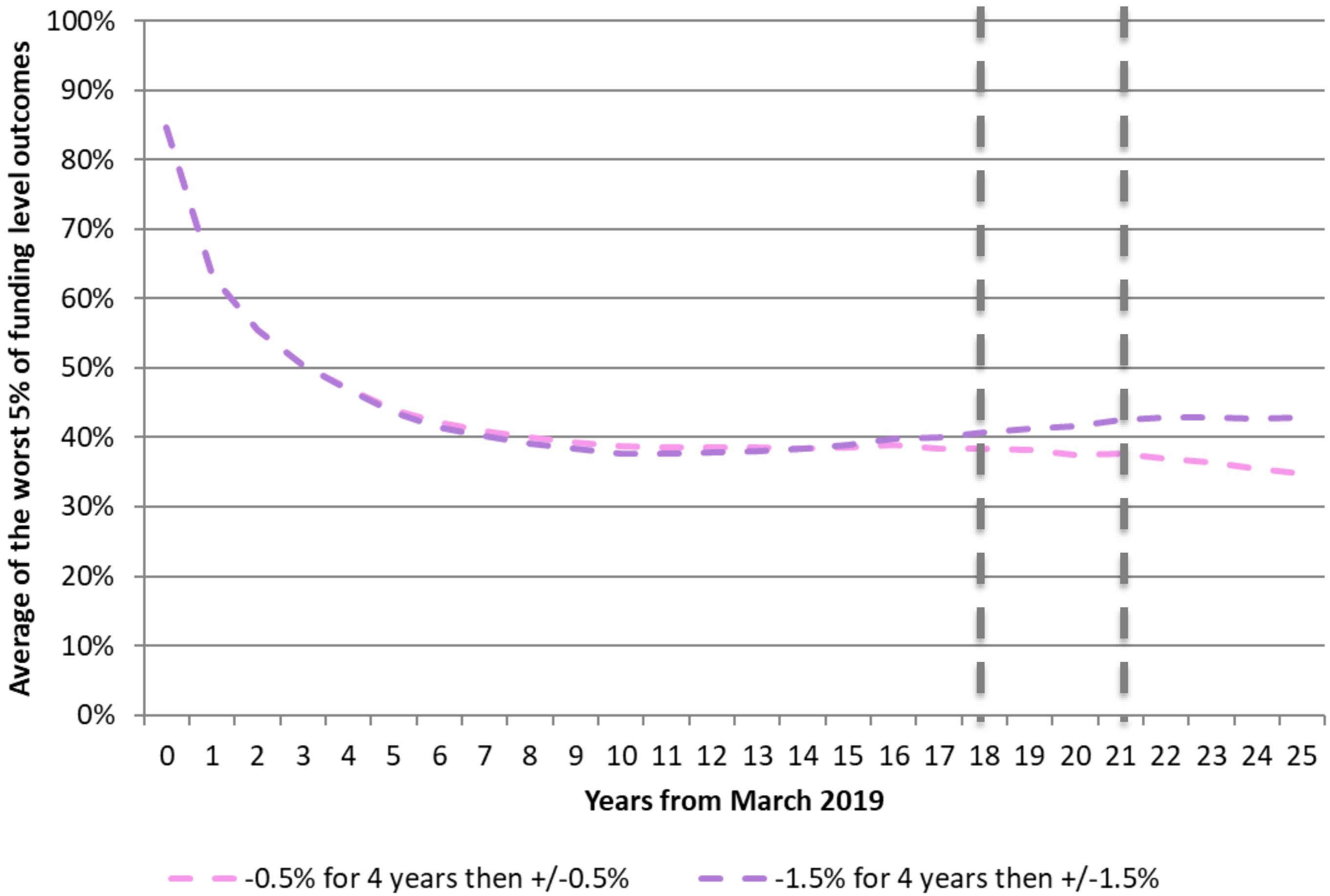
Contribution rate bounces back quicker under +/-1.5% scenario, leading to more positive long term outcomes

Average of the worst 5% of funding Levels (scenarios 1-4)



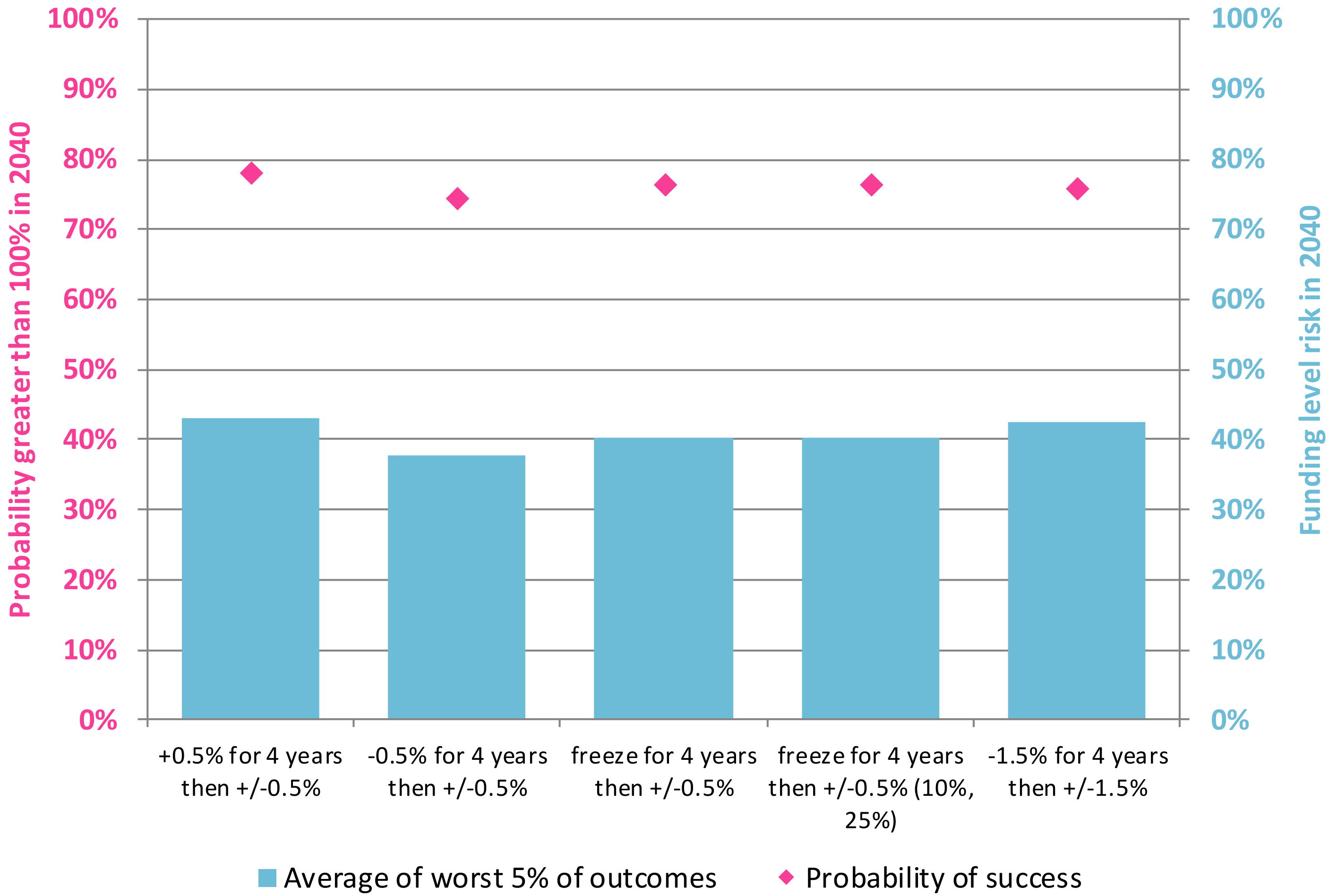
Downside risk is considerably higher than for CEC, likely due to lower current contribution rate
Downside risk continues to worsen over time if short term reductions are taken now

Average of the worst 5% of funding Levels (scenarios 2 and 5)



+/-1.5% scenario has lower downside risk as contributions increase faster in bad scenarios, contribution rate reductions today are only acceptable if employer is prepared to pay large contribution rate increases in future

Success vs risk in 2040



Increasing contributions now has best funding outcomes, freezing has acceptable downside risk. Reducing contributions now leads to high downside risk

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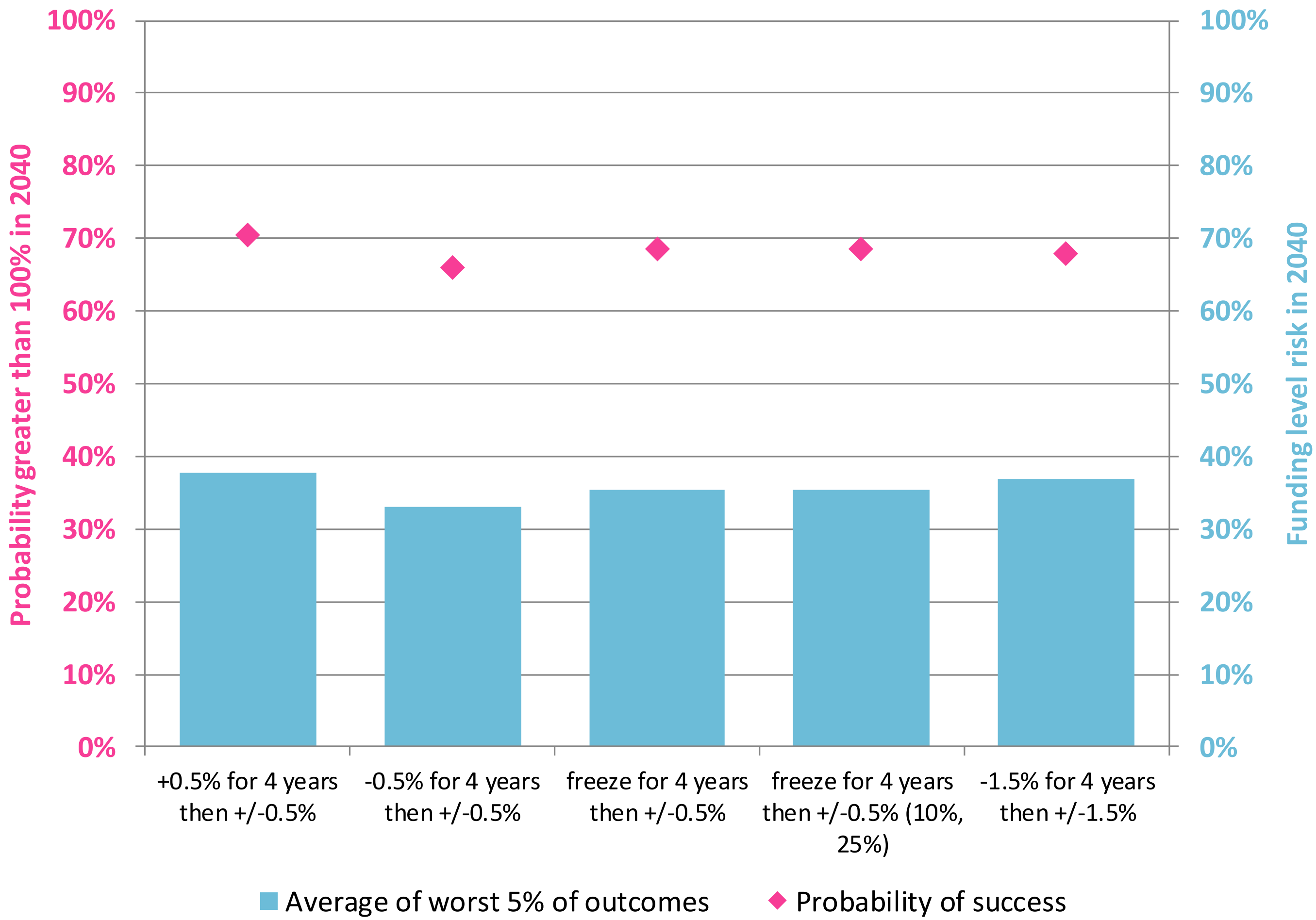
Success vs risk in 2040 – without mean reversion



The upside and downside risk measures reduce by around 5-8%.

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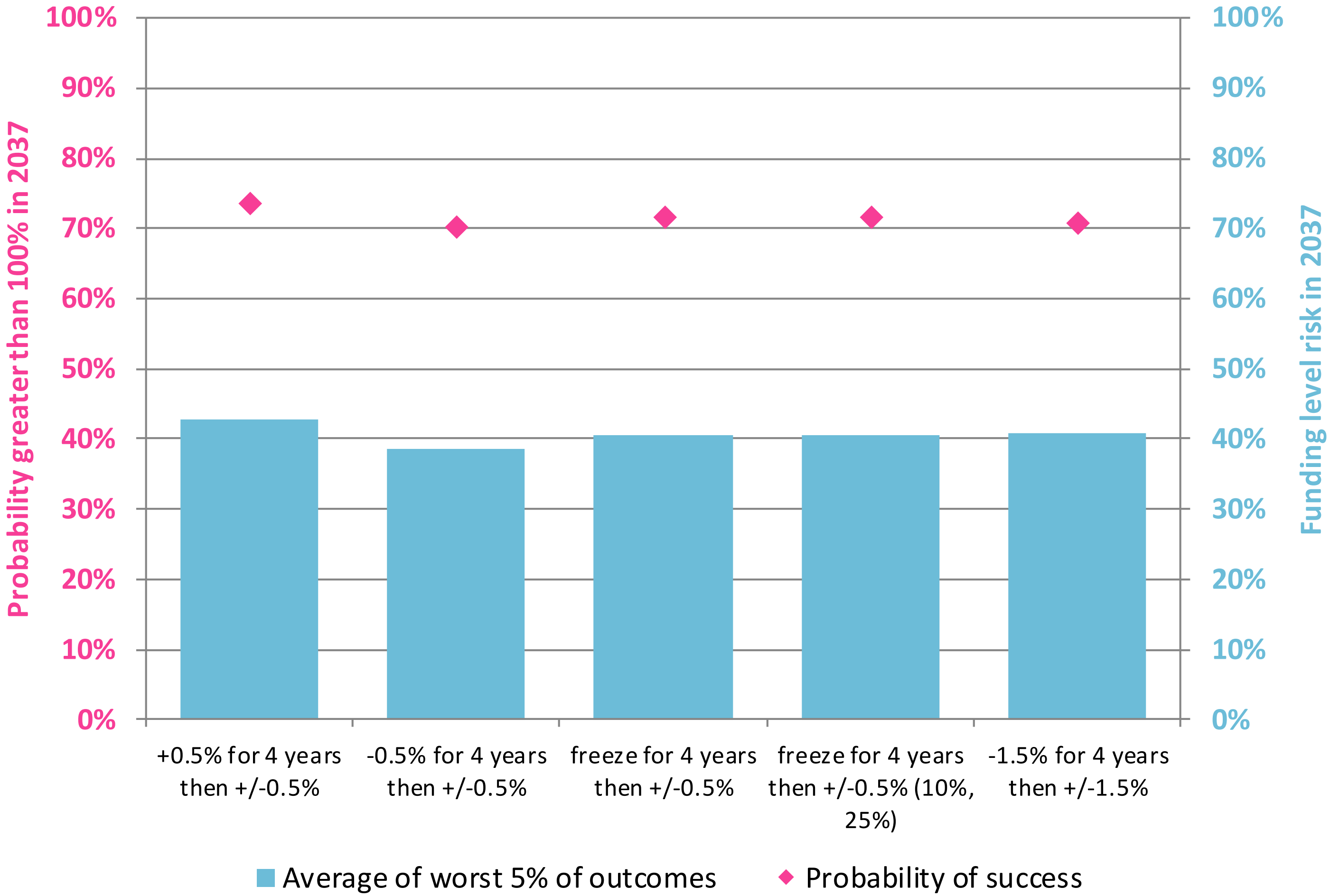
Success vs risk in 2037



Time horizon could be reduced and funding target still met in >67% of outcomes

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Summary of results

Contribution strategy	Likelihood of meeting funding target in 2037	Likelihood of meeting funding target in 2040	Average of the worst 5% of funding levels in 2040
+0.5% for 4 years then +/-0.5% (floor: 5%, cap 30%)	74%	78%	43%
-0.5% for 4 years then +/-0.5% (floor: 5%, cap 30%)	70%	74%	38%
Freeze for 4 years then +/-0.5% (floor: 5%, cap 30%)	72%	76%	40%
Freeze for 4 years then +/-0.5% (floor: 10%, cap 25%)	72%	76%	40%
-1.5% for 4 years then +/-1.5% (floor: 5%, cap 30%)	71%	76%	43%

Contribution strategy should have a greater than 2/3rds (67%) likelihood of success
Downside risk FL- Red: <40%, Amber: between 40% and 49%, Green: >49%

Comment on results

- At both time horizons (2037 and 2040), all strategies modelled exceed a 67% likelihood of success
- Increasing the contribution rate from 1 April 2021 leads to the most desirable outcomes
- Reducing contribution rates in the short term leads to high downside risk in the long term. This tells us that contribution rate reductions today may mean large increases will be required in future.
- Applying a narrower funnel of possible contribution rates (a floor of 10% and cap of 25% as opposed to a floor of 5% and cap of 30%) has a negligible impact on the likelihood of success and downside risk
- Setting funding strategy is striking a balance between affordability and prudence. The Fund will need to consider:
  - Will freezing/reducing the rate today result in difficulties increasing the rate in future? (e.g. if future investment performance is poor)
  - As there is uncertainty around the benefit structure (which is likely to increase the cost of benefits) and the long term economic outlook (e.g. due to Brexit) is a reduction to contribution rates appropriate at this time?

What if asset values fall by 10% immediately?

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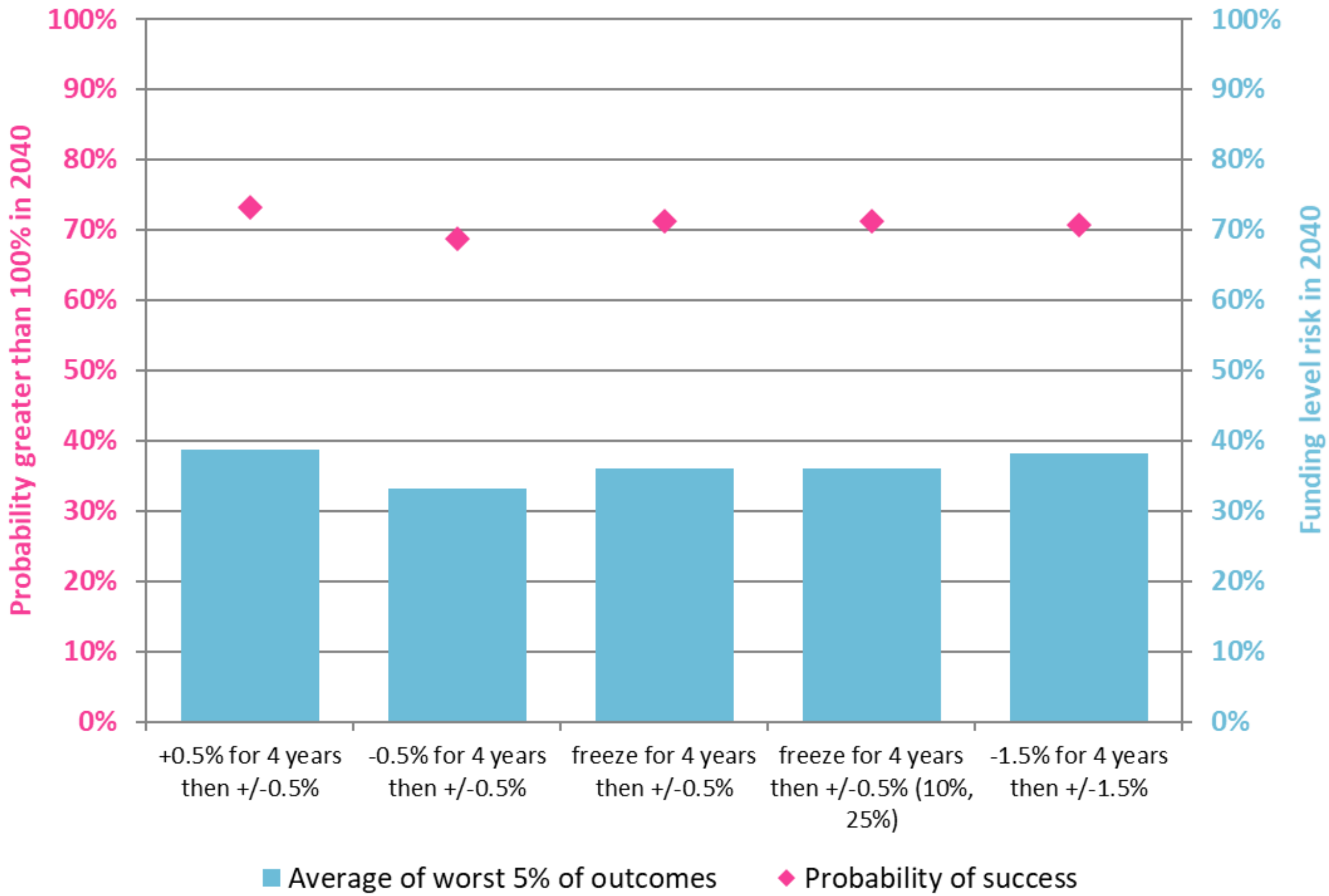
Success vs risk in 2040 – 10% less starting assets



If assets were 10% lower today, likelihoods of success in 2040 would be c5% lower

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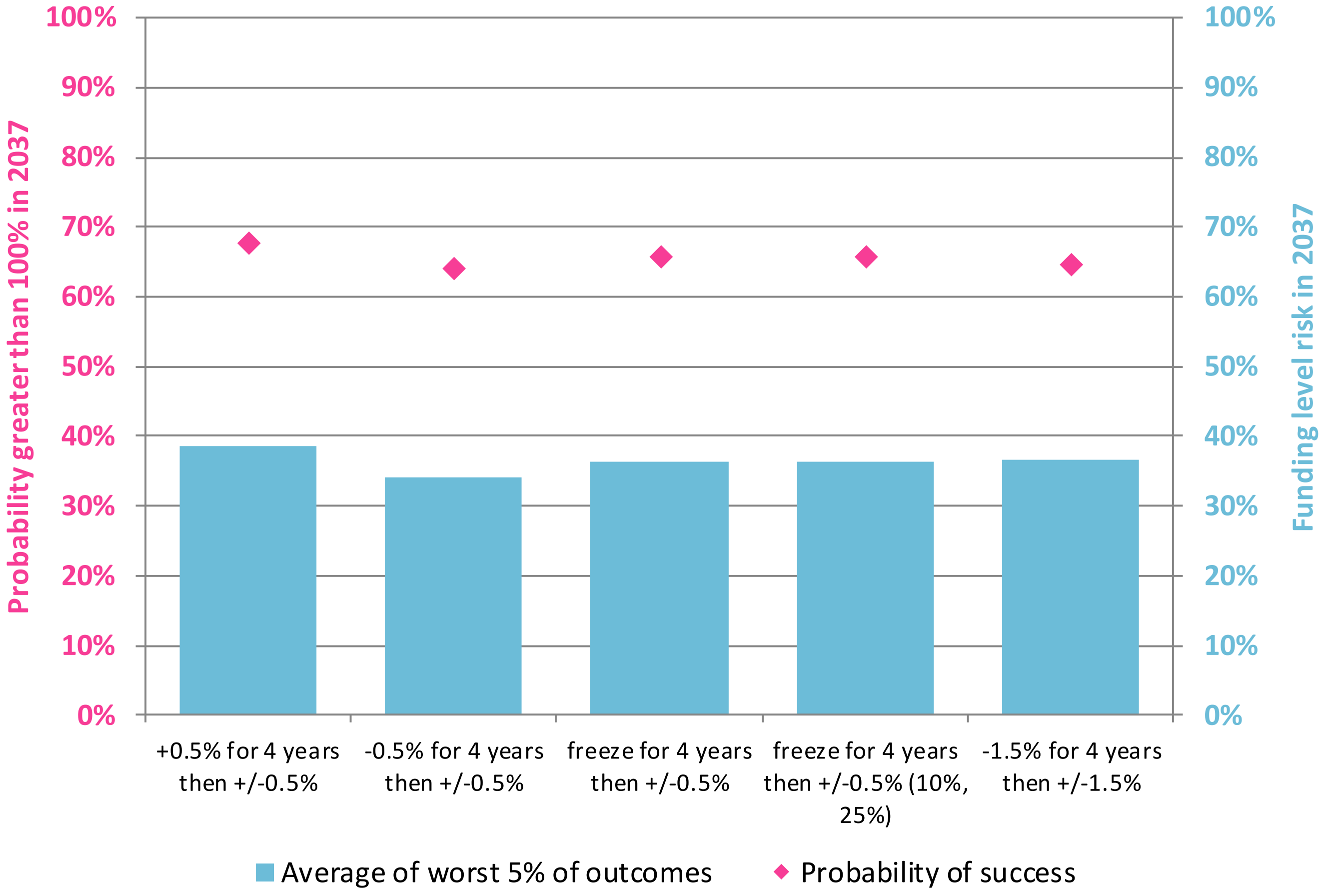
Success vs risk in 2037 – 10% less starting assets



If assets were 10% lower today, likelihoods of success in 2037 would be c6% lower,
All strategies except strategy 1 have less than 67% likelihood of success

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Comment on results

If assets were to fall by 10% today, the long term modelling shows that:

- A contribution strategy that increases by 0.5% p.a. for the next 4 years continues to meet a 67% likelihood of success at both time horizons
- All other strategies rely on the final 3 years of the projections to meet this likelihood

Appendix - Technical & Professional Notes

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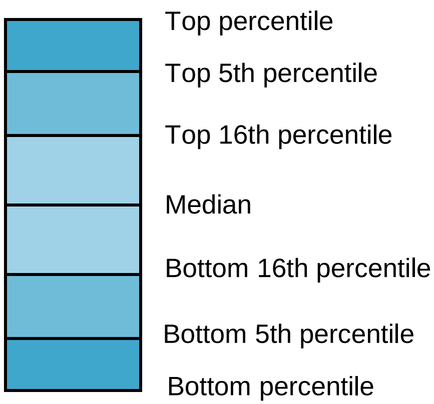
Reliances, limitations and additional details (1)



- We undertake 5,000 simulations of the future for each scenario. The outcomes of the simulations are ranked from “best” to “worst”. The spread of outcomes at a given point in time for a given strategy can be illustrated in charts as follows.
- The “median” funding level can be considered to be the average outcome. It should be noted that this is not the same as saying this is the most likely outcome, rather it represents the value with which we would expect all outcomes to have a 50% chance of being above and a 50% chance of being below.
- The bottom 16th percentile – approximately 1 outcome in 6 is worse than this level.
- The top 16th percentile – approximately 5 outcomes in 6 would be expected to be below this level.
- The bottom 5th percentile can be considered a “bad” outcome – 1 outcome in 20 of the simulations is expected to be worse than this.
- The top 5th percentile can be considered a “good” outcome – 19 outcomes in 20 of the simulations are expected to be below this level.
- The bottom percentile can be considered an “extremely bad” outcome, which occurs with a probability of 1 in 100.
- The top percentile can be considered an “extremely good” outcome, which occurs with a probability of 1 in 100.
- When plotting the distribution of contribution rates, rather than funding levels, the description of any outcome as ‘bad’ or ‘good’ is reversed.
- In all the charts we consider, there will be some outcomes above and below the highest and lowest levels shown.

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Reliances, limitations and additional details (2)

Data – Cashflows

In projecting forward the evolution of the Fund, we have used estimated cash flows generated using our actuarial valuation system, based on information provided as at 31 March 2019 by the Fund.

Data – ESS

The distributions of outcomes depend significantly on the Economic Scenario Service (ESS), our (proprietary) stochastic asset model. This type of model is known as an economic scenario generator and uses probability distributions to project a range of possible outcomes for the future behaviour of asset returns and economic variables. Some of the parameters of the model are dependent on the current state of financial markets and are updated each month (for example, the current level of equity market volatility) while other more subjective parameters do not change with different calibrations of the model.

Key subjective assumptions are the average excess equity return over the risk free asset (tending to approximately 3% p.a. as the investment horizon is increased), the volatility of equity returns (approximately 18% p.a. over the long term) and the level and volatility of yields, credit spreads, inflation and expected (breakeven) inflation, which affect the projected value placed on the liabilities and bond returns. The market for CPI linked instruments is not well developed and our model for expected CPI in particular may be subject to additional model uncertainty as a consequence. The output of the model is also affected by other more subtle effects, such as the correlations between economic and financial variables.

Our expectation (i.e. the average outcome) is that long term real interest rates will gradually rise from their current low levels. Higher long-term yields in the future will mean a lower value placed on liabilities and therefore our median projection will show, all other things being equal, an improvement in the current funding position (because of the mismatch between assets and liabilities). The mean reversion in yields also affects expected bond returns.

While the model allows for the possibility of scenarios that would be extreme by historical standards, including very significant downturns in equity markets, large systemic and structural dislocations are not captured by the model. Such events are unknowable in effect, magnitude and nature, meaning that the most extreme possibilities are not necessarily captured within the distributions of results.

Reliances, limitations and additional details (3)

Given the context of this modelling, we have not undertaken any sensitivity analysis to assess how different the results might be with alternative calibrations of the economic scenario generator, or allowances for resource & environment constraints.

We would be happy to provide fuller information about the scenario generator, and the sensitivities of the results to some of the parameters, on request.

Model

Except where stated, we do not allow for any variation in actual experience away from the demographic assumptions underlying the cash flows. Variations in demographic assumptions (and experience relative to those assumptions) can result in significant changes to the funding level and contribution rates. We allow for variations in inflation (RPI or CPI as appropriate), inflation expectations (RPI or CPI as appropriate), interest rates and asset class returns. Cash flows into and out of the Scheme are projected forward in annual increments, are assumed to occur in the middle of each Scheme year and do not allow for inflation lags. Investment strategies are assumed to be rebalanced annually.

Unless stated otherwise, we have assumed that all contributions are made and not varied throughout the period of projection irrespective of the funding position. In practice the contributions are likely to vary especially if the funding level changes significantly.

Investment strategy is also likely to change with significant changes in funding level, but unless stated otherwise we have not considered the impact of this.

The returns that could be achieved by investing in any of the asset classes will depend on the exact timing of any investment/disinvestment. In addition, there will be costs associated with buying or selling these assets. The model implicitly assumes that all returns are net of costs and that investment/disinvestment and rebalancing are achieved without market impact and without any attempt to 'time' entry or exit.

For the purposes of modelling very low investment risk strategies or matched bond portfolios, we have constructed an LBP (liability benchmark portfolio) that is a hypothetical portfolio that exactly matches the changes in value and cash flows of the liabilities (with a particular allowance for accrual) under all states of the world. It is generally not possible in practice to construct a portfolio with the same high quality of matching as the LBP but major financial and investment risks can be broadly quantified. However, a more detailed analysis is required to understand fully the implications and appropriate implementation of a very low risk or ‘cash flow matched’ strategy.

Reliances, limitations and additional details (4)

Assumptions

We have estimated future service benefit cash flows and projected salary roll for new entrants after the valuation date such that payroll remains constant in real terms (i.e. full replacement). There is a distribution of new entrants introduced at ages between 25 and 65, and the average age of the new entrants is assumed to be 40 years. All new entrants are assumed to join and then leave service at SPA, which is a much simplified set of assumptions compared with the modelling of existing members. The base mortality table used for the new entrants is an average of mortality across the LGPS and is not client specific, which is another simplification compared to the modelling of existing members. Nonetheless, we believe that these assumptions are reasonable for the purposes of the modelling given the highly significant uncertainty associated with the level of new entrants.

There are a number of different types of increases applied before and after retirement to benefits payable from the Fund.

In the modelling we have assumed that the Fund will undergo valuations every three years and a contribution rate will be set that will come into force one year after the simulated valuation date. For ‘stabilised’ contributions, the rate at which the contribution changes is capped and floored. There is no guarantee that such capping or flooring will be appropriate in future; this assumption has been made so as to illustrate the likely impact of practical steps that may be taken to limit changes in contribution rates over time. We have assumed that the Actuary to the Fund will make his or her calculations using broadly the same methodology as that currently used, but note that this is a source of uncertainty that we have not attempted to measure in the model other than where noted specifically.

A judgement always has to be made as the most appropriate assets from the ESS to model the strategy under consideration. We have agreed this with yourselves during the scoping stage and further details are in the appendices.

TAS Compliance

The models used to carry out this modelling, and this presentation, comply with Technical Actuarial Standards 100 (Principles for Technical Actuarial Work) and 300 (Pensions).

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Reliances, limitations and additional details (5)

		Annualised total returns												
		Cash	Index Linked Gilts (medium)	Fixed Interest Gilts (medium)	Overseas Equity	Private Equity	Property	Emerging Markets Equity	Infrastructure Equity	Diversified Growth Fund	Multi Asset Credit (sub inv grade)	Inflation	17 year real yield	17 year yield
5 years	16th %'ile	-0.4%	-2.3%	-2.9%	-4.1%	-7.3%	-3.5%	-7.0%	-4.9%	-1.9%	1.1%	1.9%	-2.5%	0.8%
	50th %'ile	0.7%	0.5%	0.3%	4.1%	4.8%	2.4%	4.3%	4.2%	3.5%	4.1%	3.3%	-1.7%	2.1%
	84th %'ile	2.0%	3.3%	3.4%	12.5%	18.8%	8.8%	17.0%	13.8%	9.1%	6.5%	4.9%	-0.8%	3.6%
10 years	16th %'ile	-0.2%	-1.8%	-1.3%	-1.4%	-3.4%	-1.5%	-3.2%	-1.8%	-0.2%	1.9%	1.9%	-2.0%	1.2%
	50th %'ile	1.3%	0.0%	0.2%	4.7%	5.5%	3.1%	5.0%	4.7%	3.7%	4.1%	3.3%	-0.8%	2.8%
	84th %'ile	2.9%	1.9%	1.7%	10.8%	15.5%	7.8%	13.6%	11.8%	7.7%	5.9%	4.9%	0.4%	4.8%
20 years	16th %'ile	0.7%	-1.1%	0.1%	1.3%	0.3%	0.6%	0.2%	1.1%	1.9%	3.4%	2.0%	-0.7%	2.2%
	50th %'ile	2.4%	0.3%	1.0%	5.8%	6.8%	4.3%	6.2%	6.0%	4.8%	5.1%	3.2%	0.8%	4.0%
	84th %'ile	4.5%	2.0%	2.0%	10.4%	13.6%	8.1%	12.5%	11.1%	7.7%	7.0%	4.7%	2.2%	6.3%
	Volatility (Disp) (1 yr)	1%	7%	10%	17%	28%	14%	25%	20%	13%	8%	1%		

The current calibration of the model indicates that a period of outward yield movement is expected. For example, over the next 20 years our model expects the 17 year maturity annualised real (nominal) interest rate to rise from -2.1% (1.5%) to 0.8% (4.0%).

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General risk warning

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Appendix 2

Employers currently part of Contribution Stability Mechanism (CSM) and proposals from 1 April 2020

Name of employer	Proposal from 1 April 2020
The City of Edinburgh Council	Recommendation 1.1
West Lothian Council	Recommendation 1.1
East Lothian Council	Recommendation 1.1
Midlothian Council	Recommendation 1.1
Police Scotland	Recommendation 1.1
Scottish Fire & Rescue Service	Recommendation 1.1
Lothian Valuation Joint Board	Recommendation 1.1
Scottish Water	Recommendation 1.1
Visit Scotland	Recommendation 1.1
Heriot-Watt University	Recommendation 1.1
Queen Margaret University	Recommendation 1.1
Edinburgh Napier University	Recommendation 1.1
Edinburgh College	Recommendation 1.1
West Lothian College	Recommendation 1.1
Audit Scotland	Recommendation 1.1
The Improvement Service	Recommendation 1.1
Children's Hospice Association Scotland	Recommendation 1.1
Scottish Futures Trust	Recommendation 1.1
West Lothian Leisure	Recommendation 1.1.1
Enjoy Leisure	Recommendation 1.1.1
Children's Hearing Scotland	Recommendation 1.1.2
Newbattle College	Recommendation 1.1.3
Barony Housing Association	Due to transfer to Strathclyde Pension Fund January 2020
SESTRAN	As previously advised to Pensions Committee: removed from CSM in March 2019

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Pensions Committee

2.00pm, Wednesday, 11 December 2019

Statement of Investment Principles

Item number	**5.5**
Executive/routine	
Wards	**All**
Council Commitments	

1. Recommendations

The Pensions Committee is requested to:

1.1 agree the revised target weights and permitted ranges for the cash and gilts allocations for the Mature Employers Group (MEG) strategy; and

1.2 adopt the revised Statement of Investment Principles.

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

EDINBVRGH
THE CITY OF EDINBURGH COUNCIL

Report

Statement of Investment Principles

2. Executive Summary

2.1 The report introduces the revised Statement of Investment Principles (SIP) for Lothian Pension Fund and Scottish Homes Pension Fund (the Funds). It replaces the SIP agreed by Committee in December 2018.

3. Background

3.1 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.

3.2 The SIP is an important part of the Fund's governance arrangements and provides the framework within which the Committee delegates the implementation of the investment strategy, as defined by the policy (asset class) groups, to officers with advice from the Joint Investment Strategy Panel. Committee retains responsibility for investment strategy.

4. Main report

4.1 The Statement of Investment Principles (SIP) is formally reviewed annually whether there are policy changes or not. It has been reviewed by officers and the Joint Investment Strategy Panel (JISP).

4.2 The revised SIP includes changes that are not material to the overall strategy of either Lothian Pension Fund or Scottish Homes Pension Fund. The main changes are:

a. The removal of Lothian Buses Pension Fund, which merged with Lothian Pension Fund at the beginning of April 2019 and now represents circa 7% of liabilities.

b. The addition of a new employer strategy at the time of merger – the Buses Strategy.

c. Adjustments to the Buses Strategy (unrelated to the merger) between April and September 2019 intended to reduce funding level volatility.

d. The renaming of the investment strategies.

Investment Strategy Updates

4.3 The asset allocation and investment performance of the Funds is reviewed in detail annually each June.

4.4 Lothian Pension Fund's updated actual and strategic allocations at 30 September are presented in the two tables below.

4.5 On a consolidated basis, its estimated market value has increased from £7.8bn at end March 2019 to £8.4bn at end September 2019.

4.6 The names given to the Lothian Pension Fund investment strategies have been amended in the Statement of Investment Principles to be consistent with terminology used in its annual report and accounts. There are now four strategies: Main Strategy (91% of assets), Mature Employers Group (MEG) Strategy (1% of assets), 50/50 Strategy (1% of assets) and Buses Strategy (7% of assets). The current target allocations for each strategy are shown in the table below.

Employer Strategies					
Policy Group	**Main**	**MEG**	**50/50**	**Buses**	**Total**
Equities	65%	0%	33%	35%	62.0%
Real Assets	18%	0%	9%	18%	17.7%
Non-Gilt Debt	10%	0%	5%	20%	10.6%
Gilts	7%	88%	48%	28%	9.6%
Cash	0%	12%	6%	0%	0.2%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

At end September 2019

Note numbers may not sum due to rounding

4.7 The Buses Strategy was created following the merger of the Lothian Buses Pension Fund with Lothian Pension Fund in April 2019. At inception, there was no change to the pre-existing investment strategy, which targeted a reduction in growth assets over the 2016-21 period in recognition of the employer's increasing maturity and its strong funding level.

4.8 Between April and September 2019, a meaningful reduction in growth assets was implemented for the Buses Strategy in line with the advice of the Joint Investment Strategy Panel. Equities were reduced from 51.5% to 35% alongside increased allocations to non-gilt debt and gilts, with the intention of reducing funding level volatility for the employer.

4.9 The MEG (Mature Employers Group) Strategy is highlighted in yellow in the table above for approval by the Pensions Committee. It is also highlighted in the SIP itself on page 10 of the Appendix to this paper. The change is required due to an oversight when the SIP was agreed last December. Due to the proximity of the JISP meeting and the Pensions Committee meeting, the table was not altered to reflect the correct mix of gilts and cash. The change is consistent with the investment objective and the current strategy implementation.

4.10 The MEG Strategy reflects the investment objective to generate sufficient cash to pay pensions as they fall due. As part of the strategy, the target weight of gilts and cash is set to broadly match the duration of the assets with the duration of liabilities. These weights will be revised in future when a material change in expected liability cash flows arises. This can happen when employers adopt or exit from the strategy or when the triennial Actuarial Valuation is undertaken.

4.11 There have been no changes to either the Main Strategy or the 50/50 Strategy, which fund approximately 92% of Lothian Pension Fund employer liabilities.

4.12 The impact of the change to the Buses Strategy (7% of Fund assets) on Lothian Pension Fund is shown in the final two columns of the table below. The actual changes over the period are shown in the other two columns, which reflect market movements, cash inflows and outflows and asset purchases and sales.

Policy Group	Actual Allocation 31 March 2019	Actual Allocation 30 Sept 2019	Strategic Allocation 31 March 2019	Strategic Allocation 30 Sept 2019
Equities	59.9%	60.9%	63.1%	62.0%
Real Assets	19.8%	19.3%	17.7%	17.7%
Non-Gilt Debt	5.2%	5.8%	9.9%	10.6%
Gilts	9.1%	7.3%	9.3%	9.8%
Cash	5.9%	6.7%	0.0%	0.0%
Total	100.0%	100.0%	100.0%	100.0%

4.13 There are no material changes to the Scottish Homes strategy – the Fund is entirely invested in gilts and cash to match liability cash flows as closely as possible.

4.14 The Joint Investment Strategy Panel (JISP) meets on 2 December 2019 and a verbal update of more recent developments will be provided to the Committee.

5. Next Steps

5.1 The SIP will be reviewed formally on an annual basis and when there are material changes requiring approval.

5.2 Appendix C of the SIP is a statement of compliance with the Financial Reporting Council’s (FRC) UK Stewardship Code. The FRC has recently launched a substantial revision to the Code, which comes into effect in 2020. The compliance statement will be revised over the coming months to address the changes.

6. Financial impact

6.1 There are no direct financial implications of this report. Investment strategy is covered elsewhere on the agenda.

7. Stakeholder/Community Impact

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

7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.

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

8. Background reading/external references

8.1 None.

9. Appendices

Appendix 1 – Statement of Investment Principles including:

- Appendix A – Investment Strategies (11 December 2019)
- Appendix B – Investment Strategy Implementation (11 December 2019)
- Appendix C – Statement of Compliance with UK Stewardship Code
- Appendix D – Statement of Compliance with the CIPFA Principles for Investment Decision Making in the Local Governance Pension Scheme

LOTHIAN PENSION FUND AND SCOTTISH HOMES PENSION FUND ('THE FUNDS')

STATEMENT OF INVESTMENT PRINCIPLES

1. INTRODUCTION

1.1 This Statement of Investment Principles (**SIP**) was agreed by the Pensions Committee (**Committee**) of the City of Edinburgh Council (**CEC**) on 11 December 2019. CEC is the administering authority for the Lothian Pension Fund and Scottish Homes Pension Fund (**the Funds**).

1.2 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 require administering authorities to prepare, maintain and publish a SIP. The SIP must be reviewed from time to time and revised within six months of any material changes in the Policy.

1.3 In preparing this statement, the Committee has taken professional advice from the Joint Investment Strategy Panel (**JISP**), which includes external advisers and members of the internal investment team who are FCA authorised individuals.

1.4 The SIP describes the objectives, policies and principles adopted by the Committee of CEC in undertaking the investment of fund monies. The SIP also discloses the extent to which the Funds comply with the six "Myners Principles" of investment practice.

2. GOVERNANCE

2.1 CEC has delegated responsibility for the supervision of the Funds to the Committee, which comprises five elected members from CEC and two co-opted members representing employer and beneficiary interests. The Committee is supported by a statutory Pensions Board consisting of five Trade Union and five employer representatives, which is responsible for ensuring that the Funds operate in accordance with the applicable laws and regulations. The Committee and Board are supported by an independent professional observer.

2.2 The Committee determines investment strategy based on proper advice from CEC's Executive Director of Resources. The Executive Director of Resources delegates this role to the Head of Finance taking advice from the JISP.

2.3 Responsibility for implementing the strategy is delegated to the Executive Director of Resources who delegates this role to the Head of Finance, taking advice from the JISP. Day to day management of the Fund's assets is undertaken by internal investment managers, and external investment managers whose activities are governed by Investment Management Agreements and the limits set out in Scheme regulations.

2.4 The SIP forms part of a governance framework that includes Statutory Regulations, the Pensions Committee, the Pension Board, the Joint Investment Strategy Panel, the Funds' Advisers and the Funds' Funding Strategy Statement.

3. HIGH LEVEL INVESTMENT PRINCIPLES

The following principles agreed by the Committee are designed to guide the Funds' governance, strategies and alignment with their agents and to support consistency in decision-making over the long term.

Governance

3.1 **Principle 1: Committee believes that their decisions, and those of officers, must give precedence to the fiduciary duty owed to members and employers.** Fiduciary duty is paramount. The Pensions Committee recognises the potential conflicts of interests inherent in a local authority administering a multi-employer pension fund. The objectives of the administering authority, its officials and officers and those of the pension fund are not necessarily the same. The primary objective is to ensure sufficient funding in the long term so that retirement benefits that employers promise to members under scheme rules can be paid when they fall due. (The legal view on fiduciary duty issued by the Scottish Local Government Pension Scheme Advisory Board is available at https://lgpsab.scot/fiduciary-duty-guidance/.)

3.2 **Principle 2: Committee believes that the Funds should mitigate risk by ensuring alignment of interests wherever possible.** Agency costs are high in the financial services industry – agents are often motivated to act in their own best interests rather than those of the principal (the Funds). Alignment of interests and partnering with similarly aligned organisations will help to reduce risk and address the principal-agency problem to the benefit of the Funds and partners. External resources should, therefore, be used where internal resources cannot be justified or obtained, or where an external perspective provides additional skills or insight into investment matters, and where suitable alignment can be established.

3.3 **Principle 3: Committee believes that it should work with like-minded partners to benefit from increased scale and greater resilience.** There are significant economies of scale in the business of managing investments, so working with like-minded partners with similar long-term objectives and liabilities can achieve lower costs and reduce operational risks with increased resilience.

3.4 **Principle 4: Committee believes that cost transparency aids decision-making.** The asymmetric structure of incentives in financial markets (upside participation in success without downside participation in failure) encourages strategies that may benefit agents (external managers and other financial intermediaries) and be detrimental to investor (Fund) returns. Agents often present fees and other charges in a way that obscures rather than illuminates. Full cost transparency should aid decision-making and so benefit Fund returns.

3.5 **Principle 5: Committee believes it should focus on policy setting, including high-level strategic asset allocation which defines risk and return objectives, with appropriate governance structure and oversight.** Implementation of more granular investment decisions (such as the selection/deselection of individual managers and investments) and regular monitoring should be delegated to suitably qualified and experienced individuals with sufficient time and other resources at their disposal. Appropriate delegation, constraints and reporting requirements should be in place. Reporting to Committee should focus on the long-term objectives of the Fund and how delegated decisions have contributed to these.

Funding

3.6 **Principle 6: Given future uncertainties, the funding strategy should be prudent and should reduce risk to employers of another employer defaulting on its pension obligations**. The Funding Strategy Statement expresses the funding objective, which informs the invested strategy options. The ultimate objective is to ensure long-term solvency so that retirement benefits that employers promise to members under scheme rules can be paid when they fall due, so full funding should be achieved in a prudent manner to ensure that liquid assets are available at the required time. This is important for members, employers and taxpayers as the scheme is ultimately state-backed.

3.7 **Principle 7: Committee believes that the Lothian Pension Fund should consider requests for different investment strategies from employers with different objectives**. Employers have conflicting desires: on the one hand, they would like to minimise the fluctuations in contributions and on the other hand, they would like to minimise the overall amount of contributions. Committee believes in allocating employers to different investment strategies reflecting their timescale for participation in the Fund and their covenant. Employers may have different objectives, so they should be given the opportunity to request a bespoke investment strategy. The Fund should consider such requests, taking account of issues such as employer covenant and implementation costs.

Investments

3.8 **Principle 8: Committee believes that the ability of the Funds to pay pension benefits when they fall due is more important than mark-to-market funding levels.** Committee recognises that there are various ways to measure the value of promised benefits in a defined benefit scheme. Committee believes that where employer circumstances allow, investment strategy should focus on delivering strong (real) returns that grow to cover cashflows over the longer term rather than focusing on protecting the funding level in the short term.

3.9 **Principle 9: Committee believes 'return-seeking' assets are likely to outperform 'risk-free' assets as the investment horizon lengthens, but this is not guaranteed.** Time horizons matter a great deal. The appropriate horizon for investment risk-taking depends on the duration of the liabilities, the profile of projected cash flows and the deficit recovery and contingency plans for the scheme (the sponsor covenant).

3.10 **Principle 10: Committee believes in owning a diversified portfolio of assets so that it is not overly exposed to any particular contingency.** Asset diversification can reduce risk where assets are not perfectly correlated. Committee recognises that the future is unpredictable and that real returns from investments are uncertain. Fund returns will be determined primarily by the high-level investment strategy allocation to different asset classes and the timing of material changes. Asset allocation balances diversified risks with the expected additional returns for these risks.

3.11 **Principle 11: Committee believes that responsible investment should reduce risk and may improve returns, but that mechanistic divestment is inconsistent with the Funds' fiduciary duty to members and employers.** The Local Government Pension Scheme (LGPS) was designed with an important social purpose in mind – the provision of retirement income for individuals. The Funds' fiduciary duty means that the pursuit of financial return is its paramount concern, although it may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment. Committee believes that the decisions to invest in, or divest from, a particular company should be made by an investment manager based on a holistic analysis of financially material issues, including environmental, climate change, social and governance issues.

3.12 **Principle 12: Committee believes it should exercise its ownership rights in a responsible way, constructively engaging with companies to reduce risk.** The Funds' interests are better protected from adverse impacts by collaborating with like-minded investors to have greater influence in engaging with companies, government and regulators. Engagement aims to encourage responsible behaviour by companies in relation to environmental, climate change, social and governance issues.

3.13 **Principle 13: Committee believes that monitoring and assessment of investment success should be viewed on a long-term basis.** No asset mix provides a stream of cash flows that perfectly matches the liability payments of the Funds as they fall due, so monitoring activity is complex. The Funds are long term in nature and the success of a given investment strategy is likely to ebb and flow with changing investment environments in an unpredictable way. Investment monitoring is challenging and should be viewed through a long-term lens.

3.14 **Principle 14: Committee believes that peer group comparative analysis needs to be treated with care.** No two pension funds are identical, so peer group analysis should be undertaken with care as different funds can hold different investment beliefs, objectives and return and risk appetites.

4. RESPONSIBLE INVESTMENT

4.1 With liabilities extending decades into the future, it is in the Funds' interests to take their responsibilities as institutional asset owners seriously. To this end, the Funds' approach to responsible investment centres on effective stewardship of all their assets, with a particular focus on good corporate governance to deliver sustainable investor value.

4.2 To demonstrate and embrace an open and transparent approach, the Funds became a signatory of the Principles for Responsible Investment (PRI) in 2008. Signatories commit to six principles and, since 2014, to an annual assessment of their responsible investing practices, which is published on the Funds' website.

4.3 The first principle of the PRI is the cornerstone of the Funds' responsible investment approach: "We will incorporate environmental, social and governance (**ESG**) issues into investment analysis and decision-making". This means that the Funds consider a wide range of issues and what financial impact they could have on the assets that they own. The Funds' investment managers are charged with integrating ESG analysis into their decision-making, and a specialist third party is used for dedicated research to identify ESG risks and opportunities, including those related to climate change. Investment managers are selected and appointed after due consideration of their approach to integrating ESG considerations into their investment process.

4.4 Another key strand of the Funds' approach to responsible investment is voting and engagement. For listed equities, the Funds are committed to exercising their right to vote the shares that they own. They are also committed to engaging with and influencing companies, governments and regulators where appropriate. 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.

4.5 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 it holds. The Funds are also members of the Local Authority Pension Fund Forum (LAPFF), which engages with companies on behalf of a large proportion of the Local Government Pension Schemes across the UK.

4.6 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 their appointed asset managers to do so too. Details of adherence to the Code are provided in Appendix B.

5. FUNDS' OBJECTIVES

5.1 The **primary objective** of the Funds is to ensure that there are sufficient funds available to meet all pension and lump sum liabilities as they fall due for payment.

5.2 The **funding objectives** for each Fund are documented in the Committee's Funding Strategy Statement, which is reviewed at least triennially. The funding objectives, together with the rates of return being targeted and levels of risk to be tolerated, are central to each Fund's investment strategy and govern the allocation across various asset classes.

6.1 The **investment objectives** of the Funds are to achieve a return on Fund assets which is sufficient over the long term to meet the funding objectives as outlined in the Funding Strategy Statement. Investment returns are generated by a combination of income (from dividends, interest and rents) and gains or losses on capital.

5.3 In effect, the Funds' objectives are to generate sufficient long term returns to pay promised pensions and to make the scheme affordable to employers now and in the future, while minimising the risk of having to increase contribution rates in the future.

5.4 Committee has set investment strategy with reference to the following **policy groups,** which are regarded as the key determinants of risk and return. The policy groups condense the vast array of investment choices into a manageable number of investment groups with broadly similar characteristics:

- **<u>Equities</u>** provide an equitable share in the assets and profits of companies. Income is provided through discretionary share dividends. Equities are listed in the UK or overseas, or are unlisted (private equity). Equities have historically produced returns above inflation.

- **<u>Gilts</u>** are debt instruments issued by the UK Government. Typically, these provide interest payments on a regular basis over the life of the loan until capital is repaid at maturity. Some gilts provide interest payments and capital repayment value that is directly linked to price inflation (the Retail Price Index (RPI)). These are known as <u>Index Linked Gilts</u> and they provide the closest match to the Funds' liabilities, most of which are inflation-linked. Some other governments also issue this type of debt, but in different currencies tied to price inflation in their own countries.

- **<u>Non-Gilt Debt</u>** instruments are issued by a range of borrowers to finance their activities in various sectors of the economy, which means that they carry varying degrees of credit risk. Income is provided through interest, which is typically paid to the lender on a regular basis until the loan capital is repaid, generally at par by the issuer at a pre-determined date. Bonds can pay a fixed, variable or inflation-linked rate of interest. Bonds are listed in the UK or overseas, or are unlisted (private debt).

- **<u>Other Real Assets</u>** are typically investments in a share of income and capital appreciation of tangible assets, including **property** (land and/or buildings for commercial or residential use), **infrastructure** (assets deemed essential to the orderly functioning of daily life, such as renewable energy generation and transmission assets, water utilities, airports and toll roads) and **timberlands**. Income comes from dividends and rents.

- **<u>Cash</u>** is also a form of investment used to provide instant or short-term liquidity, and can be held in both sterling and foreign currencies (including Treasury Bills, Money Market Funds and Secured Investments). Cash generates interest income, but typically at a lower rate than bonds and other debt.

5.5 As the returns of the above investments are not completely correlated, the Funds expect to achieve diversification and better risk-adjusted returns by investing in assets from each policy group.

6. FUNDS' STRATEGIES

6.1 The Committee's agreed investment strategies (presented in Appendix A) are expressed in terms of allocations to various policy groups (or asset classes). These reference portfolios are expected to generate the required return with a reasonable probability of success. The rate of return being targeted and the level of risk to be tolerated are central to the determination of the investment strategy (or asset mix) of each Fund.

6.2 To provide suitable investment strategies for differing requirements of employers, **Lothian Pension Fund** currently operates four investment strategies, as follows:

6.3 **Main Strategy** is a diversified portfolio, mostly invested in long-term, return-seeking assets, such as equities, due to the long-term nature of the pension liabilities. Approximately 91% of employers' assets are invested in the Main Strategy.

6.4 **MEG ("Mature Employers Group") Strategy** invests in a portfolio entirely invested in UK gilts and cash to reduce investment risk for employers (except for Transferee Admitted Bodies) that are close to leaving the Fund. These employers have a low tolerance for risk and this strategy protects them from short-term changes in funding level and employer contribution rates. Less than 1% of employers' assets are invested in the MEG Strategy.

6.5 **50/50 Strategy** invests in a portfolio comprising 50% of the Main Strategy and 50% of the MEG Strategy for employers with a 'medium' tolerance for investment risk. Approximately 1% of employers' assets are invested in the 50/50 Strategy.

6.6 **Buses Strategy** is a diversified portfolio of assets tailored to suit the risk appetite of the Lothian Buses company**.** The Lothian Buses Pension Fund merged with Lothian Pension Fund in Q1 2019. This strategy was agreed by Committee in March 2016.

6.7 There may also be demand from individual employers for other investment strategies. 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.

6.8 **Scottish Homes Pension Scheme** achieved full funding at the most recent actuarial valuation in March 2017. Its investment strategy protects this closed and mature scheme from short-term changes in funding level and increases in contribution rates by investing in UK gilts and cash.

6.9 The Funds' investment strategies are measured against strategy-specific benchmarks by an independent performance measurement specialist, and these are reported to Committee annually with reference to asset market returns as well as liability valuations. The Executive Director of Resources is responsible for monitoring investments and investment activity and he delegates this function to the Head of Finance taking advice from the JISP, which meets at least quarterly.

7. STRATEGY IMPLEMENTATION

7.1 The Committee delegates implementation of strategy to the Executive Director of Resources, who delegates the role to the Head of Finance, taking advice from the JISP. The Head of Finance operates within the parameters agreed by the Committee, investing the Funds' assets in the policy groups within the permitted ranges.

7.2 The Head of Finance, advised by the JISP, identifies the combination of investment managers and mandates within the policy groups to deliver the objectives of the Funds. The investment managers and mandates are listed in Appendix A. The Lothian Pension Fund employs both external and internal managers, recognising that there are cost and alignment advantages of an in-house investment team.

7.3 To reduce the risk that a Fund does not deliver its objective, controls are set around policy group allocations and each manager/mandate. For external managers, these are detailed in formal Investment Management Agreements; and similarly, formal investment objectives and constraints are set for internal mandates. The investment managers are responsible for the selection of individual holdings.

7.4 The Funds' investment managers and mandates are measured against mandate-specific benchmarks of risk and return by an independent performance measurement specialist. Performance and mandate implementation is monitored by the JISP on a quarterly basis.

7.5 The Funds collaborate with other investors to benefit from increased scale and cost sharing arrangements. The Funds obtained regulatory approval from the Financial Conduct Authority (FCA) to facilitate this element of strategy implementation.

8. OTHER INVESTMENT CONSIDERATIONS

Realisation of investments

8.1 Most of the Funds' investments are in liquid markets and can be expected to be sold 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 sold. The overall liquidity of each Fund's assets is considered in the light of potential demands for cash.

Stock Lending

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

Underwriting

8.3 Managers are permitted to underwrite and sub-underwrite stock issues subject to the security being deemed attractive on a medium-term view and subject to the application being limited to an amount the manager would wish to hold over the medium term.

Derivatives

8.4 The Committee has approved the use of derivatives, subject to prevailing legislation and control levels outlined in investment manager agreements. A derivative is a security or contract that derives its value from its relationship with another asset. The Funds may make use of contracts for differences and other derivatives either directly or in pooled funds investing in these products for efficient portfolio management or to hedge specific risks. For example, forward currency contracts allow the Funds to reduce risk from currency fluctuations and equity futures allow the Funds to reduce risk during major portfolio rebalances/transitions.

Safekeeping of Assets

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

9. COMPLIANCE

Regulations and Investment Limits

9.1 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.

9.2 The Regulations contain limits on the percentage of a pension fund that may be invested in certain asset types. In accordance with the Regulations, the Committee have agreed the limits applicable to the Funds' investments in partnerships 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 partnerships: 5% (statutory maximum of 5%)

- Contributions to all partnerships: 20% (statutory maximum of 30%)

The Committee took proper advice in respect of these limits from the Joint 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

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

Review of SIP

9.4 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.

APPENDIX A – INVESTMENT STRATEGIES (11 DECEMBER 2019)

LOTHIAN PENSION FUND: MAIN STRATEGY

Investment Objectives: to achieve a return of at least gilts +2.8% per annum and generate sufficient cash to pay pensions as they fall due.

Policy Group	Reference Portfolio Current Target 11 December 2019	Reference Portfolio Target Weight 2019-24	Permitted Range	Long Term Expected Return
Equities	65%	65%	50% - 70%	Gilts +3.5% p.a.
Real Assets	18%	18%	10% - 25%	Gilts +2.5% p.a.
Non-Gilt Debt	10%	10%	0% - 20%	Gilts +1.0% p.a.
Gilts	7%	7%	0% - 20%	Gilts +0.0% p.a.
Cash	0%	0%	0% - 10%	NA
Total	**100%**	**100%**		**Gilts + 2.8% p.a.**

LOTHIAN PENSION FUND: MEG ("Mature Employers Group") STRATEGY

Investment Objective: to achieve a return in line with gilts and generate sufficient cash to pay pensions as they fall due.

Policy Group	Reference Portfolio Current Target 11 December 2019	Reference Portfolio Target Weight 2019-24	Permitted Range	Long Term Expected Return
Equities	0%	0%	NA	
Real Assets	0%	0%	NA	
Non-Gilt Debt	0%	0%	NA	
Gilts	88%	88%	80% - 100%	Gilts +0% p.a.
Cash	12%	12%	0% - 20%	NA
Total	**100%**	**100%**		**Gilts + 0% p.a.**

LOTHIAN PENSION FUND: 50/50 STRATEGY

Investment Objective: to achieve a return in line with a 50:50 investment in the Main Strategy and the MEG Strategy and generate a return that pays pensions as they fall due.

LOTHIAN PENSION FUND: BUSES STRATEGY

Investment Objective: to achieve a return of gilts +2.1% - 2.4% per annum and generate sufficient cash to pay pensions as they fall due.

Policy Group	Reference Portfolio Interim Target 11 December 2019	Reference Portfolio Target Weight 2016 - 21	Permitted Range	Long Term Expected Return
Equities	35%	40%	interim weight +/- 10%	Gilts +3.5% p.a.
Real Assets	17.5%	18%	interim weight +/- 10%	Gilts +2.5% p.a.
Non-Gilt Debt	20%	22%	interim weight +/- 10%	Gilts +1.0% p.a.
Gilts	27.5%	20%	interim weight +/- 10%	Gilts +0.0% p.a.
Cash	0%	0%	0% - 10%	NA
Total	**100%**	**100%**		**Gilts + 2.1% - 2.4% p.a.**

SCOTTISH HOMES PENSION FUND

Investment Objective: to match cash flows from gilt income and redemption payments as closely as possible with the expected liability payments of the Fund to minimise the risk of additional employer contributions being required.

APPENDIX B: INVESTMENT STRATEGY IMPLEMENTATION (11 DECEMBER 2019)

The investment strategies in Appendix A are implemented by investing in a range of mandates managed by external or internal investment managers. The current mandates and managers for the Funds are presented in the table below:

Policy Group	Mandate	Manager
Equities		
	UK All Cap	Internal
	UK Mid Cap	Internal
	Europe ex-UK	Internal
	US	Internal
	Global Low Volatility	Internal
	Global High Dividend	Internal
	Global Multi-Factor	Internal
	Global Growth	Baillie Gifford
	Global Stable	Nordea
	Global Value	Harris
	Private Equity	Internal/Various
	Currency Hedging	Internal
Real Assets		
	Property	Internal
	Infrastructure	Internal/Various
	Timberland	Internal/Various
Non Gilt Debt		
	Sovereign Bonds	Internal
	Corporate Bonds	Baillie Gifford/LGIM
	Private Debt	Internal/Various
Gilts		
	Index-Linked Gilts	Internal
Cash		
	Cash	Internal/Various

APPENDIX C – STATEMENT OF COMPLIANCE WITH UK STEWARDSHIP CODE

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting transparency and integrity in business. It sets the UK's Corporate Governance and Stewardship Codes. The Funds' Statement of Compliance with the UK Stewardship Code is presented below:

Principle 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

We acknowledge our role as an asset owner under the UK Stewardship Code and seek to hold to account our fund managers and service providers in respect of their commitments to the Code.

In practice, our policy is to apply the Code through a) the appointment of Hermes Equity Ownership Services (EOS); b) membership of the Local Authority Pension Fund Forum (LAPFF); c) the work of Baillie Gifford, an external investment manager; and d) the work of the internal investment team.

We believe that Hermes EOS enables us to provide the highest standards of stewardship on behalf of the beneficiaries of the Funds through their monitoring of shareholdings, so that we can fulfil our fiduciary responsibilities as long-term shareholders.

- Hermes EOS has the expertise to undertake corporate engagement on an international basis, and they do this for us. Their aim is to bring about positive long-term change at companies through a focused and value-oriented approach. Engagements undertaken by Hermes EOS on our behalf are guided by the Hermes EOS Corporate Governance Principles.
- 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.

Through our active membership of LAPFF, we keep informed of potential issues of concern at both individual companies and across the market, which leads to collaborative engagements in which the Funds sometimes participate. An elected member of the Pensions Committee has been a member of the Executive for several years.

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.

The internal investment team integrates environmental, social and governance (ESG) issues into its decision making, in line with the Principles for Responsible Investment to which the Funds are a signatory. The internal team also engages directly with companies in which the Funds invest.

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.

The Funds' efforts to manage its potential conflicts of interest can be summarised below:

- We are supported in effectively managing conflicts of interest in relation to our stewardship work by Hermes EOS. Hermes EOS explains how it manages conflicts of interest on our behalf in its Stewardship conflicts of interest policy document.

- We also encourage the asset managers employed by the Funds to have effective policies addressing potential conflicts of interest.

- In respect of conflicts of interest within the Funds, Pensions Committee members are required to make declarations of interest prior to Committee meetings.

- Our policy of constructive engagement with companies is consistent with the Funds' fiduciary responsibilities.

Principle 3: Institutional investors should monitor their investee companies.

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.

- Activity is reported on the Funds' website quarterly, including the number of company meetings at which the Funds have voted and how the Funds have voted.

LAPFF also monitors and engages with companies and provides an 'Alerts' service, which highlights concerns over corporate governance issues.

The internal investment management team also monitors its investee companies regularly, on an ongoing basis. It adheres 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.

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.

As highlighted above, responsibility for day-to-day interaction with companies is delegated, including the escalation of engagement when necessary.

- We expect the approach to engagement on our behalf to be value-orientated and focused 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.

- The internal team also monitors investee companies and escalates engagement activity directly with investee companies as required.

- We may also propose escalation of activity through the Local Authority Pension Fund Forum.

- Consistent with our fiduciary duty to beneficiaries and to encourage improved conduct in future, we consider participating in shareholder litigation where it appears likely that the Funds will recover losses (net of costs) sustained because of inappropriate actions by company directors.

Principle 5: Institutional investors should be willing to act collectively with other investors where appropriate.

We seek to work collaboratively with other institutional shareholders to maximise the influence that we can have on individual companies. We do this through:

- the appointment of Hermes EOS, whose engagement service pools asset ownership with the aim of protecting and enhancing shareholder value. Hermes EOS represents us and other like-minded asset owners globally using its expertise to enhance our effectiveness in communicating with companies, industry bodies, regulators and legislators.

- membership of the Local Authority Pension Fund Forum, which is a collaborative effort of approximately 70 local authority pension funds. It engages and lobbies for positive changes on environmental, social and governance issues on behalf of its members. See http://www.lapfforum.org/ for more details.

- being a signatory of the PRI in our own right. See https://www.unpri.org/ for more details.

- 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. See https://www.cdp.net/en for more details.

Principle 6: Institutional investors should have a clear policy on voting and disclosure of voting activity.

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.

- Our preference is for managers to vote on the Funds' behalf and for responsible stewardship to be integral to the investment decision-making process. We are comfortable with delegation of voting to Baillie Gifford for the funds they manage. The manager's voting policies can be found at the website mentioned above.

- For all other mandates, Hermes EOS votes consistently across the portfolios it covers, and makes voting decisions based on a thorough analysis of publicly available information and always taking 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. Underpinning voting decisions are Hermes EOS Regional Corporate Governance policies, which can be found in the following link:

  https://www.hermes-investment.com/uki/about-us/policies-and-disclosures/

- We disclose our historic voting information on our website. This includes the total number of votes cast at which company meetings and whether the votes were cast for or against company management. We disclose in arrears so that we are transparent and accountable but dialogue with companies in our portfolios is not compromised. See http://www.edinburgh.gov.uk/lpf1/info/77/voting_and_engagement_record for full details.

Principle 7: Institutional investors should report periodically on their stewardship and voting activities.

We do report on our stewardship and voting activities:

- We report annually on stewardship and voting activity in the Funds' annual report and accounts and quarterly on our website.

- We also report annually on stewardship and voting activity directly to the Pensions Committee.

We reviewed this Statement of Compliance with the UK Stewardship Code in December 2019. We will review the Statement annually.

APPENDIX D – CIPFA PRINCIPLES FOR INVESTMENT DECISION MAKING AND DISCLOSURE

The Chartered Institute of Public Finance and Accountancy (CIPFA) published six Principles for Investment Decision Making and Disclosure in the Local Governance Pension Scheme in the UK in 2012. 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. 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, who in turn delegates to the Funds' officers. 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 Joint 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 Joint Investment Strategy Panel meets at least 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 Joint 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 understanding of risks and the setting of investment strategy. Each Fund has a scheme-specific investment strategy.
- Employers' attitude to risk is specifically considered in the setting of strategy, and employers can request a bespoke investment strategy.
- Reviews of investment strategy focus on the split between broad asset classes (equities, gilts, non-gilt debt, real assets and cash).
- Investment Management Agreements set clear benchmarks and risk parameters 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 includes specific consideration of the desire 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.
- Lothian Pension Fund recognises that employers' circumstances vary and an alternative investment strategy for their section(s) of the Fund may be deemed suitable. The Fund will consider requests for such alternatives, 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 the 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 monitors the external investment managers' performance and risk on a regular basis and reports this to the Joint Investment Strategy Panel. The Joint Investment Strategy Panel assesses the performance and risk of both internal and external investment managers on a regular basis (typically quarterly).
- The Funds' contracts with its advisers are regularly market tested.
- The Joint 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' approach to responsible investment is described in the Statement of Investment Principles and on the Funds' website.
- The Funds' policy on responsible ownership is included in the statement on the Financial Reporting Council's Stewardship Code (see Appendix C 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 entitled to make a deputation 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.

Pensions Committee

2.00pm, Wednesday, 11 December 2019

Stewardship and Engagement

Item number	**5.6**
Executive/routine	
Wards	**All**
Council Commitments	

1. Recommendations

The Pensions Committee is requested to:

1.1 note the contents of this report

Stephen S. Moir

Executive Director of Resources

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Report

Stewardship and Engagement

2. Executive Summary

2.1 This report provides the annual update on the activity of the Lothian Pension Fund and Scottish Homes Pension Fund (‘LPF’) in relation to the stewardship of the assets of LPF, including the approach to environmental, social and governance (ESG) issues.

2.2 LPF pursues a policy of constructive engagement on such issues, which is consistent with fiduciary duties.

2.3 LPF has been a signatory to the Principles for Responsible Investment (PRI) since 2008, and so participates in the PRI’s Reporting Framework, an annual assessment of LPF’s responsible investment activities. This report summarises the PRI assessment and feedback for 2019.

2.4 LPF also participates in collaborative shareholder engagements through organisations including the Local Authority Pension Fund Forum (LAPFF), Hermes EOS (EOS) and Climate Action 100+, who act on behalf of asset owners with funds valued at over £250bn, £500bn and US$35tn respectively. LPF continues to be represented on the LAPFF Executive Committee. This report provides an update on developments.

3. Background

3.1 Lothian Pension Fund made a significant commitment to active and responsible share ownership by becoming a signatory to the PRI in 2008, and it has remained a signatory since then. Founded in 2006, the PRI (Principles for Responsible Investment) is the world’s leading proponent of responsible investment. It is an independent, not-for-profit organisation (supported by the United Nations) that encourages investors to use responsible investment to enhance returns and better manage risks. Where consistent with fiduciary responsibilities, signatories commit to six principles, which are detailed in the main report.

3.2 LPF allocates meaningful resources to fulfil this commitment. A third-party provider of voting and engagement services (currently Hermes EOS), membership of the Local Authority Pension Forum (LAPFF) and third-party providers of environmental, social and governance (ESG) research (currently MSCI ESG Research) and private fund monitoring (currently GRESB, which was added during 2019) are all components of LPF's responsible investment policy implementation, which support LPF's officers.

3.3 LPF pursues a policy of constructive engagement, which is consistent with fiduciary duties. The fiduciary duty responsibilities of the Scottish Local Government Pension Funds were clarified by the legal opinion sought and received by the Scheme Advisory Board of the Scottish Local Government Pension Scheme in June 2016. The opinion essentially reaffirmed the position taken by Senior Counsel in England & Wales, confirming that the advice is also applicable in Scotland. The legal opinion reinforces the approach taken by LPF to date.

3.4 LPF also participates in class action lawsuits in which a group sues another party to recover a loss in share value. LPF recovered £126,000 during the 2018/19 financial year.

4. Main report

Principles for Responsible Investment (PRI)

4.1 The Principles for Responsible Investment were developed by an international group of institutional investors to address the increasing relevance of environmental, social and corporate governance issues to investment practices.

4.2 Signatories to the PRI commit to six principles. The principles and LPF's compliance with each of them are laid out in paragraphs 4.3 to 4.23 below. An excerpt from the PRI website (www.unpri.org) describes the commitment thus:

"In Signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society."

Principle 1: we will incorporate ESG issues into investment analysis and decision-making

4.3 LPF believes strongly that environmental, social and governance (ESG) issues affect the financial performance of the companies in which they invest. They are essential ingredients in the estimation of investment risk and opportunity, and so LPF's investments are assessed in a holistic manner with ESG issues as an important part of that evaluation. Empirical evidence indicates that the shares of companies with improving ESG ratings are better investments than those that are simply highly rated. This supports LPF's approach of engaging with companies to improve environmental, social and governance practices as this can lead to better long-term outcomes for LPF and society as a whole.

4.4 The internal team integrates ESG issues into its actively managed fundamental portfolios as part of the formal due diligence process before investments are made.

The analysis of ESG factors is supported by the research of a specialist third party service (currently MSCI ESG Research), which provides ESG specific data, analysis and research to help identify the risks and opportunities that companies face. This ensures that consideration of ESG factors can be applied to the investment process using data that has been collated in a consistent manner.

4.5 As well as incorporating ESG issues into the analysis of internally managed portfolios, the internal team also monitors and engages at least quarterly with LPF's external managers, who are required to report on how ESG issues influenced their investment analysis and decision-making.

4.6 During the year, LPF joined the investor-led data provider GRESB to support assessment of the ESG risks, opportunities and impacts in property and infrastructure assets, and to promote sustainability.

4.7 LPF continues to track its 'carbon footprint' - the current data is presented in paragraph 4.31 of this report - and to monitor carbon-related risks, which inform decision-making and direct engagement activity.

Principle 2: we will be active owners and incorporate ESG issues into our ownership policies and practices

4.8 LPF's approach to Principle 2 is to vote all its shares and to engage with companies through its third-party provider and its portfolio managers, both internal and external. It also participates in class action lawsuits, in which groups of shareholders collectively sue a company to recover a loss in share value, or to exert influence on the company.

4.9 For the vast majority of holdings, Hermes Equity Ownership Services (EOS) votes and engages on behalf of LPF, and Baillie Gifford also votes and engages in relation to the holdings in the equity mandate that it manages for LPF.

4.10 Hermes EOS also engages at industry and country level to influence regulators, professional bodies and legislators by responding to relevant consultations, all with the aim of improving governance standards in the investment industry.

Voting & Engagement

4.11 Hermes EOS collates and reports voting and engagement data for calendar year periods. A complete summary of the voting statistics as well as a summary of voting disclosures, which explain the decisions to vote against management, are posted on LPF's website quarterly and a link is provided at the end of this report.

4.12 During calendar year 2018, LPF voted at the annual meetings of the 534 companies in which it was invested. There were votes on 7,397 resolutions, and LPF opposed 804 of them.

4.13 Hermes EOS also engaged on LPF's behalf with companies across the world on topics such as board structure, executive compensation and climate change. An overview of its current engagement plan is available in the Lothian Pension Fund Annual Report 2019/20.

4.14 Engagement activity is also undertaken for LPF by 1) the Local Authority Pension Fund Forum (LAPFF), which represents the majority of LGPS funds in the UK; and 2) the internal investment management team, which engaged as a participant member of the Climate Action 100+ initiative to curb greenhouse emissions, improve governance and strengthen climate-related financial disclosures.

Class Actions

4.15 Following a court ruling in 2010, which narrowed the ability of investors to seek redress under US law, LPF's class action activity and recovered compensation have fallen to relatively low levels. Recoveries over 2018/19 amounted to £126,000, while recoveries this financial year up to 17 October 2019 were £185,000. Officers continue to monitor class action activity in relation to LPF's shareholdings and collect compensation where it is economical to do so.

Principle 3: we will seek appropriate disclosure on ESG issues by the entities in which we invest

4.16 LPF, its partners and service providers seek to enhance ESG disclosure by investee companies. During 2018/19, LPF continued longstanding and successful efforts to enhance BP's disclosure. It co-filed a resolution at 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.

4.17 LPF's work with Climate Action 100+, an initiative with which our partners EOS and LAPFF are also heavily involved, seeks to increase disclosure of climate impact in line with the recommendations of the Taskforce for Climate-related Financial Disclosures (TCFD) as well as producing business strategy plans in-line with the aims of the Paris Agreement.

Principle 4: we will promote acceptance and implementation of the principles within the investment industry

4.18 Lothian promotes the fact that it is a PRI signatory in its communications and on its website. It reports publicly the results of the PRI's annual assessment.

4.19 Scrutiny of investment portfolios includes the consideration of the principles, including how ESG issues are incorporated into the investment process, voting, engagement and the level of reporting. This applies to both internal and external portfolios, both at inception and on an ongoing basis.

Principle 5: we will work together to enhance our effectiveness in implementing the principles

4.20 Lothian collaborates with other investors to enhance effectiveness of implementing the principles. It does this in a variety of ways:

- by employing a third-party service provider (currently Hermes EOS, which has a client base with assets under ownership of £500 billion);
- through membership of the Local Authority Pension Fund Forum (LAPFF), which comprises over 80 UK local authority pension funds and 5 of the English and Welsh pools with combined assets of over £250bn. LAPFF's mission is *"to protect the long-term investment interests of beneficiaries by promoting the highest standards of corporate governance and corporate responsibility amongst investee companies."*
- through active 'participant membership' of Climate Action 100+, a collective engagement initiative supported by owners of US$35tn of assets;
- by cooperating with other asset owners to share best practice through active participation in industry bodies, including the Scottish LGPS RI Working Group, the Cross-Pool RI Group (English and Welsh Pools) and the UK Pension Scheme RI Roundtable (large UK asset owners, such as the Church of England schemes, USS, NEST, the Environment Agency);
- through active involvement in local authority and industry conferences, including delivering training and presentations.

4.21 When the shares of the asset owners represented in the initiatives above are aggregated, the holdings are often significant enough that they can influence company boards. These collaborative efforts are beneficial to LPF as a relatively small asset owner, and they also encourage implementation of the principles more widely.

Principle 6: we will each report our activities and progress towards implementing the principles

4.22 As a signatory, LPF is obliged to report on its responsible investment activities annually through the PRI's Reporting Framework. This ensures accountability of signatories through a standardised transparency tool and promotes future development of responsible investment through annual feedback provided by the PRI. The PRI annual assessment report for 2019 is summarised below.

4.23 In addition to PRI reporting, all LPF's voting and engagement activity is made available on the website every quarter. In these reports, Hermes EOS presents progress of their engagement milestones and Baillie Gifford describes the detail of its engagement activity. A large section in the Lothian Pension Fund Annual Report 2018/19 is dedicated to LPF's Responsible Investment policy and activities.

PRI Assessment Report 2019

4.24 The assessment report is designed to provide feedback to signatories to support ongoing learning and development. It measures progress against the six principles of the PRI and allows comparison with peers.

4.25 LPF's 2019 assessment report is available on its website and a link is provided at the end of this paper. The results are summarised in the table below.

4.26 LPF scored "A+" or "A" in all modules. Lothian Pension Fund expanded its reporting in 2018 to include alternative asset categories, including property, infrastructure and private equity.

4.27 There were significant changes to the Listed Equity assessment criteria in 2019, resulting in 'grade deflation' - the peer group scores were affected and declined in some areas, but Lothian obtained an A rating in all three areas of its Listed Equity management.

Assets Under Management	Module Name	LPF 2018	LPF 2019	Peer Median 2019
100%	Strategy & Governance	A	A+	A
Indirect - Manager Selection, Appointment & Monitoring				
<10%	Listed Equity	A	A	A
<10%	Fixed Income - Corp Non-Financial	A	A	B
<10%	Private Equity	A	A	A
<10%	Property	A	A	B
<10%	Infrastructure	A	A	A
Direct & Active Ownership Modules				
>50%	Listed Equity - Incorporation	B	A	B
>50%	Listed Equity - Active Ownership	A	A	B

4.28 In 2020, PRI intends to introduce mandatory climate reporting. Lothian provided voluntary data for the 2018 and 2019 reports. A comprehensive overhaul of reporting is also planned for 2021, which is likely to result in further 'grade deflation' with all median scores dropping to better differentiate participants and incentivise higher standards across the industry.

Carbon Analysis

4.29 Lothian Pension Fund monitors the exposure of its underlying holdings to assess carbon output risk in the portfolio, and so sensitivity to future carbon pricing. Carbon footprinting seeks to measure the output of greenhouse gases from a firm's (or portfolio's) activities. It does not account for fossil fuel reserves, or operational stranded asset risk. Nor does it account for the "level 3" carbon output from products that the activities create.

4.30 There are various methodologies to measure a carbon footprint. LPF's preferred method uses 'carbon intensity', which is also the method preferred by the Taskforce for Climate-related Financial Disclosures (TCFD) for presenting carbon data. This is because it is an efficiency measure and less affected by general economic conditions than some other measures in use. Carbon intensity is calculated by dividing a firm's emissions (tons of CO_2 equivalent) by its sales (millions of dollars).

4.31 LPF's base for carbon footprinting is the data from Q4 2017. The table below compares that 2017 data for Fund and benchmark (MSCI All Countries World Index) with the data from the latest annual update in February 2019. It shows the percentage reduction in carbon intensity for both.

Portfolio/Benchmark	Carbon Intensity (tons CO2e/$m sales) Quarter 4, 2017	Carbon Intensity (tons CO2e/$m sales) Quarter 1, 2019	Change
Lothian - All Equities	243.8	225.9	-7.3%
MSCI All Countries World Index (Benchmark)	241.0	224.3	-6.9%

4.32 Although carbon footprinting provides useful insights, it is important to recognise that reducing exposure to, or completely divesting from, carbon intensive stocks in no way reduces global carbon emissions. It does reduce a portfolio's carbon footprint, which might seem appealing, but it has no real-world impact. It simply transfers ownership of the emissions to another party. In terms of real-world outcomes, it is systemic decarbonisation that matters, not portfolio decarbonisation. Systemic decarbonisation can only be achieved by engaging with listed systemic emitters to change business practices and shift capital allocation towards green solutions, along with denying new debt financing to systemic emitters and supporting green projects with new capital (debt and primary equity capital).

4.33 Although the carbon intensity measure does not identify exactly where carbon risk resides, the internal team is able to interrogate the data in a more granular fashion to assess individual company risks. Indeed, this analysis resulted in LPF joining the Climate Action 100+ initiative (http://www.climateaction100.org/) as a participant member, meaning that LPF is actively involved in an engagement with a large utility company. As a representative of a group of shareholders with over $35tn in assets, the internal team has gained better access to management and the ability to influence systemically important carbon emitters to achieve alignment with the Paris

Agreement. The first progress report for the initiative was released in October 2019 and is available on the website above.

Local Authority Pension Fund Forum (LAPFF)

4.34 The Pensions Committee has been represented on the Executive Committee of the LAPFF for many years. The latest representative, Councillor Alasdair Rankin, announced his intention to relinquish that post during the summer of 2019. John Anzani, Member Representative on the Pensions Committee, has now been elected to the Executive Committee of LAPFF following Pensions Committee approval in September 2019.

5. Next Steps

5.1 Mindful of its commitment to the PRI and its responsibilities to protect the long-term interests of beneficiaries, LPF will continue to undertake and report on the activities described in this report.

6. Financial impact

6.1 There is no financial impact as a result of this report. The costs of LPF's stewardship activities are included in the pension fund's budget. US class actions are conducted on a "no win no fee" basis. LPF is not currently involved in any non-US actions.

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 The 2018/19 Annual Report is available here (pages 16-25 cover RI):

http://www.edinburgh.gov.uk/lpf1/downloads/file/947/lpf_audited_annual_report_and_accounts_201819

LPFs' 2019 PRI assessment report is available at:

http://www.edinburgh.gov.uk/lpf1/downloads/file/948/pri_annual_assessment_2019

Hermes Lothian specific voting and engagement report is available at:

http://www.edinburgh.gov.uk/lpf1/downloads/file/933/hermes_eos_annual_voting_and_engagement_report_2018

Further EOS voting and engagement information is available at:

https://www.hermes-investment.com/uki/stewardship/eos-literature/

Lothian Pension Fund's internal equity management ESG integration approach:

http://www.edinburgh.gov.uk/lpf1/downloads/file/801/internal_equity_management_esg_integration

The CalPERS Effect

http://www.mondovisione.com/news/calpers-effect-continues-to-improve-company-performance-shareholder-engageme/

Lothian Pension Fund: http://www.lpf.org.uk/info/68/responsible_investment

United Nations Principles for Responsible Investment http://www.unpri.org/

Local Authority Pension Fund Forum http://www.lapfforum.org/

9. Appendices

None

Pensions Committee

2.00pm, Wednesday, 11 December 2019

Service Plan Update

Item number	**5.7**
Executive/routine	
Wards	**All**
Council Commitments	

1. Recommendations

The Pensions Committee is recommended to:

1.1 note progress made by the Lothian Pension Fund (LPF) on its 2018-2020 Service Plan, together with the regulatory update.

Stephen S. Moir

Executive Director of Resources

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

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Report

Service Plan and Regulatory Update

2. Executive Summary

2.1 The purpose of this report is to provide an update on progress against the 2018–2020 Service Plan, performance indicators and the actions to enable LPF to meet its key objectives.

2.2 Overall progress is being made against the service plan objectives for 2019/20 and an underspend is projected for the financial year.

3. Background

3.1 The 2018-2020 Service Plan outlines the performance indicators and the key actions to enable LPF to meet its four key objectives:

- Customer First;
- Honest and Transparent;
- Working Together; and
- Forward Thinking.

3.2 Lothian Pension Fund's Service Plan is reviewed every two years to ensure its key performance indicators and objectives are up-to-date, clear, challenging and achievable. The next review is due in March 2020 and will look to more directly align its key objectives with more recent developments in the business plan and organisational development.

4. Main report

4.1 Progress is being made against the service plan. Progress of particular note since the last update to Committee is shown below.

Pensions Regulator standards and compliance

4.2 Performance indicators (shown later in this report) show compliance with the regulatory requirements for timely issuance of members' annual benefit statements and the receipt of employer contributions. In addition, LPF:

a) provided the Scheme Return for the Lothian Pension Fund and Scottish Homes Pension Fund before the required deadline of 19 November 2019;
b) participated in The Pensions Regulator's (TPR) annual survey of public service pension scheme in November; and
c) provided an update for the TPR in relation to progress on LPF's data quality action plan, employer record keeping and website enhancement.

Performance Indicators

4.3 Performance Indicators for the second quarter of the 2019/20 financial year are provided in appendix 1. Committee will recall there are currently 27 performance indicators including a wider range of pensions administration indicators.

4.4 An overview of the key points includes:

- Eleven of the indicators are currently amber. A number of these are as a direct result of the Scheme Regulations updated in June 2019, which allowed deferred members over the age of 55 to access their benefits.
- The proportion of critical pensions administration work completed within standards dipped from 96.6% in Q1 to 84.1%. The main reason for the shortfall was late notification to early leavers with less than 2 years' service of their options at leaving and processing refund payments. This was due to high volumes of deferred members over age 55 accessing their benefits combined with long-term illness and holidays. A training programme has been delivered to new trainee pensions administrators and, as backlogs are cleared, it is anticipated this will bring performance within target. Performance is continuously monitored. Cumulative performance in Q2 was 89.57%.
- Estimates requested by employers of retirement benefits within 10 working days fell from 93.6% to 67.9% in Q2.
- The PI around notifying leavers of their deferred benefits options within 10 days dropped from 82.6% in Q1 to 40.0%.
- 86.9% of staff have completed their pro-rata training target up to 30 September 2019. As the period accounts for a relatively short time horizon, it is expected that the target should be achieved by the end of the year.

To clear backlogs and to try and reduce follow up telephone calls from members, a large volume of which related to the specific regulatory change for deferred members at age 55, incoming calls were restricted to certain times in the day, for the limited period of 3 to 30 September 2019. This allowed staff to work on the backlogs. An undertaking to call back members within 1 day was in place.

Employers survey

4.5 31 responses were received from employers this year and the key results were:

- 100% of the respondents this year said they were satisfied with the overall service provided by LPF. This is up from 86% satisfied in 2018, but comparable to the feedback in 2017.
- the monthly employer bulletin continues to be well received with 85% (94% in 2018) satisfaction and the preferred method of communications for most;
- 90% agreed the website was useful (89% in 2016/17);
- the introduction of i-Connect and GoAnywhere in 2018 saw lower survey results than previous years. Work has continued with employers and results are more positive this year with 75% of those answering agreeing that submitting monthly contributions was straightforward (up from 55% in 2018) and 95% felt the process of advising LPF of new joiners was straightforward. 100% felt that the process for creating new starts was also straightforward.
- GoAnywhere also received a more positive response with 100% now agreeing that submitting forms and documents was straightforward and 94% feeling receiving forms and documents from LPF was a simple user-friendly process.
- Once again, our year end process came in for praise. The instructions provided, the Year End User Group, the method for submitting information and explanation given for any queries that only attracted 1 negative response.

Other comments included “Staff are always helpful and supportive”, “Staff are always prompt replying to any queries raised and provide informative good advice or detailed instructions as/when required”, “Monthly Returns are more time consuming and challenging than Pensionsweb” and “having two different portals makes submitting more time consuming.”

Website

4.6 LPF has now replaced its website with a responsive accessible website with more focused content that links to a bespoke member website provided by Hymans Robertson. A link to the new website is included in the background reading section of this report for ease of reference.

Membership and Cashflow monitoring

4.7 Tables detailing the cashflows as at the end of October 2019 and projections for the financial year are shown in Appendix 2. These have been prepared on a cashflow basis (compared to the accruals basis of the year-end financial statements and budget projections).

4.8 It is expected that Lothian Pension Funds’ active members as a proportion of total membership will continue to decrease during the year, causing a fall in contributions and increase in pension and lump sum payments.

4.9 For the last three years LPF has had a negative cash flow position, whereby pension payments exceed total contributions received. Increased investment income has been targeted in recent years to address this scenario.

4.10 The following areas are covered elsewhere on the agenda:

- cost benchmarking;
- contribution stability mechanism; and
- risk management.

5. Next Steps

5.1 LPF will continue to progress matters in accordance with the Service Plan 2018-20 and respond to regulatory consultations as appropriate.

6. Financial impact

6.1 A summary of the projected and year-to-date financial outturn compared to the approved budget for 2019/20 is shown in the table below:

Category	Revised Approved Budget £'000	Projected Outturn £'000	Projected Variance £'000	Budget to date £'000	Actual to date £'000	Variance to date £'000
Employees	5,354	5,063	(291)	3,123	2,605	(518)
Transport & Premises	255	255	-	149	141	(8)
Supplies & Services	2,128	1,848	(280)	1,241	1,119	(122)
Investment Managers Fees -Invoiced	5,200	4,600	(600)	3,033	2,860	(173)
-Uninvoiced	19,700	19,700	-	11,492	11,492	-
Other Third Party Payments	1,439	1,399	(40)	839	667	(172)
Central Support Costs	643	672	29	375	392	17
Depreciation	147	147	-	86	86	-
Gross Expenditure	**34,866**	**33,684**	**(1,182)**	**20,339**	**11,062**	**(560)**
Income	(1,915)	(1,978)	(63)	(1,117)	(1,133)	(16)
Total Cost to the Funds	**32,951**	**31,706**	**(1,245)**	**19,221**	**18,229**	**(993)**

6.2 The financial outturn includes year to date budget, actual expenditure and variance as at the end of October 2019. Year to date actual expenditure includes provision for services incurred but for which no invoice has yet been received.

6.3 The projection shows an underspend of approximately £1,245k. The key variances against budget are:

- *Employees* - £291k underspend. A detailed review of the LPF group's staffing structure took place in the first quarter of the year with a number of new posts created and prior recruitment targets realigned. Currently, LPF is recruiting staff to fill these positions, with this timing difference creating the majority of the expected underspend.

- *Supplies & Services* - £280k underspend expected against budget. A majority of this underspend relates to lower than expected investment front office system costs.
- *Investment Management Fees (Invoiced)* – £600k underspend. The Aberdeen Standard property portfolio was taken over by the in-house investment team at the end of September, this will deliver a significant saving against budget. Similarly, LPF has also secured savings through realisation of £50m in externally managed equity, this being used to fund purchases of investment grade credit (fees to be reflected in uninvoiced expenditure).
- *Other Third-Party Payments* - £40k underspend; savings forecast on global custody given the Lothian Buses Pension Fund's consolidation into the main fund and also more favourable terms agreed with the LPF's custodian in the two year contract extension.
- *Central Support Costs* - £29k overspend. The approved budget includes a £500k total provision for the LPF's ICT service arrangements. At present, no change has been reflected in the projected outturn for this ICT provision, although there is likelihood of slippage. LPF has agreed a £166k (assuming full year) charge to be levied by the Council for ICT and Telephony services provided through the Administering Authority's Digital Services Team and its contract with CGI UK Ltd. This increased charge (original budget £90K) reflects greater precision in the service cost apportionment by the Council. The forecast overspend on this cost centre represents net higher than budgeted costs for the remaining (non ICT) support services provided by the Council though the existing Annual Service Level Agreement.

6.4 Uninvoiced expenditure (i.e. investment management costs deducted from capital) is assumed to be in-line with budget. There has been no change to the investment strategy for the period, on which the budgeted figures are based. LPF has initiated discussions with its external managers with regards to the Pensions and Lifetime Saving Associations, Cost Transparency Initiative. The expectation would be for fund managers to complete a standardised template disclosing the full cost of LPF's investments on a quarterly basis.

6.5 The financials above do not include any provision in respect of the proposed office move. At the September meeting a paper was approved to commit to the move on the basis of the high side financials of £115,000 for the move (inclusive of cost of exit existing building and entry to new building) and low side financials of -£50,000. This included key assumptions set before professional surveys on market and building condition including testing market appetite to assign our existing lease and the expected cost of fit-out and repair works for the new office. Since the previous meeting we have completed the necessary surveys and identified material risk to these financials. The key moves include (in brackets the extra cost to high side): a) expectation of longer void / incentive period for existing office (+£75,000); b) potential redundant rental period in new office attributable to delivery of communication infrastructure (+£75,000); c) the need for remedial works to ensure new office fit for occupancy (+£50,000); d) costs to install circuits (+£17,000); e) offsetting improved landlord contribution (£40,000); providing a net potential adverse movement of £177,000 resulting in a combined cost of move of £292,000. Additional landlord improvement works have also been secured but these are not reflected in the financials. There remains a degree of risk that the position could improve or deteriorate based on completion of works, CGI estimates being only provisional and market for assignment of our existing lease. Accounting for each category of spend will reflect underlying accounting policies. This spend is necessary and work continues to secure the move. A report will be submitted to the March committee with the final costs.

7. Stakeholder/Community Impact

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

7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.

7.3 There are no adverse sustainability impacts arising from this report. Background reading/external references

8. Background reading/external references

8.1 LPF Service Plan 2018-2020

8.2 Please follow this link to familiarise yourself with the new website design once launched in mid December - www.lpf.org.uk

9. Appendices

Appendix 1 – Service Plan Performance Indicators

Appendix 2 – Forecasted Cashflow

Appendix 1

Service Plan Performance Indicators – Targets & Actual Performance 2019/20

	Q1 April to June	Q2 July to Sept	Q3 Oct to Dec	Target	Status
Customer First					
Maintain Customer Service Excellence Standard	Annual assessment will be carried out in early 2020			Retain CSE Award	Not yet known
Maintain Pensions Administration Standards Association (PASA) accreditation (assessment March 2019).	Annual accreditation to be carried out in Autumn/Winter 2019 (Review process underway – Nov 19)			Retain PASA accreditation	Not yet known
Overall satisfaction of employers, active members and pensions measured by surveys	Rolling 12-month performance to end September 2019 is 92.8%			91%	
Proportion of active members receiving a benefit statement and time of year statement is issued	100% issued			100% issued by 31 August 2019	
Forward Thinking					
Performance and Risk of Lothian Pension Fund	Actual 11.3%pa, Benchmark 10.9%pa. Exceeding benchmark with lower risk.			Meet benchmark over rolling 5 year periods with lower risk with risk/return measures including performance in rising and falling markets	
Proportion of critical pensions administration work completed within standards	96.6%	84.1%		Greater than 92%	
Provide new members with scheme information within 20 working days of getting details from employer	N/A	100%		100%	
Provide transfer-in quote within 10 working days of receiving the Cash Equivalent Transfer Value (CETV) from member's previous pension provider.	83.33%	82.6%		96%	
Notify members holding more than 3 months, but less than 2 year 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.	82.61%	40.29%		85%	
Pay a refund of contributions within 7 working days of receiving the completed declaration and bank detail form.	95.12%	80.43%		91%	
Notify early leavers entitled to deferred benefits of their rights and options within 10 days of being informed of end of pensionable service.	98.83%	92.39%		91%	

	Q1 April to June	Q2 July to Sept	Q3 Oct to Dec	Target	Status
Provide a maximum of one guaranteed Cash Equivalent Transfer Value (CETV) within 10 working days of receiving a request.	98.38%	97.55%		91%	
Payment of CETV within 20 working days of receiving all completed transfer out forms.	95.24%	86.67%		96%	
Pay lump sum retirement grant within 7 working days of receiving all the information we need from the member.	99.13%	98.93%		96%	
Estimate requested by employer of retirement benefits within 10 working days.	93.64%	67.96%		91%	
Pay any lump sum death grant within 7 working days of receipt of the appropriate documentation.	93.24%	93.44%		96%	
Notification of dependant benefits within 5 working days of receiving all necessary paperwork.	97.98%	95.06%		96%	
Acknowledge the death of a member to next of kin within 5 working days.	98.65%	99.32%		96%	
Respond in writing within 20 working days to formal complaints that have escalated from frontline resolution, or recorded directly as an investigation.	100%	100%		100%	
Pension Admin Workflow - Non Key Procedures Performance.	81.39%	74.34%		76%	
Honest & Transparent					
Audit of annual report				Unqualified opinion	Not yet known
Percentage of employer contributions paid within 19 days of month end	99.5%	99.9%		99.00%	
Data quality – compliance with best practice as defined by the Pensions Regulator	Assessment made at 2020 year-end			Fully compliant	Not yet known
Monthly Pension Payroll paid on time	100%	100%		Yes	
Working Together					
Level of sickness absence	4.72%	2.54%		4%	
Proportion of staff engaged as measured in the Staff Engagement Survey	69%			70%	
Percentage of staff that have completed two days training per year.	66.3%	86.9%		100%	

Service Plan Membership and Cashflow Monitoring 2019/20

Lothian Pension Fund	**2019/20 YTD**	**2019/20 Projected**
Income	**£'000**	**£'000**
Contributions from Employers	99,221	183,000
Contributions from Employees	32,275	53,000
Transfers from Other Schemes	2,583	5,000
	134,079	**241,000**
Expenditure		
Pension Payments	(103,314)	(179,000)
Lump Sum Retirement Payments	(41,949)	(70,000)
Refunds to Members Leaving Service	(349)	(650)
Transfers to Other Schemes	(5,968)	(11,000)
Administrative expenses	(1,458)	(2,500)
	(153,038)	**(263,150)**
Net Additions/(Deductions) From Dealings with Members	**(18,959)**	**(22,150)**

Scottish Homes Pension Fund	**2019/20 YTD**	**2019/20 Projected**
Income	**£'000**	**£'000**
Administration charge	80	80
Expenditure		
Pension Payments	(3,820)	(6,450)
Lump Sum Retirement Payments	(355)	(650)
Transfers to Other Schemes	-	(100)
Administrative expenses	(47)	(80)
	(4,222)	**(7,280)**
Net Additions/(Deductions) From Dealings with Members	**(4,142)**	**(7,200)**

Pensions Committee

2.00pm, Wednesday, 11 December 2019

Lothian Pension Fund Branding Review

Item number	**5.8**
Executive/routine	
Wards	**All**
Council Commitments	

1. Recommendations

The Pensions Committee is requested to:

1.1 note this report providing an update on and background to the visual brand refresh for the Lothian Pension Fund group.

Stephen S. Moir

Executive Director of Resources

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Report

Lothian Pension Fund Visual Brand

2. Executive Summary

2.1 Lothian Pension Fund (LPF) has taken the opportunity to refresh its visual brand alongside the launch of the new website. The new look is modern, clean, professional and portrays our values as being trusted, reliable and customer focussed.

3. Background

3.1 LPF has undergone an exercise to modernise both their visual brand along with their ‘tone of voice’ for member and colleague communications, to ensure that the branding and communications truly represent their values.

4. Main report

4.1 The existing flower logo does not visually reflect what LPF does as an organisation. The colour palette is muted, the visual brand is not memorable and struggles to stand out against a coloured background and with limited design scope.

4.2 The new visual brand looks modern, clean, professional and portrays LPF’s values as being trusted, reliable and customer focussed. Please see appendix 1 for images of the design.

4.3 The visual brand consists of three blocks which represent a positive, confident upward bar chart to show pension funds accumulating. They can also symbolise buildings, infrastructure and the LPF members and colleagues. The three blocks also represent the three collaborative partners and look solid and dependable.

5. Next Steps

5.1 The refreshed visual brand will go live on 1 December 2019 and will be rolled out across all internal and external communications, including the new websites, member correspondence, business cards, social media and colleague newsletters and in due course office signage etc.

5.2 It is critical to the brand re-launch that this change is done consistently across all the LPF group's internal and external facing presence from 1 December in order to maximise the benefit and portray organisational strength to stakeholders, existing staff, prospective recruits and the wider market of business counterparties.

6. Financial impact

6.1 The cost of the design of the new visual brand was £250.

6.2 There was no cost to update member or social media communications, as all visual brand changes happen electronically in-house.

6.3 We digitally create letter-heads and other stationery at the point of use, therefore wastage associated with existing stationery will be very minimal.

6.4 The visual brand refresh was timed alongside the website refresh to avoid any cost implications.

7. Stakeholder/Community Impact

7.1 The Pension Board, comprising employer and member representative, 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, except that it is envisaged that the brand re-launch will further support the outcomes of the LPF Governance Review in reinforcing the separate governance model of the LPF group.

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

8. Background reading/external references

8.1 See appendix for more detail including visuals of the refreshed visual brand.

9. Appendices

Appendix 1 – Our Vision Brand

LOTHIAN
PENSION FUND

Our Visual Brand

Susan Macfarlane

11 December 2019

Background

- Our visual brand sets us apart from other organisations, makes us unique and helps to shape our culture and identity.
- We want our members to trust us to safeguard their retirement savings and know that we focus on value for money.
- Our colleagues and members should see us as a warm, professional, friendly, open and honest organisation that puts them at the heart of what we do and our visual brand will reflect this.

LOTHIAN
PENSION FUND

Why did we need to change our visual brand?

- As the previous colour palette was muted, the visual brand struggled to stand out against a coloured background and limited our design scope.
- We undertook an exercise to modernise both our visual brand along with our ‘tone of voice’ to ensure that our branding and communications truly represent our values.
- Our previous visual brand looked outdated and didn’t reflect what we do as an organisation.
- The flower image was perceived as gentle and feminine and has been described as looking more suited to a yoga or pharmaceutical company.

LOTHIAN
PENSION FUND

What were we looking for in our new visual brand?

- We focussed on a more modern and memorable visual brand that reflected our vibrancy and prudent nature and showed that we are dependable and customer focussed.
- We worked with a graphic designer to create the new visual brand which is explained on the next slide.

LOTHIAN
PENSION FUND

Our new visual brand

1 LOTHIAN PENSION FUND

2 LOTHIAN PENSION FUND

3 LOTHIAN PENSION FUND

4 LOTHIAN PENSION FUND

- The new visual brand looks modern, clean, professional and portrays our values as being trusted, reliable and customer focussed.
- The blocks can represent a positive, confident upward bar chart to show pension funds accumulating, or can represent buildings, infrastructure and our members and colleagues. The structure looks solid and dependable like Lothian Pension Fund.
- As well as a graph, images 1 and 2 give the impression of a house/building, symbolising both growth and security. Images 3 and 4 also show growth and echo our Scottish roots, as the image can represent heather, or the top of a thistle.
- The colour palette has been specially chosen. Purple is the colour of prosperity, whilst blue is common among financial institutes as it represents trust and security. The colours are also aesthetically pleasing and place the brand in a clearly defined market.
- The visual brand comes in a suite of different designs for maximum versatility. Logos 1 and 2 show the visual brand used in both full colour and as a ‘white out’ against a gradient of the logo colour. Images 3 and 4 are an alternative option, that work well for web banners etc. (as shown in image 4).

Pensions Committee

2.00pm, Wednesday, 11 December 2019

Risk Management Summary

Item number	**5.9**
Executive/routine	
Wards	**All**
Council Commitments	

1. Recommendations

The Pensions Committee is requested to:

1.1 note the Quarterly Risk Overview.

Stephen S. Moir

Executive Director of Resources

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Report

Risk Management Summary

2. Executive Summary

2.1 In line with the Lothian Pension Fund's (LPF) ongoing risk management procedures, this paper provides an overview of LPF's risk analysis for consideration by the Committee.

3. Background

3.1 LPF's risk management procedures require it to:

3.1.1 maintain a detailed operational risk register which sets out all the risks identified and assessed by the officers on an ongoing basis, the degree of risk associated in each case and our action to mitigate these risks (the Operational Risk Register); and

3.1.2 produce a summary report of the risk register for the Pensions Committee and the Pensions Audit Sub Committee which highlights the material risks facing the pension funds and identifies any new risks/concerns and the progress being made over time by the officers in mitigating the relevant risks (the Quarterly Risk Overview).

4. Main report

4.1 The Operational Risk Register is issued to the Conveners of the Pensions Committee and the Pensions Audit Sub Committee and the Independent Professional Observer on a quarterly basis.

4.2 The Quarterly Risk Overview, as at 30 October 2019, is set out in Appendix 1 to this report for consideration.

4.3 At its meeting on 26 June 2019 LPF proposed that a three-year graphic of the risks be added to provide greater insight around the progression of the risks over the years. Appendix 1 now includes a three-year graphic of the risks to assist the Committees understanding.

4.4 The annual in-depth review of the risk register has been presented to the Audit Sub Committee this quarter, which currently involves that committee scrutinising the full risk register in greater detail.

5. Next Steps

5.1 Quarterly review and reporting of risk register.

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 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 – Quarterly Risk Summary, as at 30 October 2019

Appendix 1

LOTHIAN PENSION FUND

QUARTERLY RISK OVERVIEW

30 October 2019

UPDATE ON MOST NOTABLE RISKS

Risk & Reference Number	**Update**	**Trend / RAG**
Adverse Investment performance causes funding levels to fall requiring higher employer contributions. **(1)**	The fund is considering the outcomes from the Joint Investment Strategy Panel's investment strategy review with its partner funds, and prioritising implementation of resulting strategies to improve synergies across the portfolios of the three funds.	**Static** ⬌
Adverse change in non-investment actuarial assumptions cause funding levels to fall requiring higher employer contributions **(2)**	The fund continues to review its communication with employers around comparative LGPS contribution rates, including on the longer-term implications and the potential benefits of LPF's unitisation strategy and internal investment approach. Effective communication regarding this is critical to the fund's wider strategy of ensuring the long-term sustainability of the scheme and that it is a destination of choice for employers. Monitoring of funding levels is also ongoing, as is engagement with employers to put in place bespoke arrangements to help manage affordability issues. *See below for risk 3.* Training for the Pension Committee and Board Members on the contribution stability mechanism took place in November and a full report is being presented to Committee this quarter in advance of the 2020 valuation.	**Static** ⬌

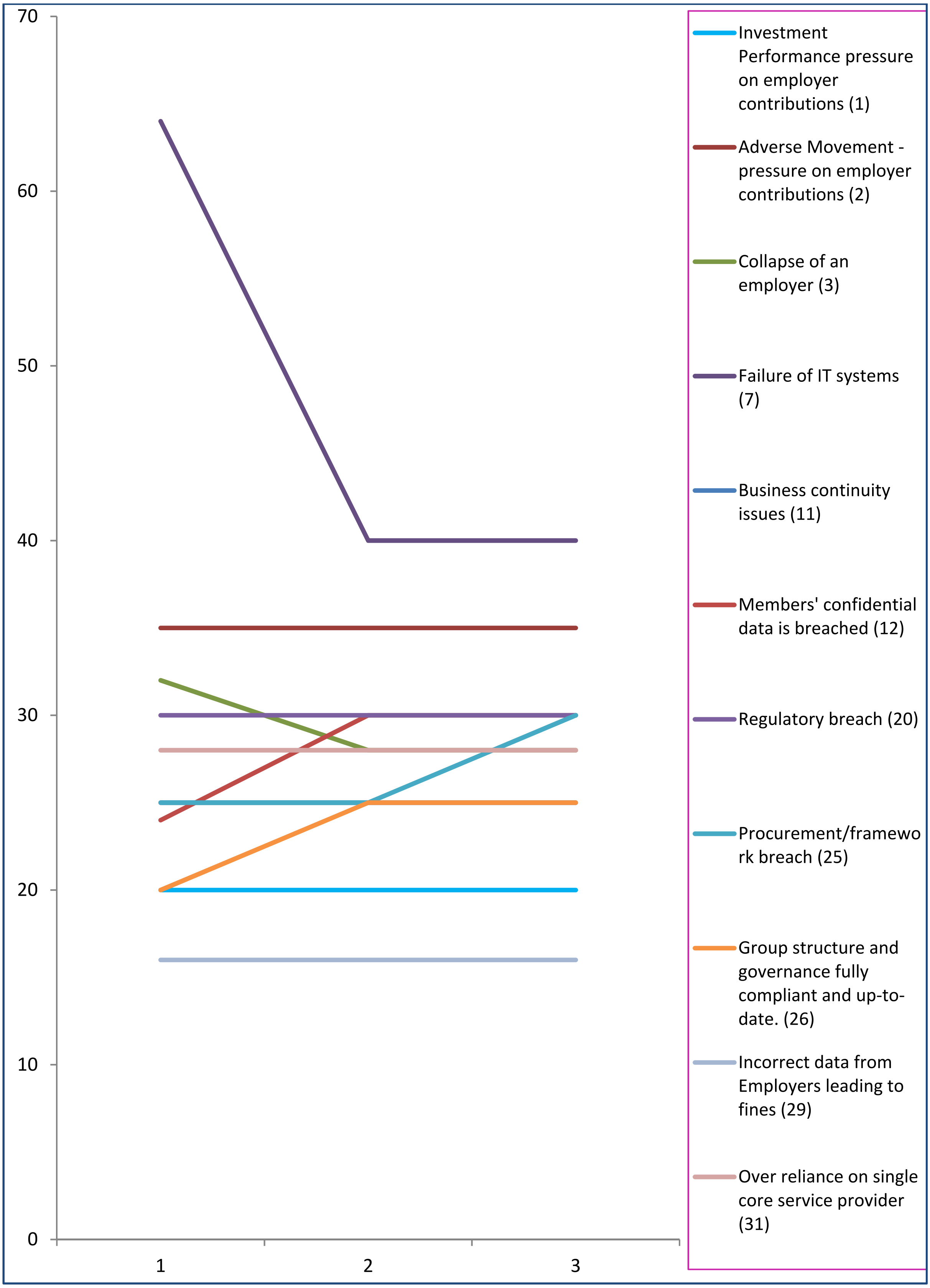
Risk & Reference Number	Update	Trend / RAG
Failure of an employer to pay contributions causes funding levels to fall, requiring higher contributions from other employers **(3)**	The funding approach introduced in the 2014 actuarial valuation for employers that are close to exiting the scheme reduces the overall risk to the fund and any liability sharing. The fund continues to engage with employers regarding any potentially adverse financial impact of the funding strategy and will consult with employers on the newly revised Strategy. Funding agreements for payment of cessation debt are being put in place where relevant for employers exiting the fund. As above, the fund continues to pursue guarantees and securities from employers (where appropriate) and update admission agreements in order to further mitigate this risk, which is becoming more applicable as the fund considers exits from larger employers. The fund continues to work with some employers to improve affordability by adopting a higher risk investment strategy in consideration for additional security being provided by those employers to off-set any additional risk to the fund and its other stakeholders.	**Static** ↔
Failure of IT systems used in the fund with serious consequences for investment management, benefit administration and oversight activities **(7)**	The fund continues to experience delays and service disruption across a number of areas. Operational issues are, to some extent, being dealt with by liaising directly with the fund's ICT relationship manager in the Council and notifying CGI of delays and disruptions experienced. Critically, key supplier management assurances are being followed up on, to ensure they continue to meet the fund's requirements. Although the risk is static this quarter work on mitigating this risk continues with the commencement of regular monthly fund ICT Oversight & Governance meetings at senior level taking place with the purpose of tracking ICT governance and security progress and issues as well as CGI drafting a detailed rough order of magnitude (ROM) which will inform the fund and CGI of the cost, work involved and the lifecycle of the project. In addition to the above actions, key policies for staff such as ICT acceptable use policy and LPF password standard guidance have been updated as well as the development and update of training around information security, phishing and cyber risks. This will be rolled out to all staff over the next quarter and completion by all staff monitored. As with previous quarters a further ICT update will be presented to the Committee as part of the private B agenda.	**Static** ↔
Business continuity issues **(11)**	As referred to in the risk overview last quarter, the current ICT review process has highlighted the need to include more detail in the business continuity plan around the fund's directly managed third party ICT systems and specific systems architecture, business continuity options and future preferences. This will be picked up as the wider ICT project develops.	**Static**

Risk & Reference Number	Update	Trend / RAG
	Work to ensure that the communication infrastructure is functioning in the new target office property has commenced to ensure no delays of service. The business continuity risk continues to remain static and is expected to reduce once the ICT and office matters have been addressed, allowing those areas to be properly taken into account in the business continuity plan. The fund has begun to work towards a new business continuity management standard (BCMS), ISO 22301.	⬌
Members' confidential data is lost or made public. Breach of Data Protection Act. **(12)**	In order to strengthen the fund's controls it has requested that the Pensions Administration system provider set tolerances for employers to alert them when uploading data on to the system. Until the tolerance levels are in place the risk will remain at the slightly increased level. The fund will otherwise continue to mitigate this risk by continuing manual checks until automatic checks are in place.	**Static** ⬌
Regulatory breach **(20)**	The fund continues to be engaged in a compliance readiness project to ensure it is well placed for additional regulations that will come into scope on LPFI providing extended services to collaborative partners. This also now includes the impact of the Competion and Market Authority's recent order around the investment consultancy industry/services, and the subsequent implementing regulations and guidance from the government bodies and regulators (TPR, FCA and HMRC). BDO continues to be instructed to carry out on-site regulatory compliance audits of LPFI in order to ensure assurance in this area. The fund has reviewed the implications of the Senior Manager and Certification Regime coming into force at the end of 2019 and a full compliance implementation programme is currently in place to meet its obligations by the required date of 9th December.	**Static** ⬌

Risk & Reference Number	Update	Trend / RAG
	As above, the fund's ICT provision is a critical aspect of its ongoing compliance with existing and enhanced data protection and financial services regulations, and so this risk will remain amber until such time as the fund has sufficiently addressed its key ICT strategies. In particular, the ICT transformation will support key strategic initiatives, including the separation of the financial ledger system/accounts from CEC and the implementation of a new document management system. The fund has reviewed any necessary Brexit contingency planning (including any staff issues) in the lead up to a possible exit of the EU, but as a UK based pension fund, collaborating with othe similar UK based funds, the direct and immediate impact is expected to be limited. The position therefore remains as reported in previous risk updates.	
Procurement/framework breach **(25)**	The fund continues to liaise with CEC's procurement team to ensure that the processes and procedures are sufficiently streamlined for the fund's specific needs and circumstances where appropriate. The amendment of the Council's contract standing orders and terms of reference provide the Pension Committee with greater oversight. We are continuing to work with CEC's Chief Procurement Officer to best position the procurement processes and procedures in a manner that fits with the specific needs of the LPF group business and satisfies CEC's parent oversight requirements. The risk has increased due to the enhanced impact the procurement regime has on the fund's developing business model (sitting unusually within all of the financial services, pensions and public sector regimes).	**Increase** ⬆
Group Structure and Governance not compliant and up to date (including integration of subsidiaries) or working effectively resulting in adverse impact on group strategy and business plan delivery **(26)**	The Pensions Committee, refresher training on the group structure took place in September 2019. To ensure all new staff are aware of group structure further staff training sessions are planned. The risk remains static to reflect transitional risk in implementing both the organsiational development review of the staff structure and also the changes being introduced by the Governance Review. In addition, the fund continues to monitor the resourcing of certain internal teams on which it relies for intra-group services.	**Static** ⬌

Risk & Reference Number	**Update**	**Trend / RAG**
Incomplete or incorrect data from employers leading to incorrect valuation of liabilities /benefit payments / fines from the Pensions Regulator (post April 2015) **(29)**	The fund continues PAS monitoring and the process is now underway to address poor performance. Until the process is complete the risk will remain amber. Heywoods supplier management continues to ensure montitoring and enforcement of critical KPI's under that contract.	**Static** ⬌
Over reliance on single service provider for core functions, potential leading to loss of service on the collapse or withdrawal of that provider, or excessive cost due to failure to achieve best value in competitive market. **(31)**	This risk remains at amber and is likely to do so until there is less dominance of key service providers in key sectors and greater options available to the fund.	**Static** ⬌

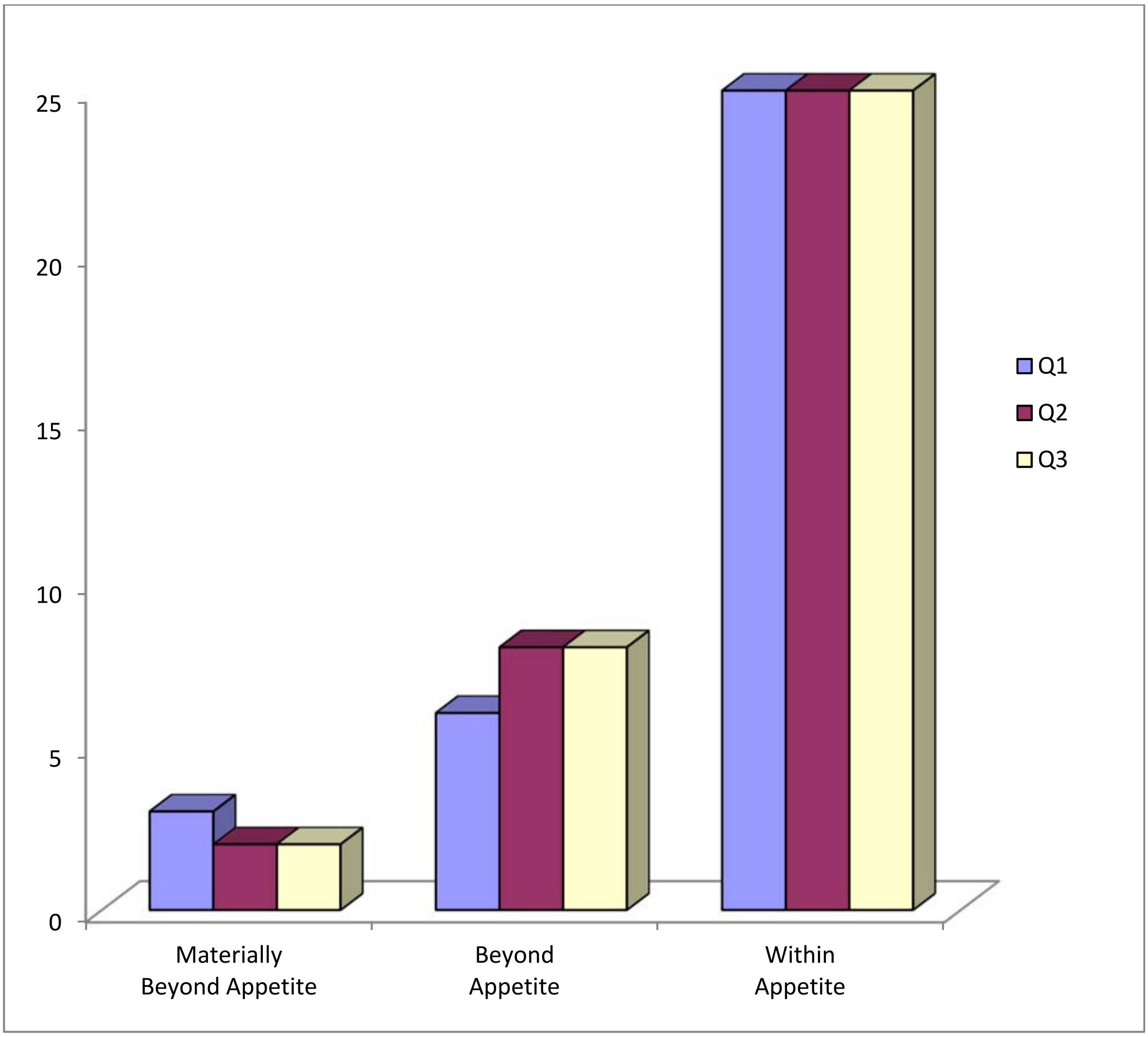
NOTABLE RISKS: PROGRESSION OF CURRENT RISK (ACCOUNTING FOR CONTROLS) IN LAST THREE QUARTERS



OTHER KEY POINTS

	Comments
New notable risks	None.
Other new risks	None.
New controls	ICT governance tracker in place, with tracking against best practice and FCA security requirements. (7) Service introduction template in place to ensure all new ICT services are onboarded correctly with appropriate controls. (7) Contract refresher as part of ongoing supplier management. (13) Tracing provider appointed, and active tracing has commenced (5). The Securities Lending contract has been updated as part of the fund's ongoing supplier management initiative. As part of that process, the indemnity coverage for security and collateral arrangements has been refined. (13) New investment front office trading system in place (11, 16, 17, 20) Routine testing of Redbox call recording in place. (16)
Eliminated risks	None.
Notable initiatives / actions	SM&CR project implementation in process in conjunction with implementation of LPF's Organisational Development Review. Staff and LPFI board training was held on 18 November 2019. (6) Independent IT Consultant is currently being procured to review the funds digital strategy. (7) The fund's acceptable use policy has been updated to more closely align with industry best practice, and guidance on passwords has been developed. Existing policies are currently under review. (7) On-line staff training on information security and phishing being developed to ensure all staff are fully aware of cyber risks and how to mitigate them. Training will be monitored to ensure all staff complete this training annually. (7) There is a Pension Board vacancy to fill, due to the recent departure of Sharon Cowle, Employer Representative on the Board. (10) Planning underway to mitigate any transitional risks associated with the proposed property move. (11) The fund's new, but interim, website is due to be launched in December 2019, which should improve member and employer communications. (22)
Material litigation	None.

All Risks: Status Overview



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Quarter 2
2019/20 All Risks: Impact and Probability Overview

Probability										
10										
9										
8										
7				3	2					
6				10, 14	20					
5					11, 25, 26	12, 32		7		
4			8	5, 28, 29, 33, 34	1, 6, 9, 18, 19, 22, 27	4, 23, 30	31			
3			13	24	16			35		
2				17						
1					21				15	
	1	2	3	4	5	6	7	8	9	10

Impact

Quarter 3
2019/20 All Risks: Impact and Probability Overview

Probability	1	2	3	4	5	6	7	8	9	10
10										
9										
8										
7				3	2					
6				10, 14	20					
5					11, 26	12, 25, 32		7		
4			8	5, 28, 29, 33, 34	1, 6, 9, 18, 19, 22, 27	4, 23, 30	31			
3			13	24	16			35		
2				17						
1					21				15	

Impact

Key: Risks by Number

1	Adverse Investment performance causes funding levels to fall requiring higher employer contributions	20	Regulatory Breach
2	Adverse change in non-investment actuarial assumptions cause funding levels to fall requiring higher employer contributions assumptions- pressure on employer contributions	21	FOI process not in accordance with law
3	Failure of an employer to pay contributions causes funding levels to fall, requiring higher contributions from other employers	22	Incorrect communication with members
4	Failure to recruit, engage and retain talent leads to workforce capability gaps with implications for oversight, control, administration and achievement of service plan goals	23	Acting beyond proper authority/delegations
5	Fraud or theft of Council/Pension fund assets	24	Inappropriate use of pension fund monies
6	Staff Negligence	25	Procurement/framework breach
7	Failure of IT systems used in the fund with serious consequences for investment management, benefit administration and oversight activities	26	Group Structure and Governance not fully compliant and up to date (including integration of subsidiaries) or working effectively resulting in adverse impact on group strategy and business plan delivery.
8	Employers make individual or collective employee decisions without considering the impact on the pension fund causing exceptional benefit entitlement or additional fund strain not able to be recovered at point of decision	27	Claim or liability arising from shared services
9	Committee members take decisions against sound advice	28	Unauthorised access to PensionsWEB
10	Pension Board not operating effectively	29	Incorrect data from Employers leading to finds etc
11	Business continuity issues	30	Inadequate contractual protection for services
12	Members' confidential data is breached	31	Over reliance on single core service provider
13	Loss due to stock lending default	32	Human resource insufficient to carry out active projects
14	Risk of incorrect pension payments	33	Breach of health and safety regulations
15	Failure to pay pensions as they fall due	34	Inadequate, or failure of, supplier and other third-party systems (including IT and data security)
16	Market abuse by investment team or others	35	Cybersecurity protections and/or back-up not sufficient to prevent cyber-attacks or minimise their impact
17	Portfolio transition issues		
18	Disclosure of confidential information		
19	Material breach of contract		

Risk Status	
	Materially beyond appetite: resolve urgently where possible (probability and impact total 35 and above)
	Beyond appetite: resolve where possible (probability and impact total 25 to 34)
	Within appetite: monitor (probability and impact total 24 and below)

Risk Scoring

	Impact
0	(None)
1	No discernible effect
2	Little discernible effect
3	Some effect noticeable
4	Some effect on service provision
5	Noticeable effect on service provision
6	Some disruption of service
7	Significant service disruption
8	Material disruption to services
9	Major service disruption
10	Catastrophic

	Probability
0	(None)
1	Virtually impossible
2	Extremely unlikely
3	Remotely possible
4	May occur
5	Fairly likely to occur
6	More likely to occur than not
7	Likely to happen
8	Probably will happen
9	Almost certainly will happen
10	Already happening

Lothian Pension Fund Group
Three Year Risk Overview

Notable Risks table

Select End Quarter you wish to look at ---> Q3 2019/20 Q2 2019/20 Q1 2019/20 Q4 2018/19 Q3 2018/19 Q2 2018/19 Q1 2018/19 Q4 2017/18 Q3 2017/18 Q2 2017/1 Q1 2017/1 Q4 2016/1 Q3 2016/1 Q2 2016/1 Q1 2016/17

Enter Risk No below

↓	Description	Q1 2016/17 Total	Q2 2016/17 Total	Q3 2016/17 Total	Q4 2016/17 Total	Q1 2017/18 Total	Q2 2017/18 Total	Q3 2017/18 Total	Q4 2017/18 Total	Q1 2018/19 Total	Q2 2018/19 Total	Q3 2018/19 Total	Q4 2018/19 Total	Q1 2019/20 Total	Q2 2019/20 Total	Q3 2019/20 Total
1	Investment Performance pressure on employer contributions (1)															
2	Adverse Movement - pressure on employer contributions (2)															
3	Collapse of an employer (3)															
4	Retention of key staff (4)															
5	Fraud or theft of Council/Pension Fund assests (5)															
6	Staff negligence, maladministration or lack of specialist knowledge (6)															
7	Failure of IT systems (7)															
8	Employers HR decisions without consideration of fund (8)															
9	Elected members take decisions against sound advice (9)															
10	Pension Board not operating effectively (10)															
11	Business continuity issues (11)															
12	Members' confidential data is breached (12)															

↓	Description	Q1 2016/17 Total	Q2 2016/17 Total	Q3 2016/17 Total	Q4 2016/17 Total	Q1 2017/18 Total	Q2 2017/18 Total	Q3 2017/18 Total	Q4 2017/18 Total	Q1 2018/19 Total	Q2 2018/19 Total	Q3 2018/19 Total	Q4 2018/19 Total	Q1 2019/20 Total	Q2 2019/20 Total	Q3 2019/20 Total
13	Loss due to stock lending default (13)															
14	Risk of incorrect pension payments (14)															
15	Late payment of pension (15)															
16	Market abuse by investment team (16)															
17	Portfolio transition issues (17)															
18	Disclosure of confidential information (18)															
19	Material breach of contract (19)															
20	Regulatory breach (20)															
21	FOI process in accordance with law (21)															
22	Incorrect communication with members (22)															
23	Not acting in accordance with proper authority/delegations (23)															
24	Inappropriate use of pension fund monies (24)															

↓	Description	Q1 2016/17 Total	Q2 2016/17 Total	Q3 2016/17 Total	Q4 2016/17 Total	Q1 2017/18 Total	Q2 2017/18 Total	Q3 2017/18 Total	Q4 2017/18 Total	Q1 2018/19 Total	Q2 2018/19 Total	Q3 2018/19 Total	Q4 2018/19 Total	Q1 2019/20 Total	Q2 2019/20 Total	Q3 2019/20 Total
25	Procurement/framework breach (25)															
26	Group structure and governance fully compliant and up-to-date. (26)															
27	Claim or liability arising from shared services (27)															
28	Unauthorise access to PensionsWEB (28)															
29	Incorrect data from Employers leading to fines (29)															
30	Inadequate contractual protection for services (30)															
31	Over reliance on single core service provider (31)															
32	HR insufficient to carry out active projects (32)															
33	Breach of Health and safety regulations (33)															
34	Inadequate, or failure of, supplier and other third-party systems (including															

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Agenda Item 8.3

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