



## **Notice of Meeting and Agenda**

### **Pensions Audit Sub-Committee**

**2.00 pm Tuesday, 23rd June, 2020**

Meeting will be via conference call

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 Any items under "Private Business" will not be published, although the decisions will be recorded in the minute.

#### **Contacts:**

Susan Handyside, Governance Manager, Lothian Pension Fund

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## 1. Quorum Check

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- 1.1 The Convener will check to ensure a quorum is in attendance to ensure the meeting can proceed.

## 2. Order of Business

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

## 3. Declaration of Interests

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

## 4. Deputations

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- 4.1 If any

## 5. Minutes

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- 5.1 Minute of Pensions Audit Sub-Committee of 10 December 2019 - 7 - 10  
submitted for approval as a correct record

## 6. Reports

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- 6.1 Agenda Planning – Report by the Chief Risk Officer, Lothian Pension Fund 11 - 16
- 6.2 Summary of March Committee Reports – Report by the Chief Risk Officer, Lothian Pension Fund 17 - 52

<b>6.3</b>	Lothian Pension Fund - Internal Audit Opinion and Annual Report for the Year Ended 31 March 2020 – Report by the Chief Internal Auditor, City of Edinburgh Council	53 - 90
<b>6.4</b>	Lothian Pension Fund – Proposed Internal Audit Plan for 2020/21 – Report by the Chief Internal Auditor, City of Edinburgh Council	91 - 96
<b>6.5</b>	External Audit Annual Plan 2019/20 – Report by the Chief Finance Officer, Lothian Pension Fund	97 - 132
<b>6.6</b>	Lothian Pension Fund Unaudited Annual Report (and Financial Statements) 2020 – Report by the Chief Finance Officer, Lothian Pension Fund	133 - 346
<b>6.7</b>	Risk Management Summary – Report by the Chief Risk Officer, Lothian Pension Fund	347 - 370

## **7. Motions**

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**7.1** If any

## **8. Resolution to Consider in Private**

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**8.1** The Sub-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.

## **9. Private Reports**

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<b>9.1</b>	Lothian Pension Fund Group Controls and Compliance – Report by the Chief Executive Officer, Lothian Pension Fund	371 - 412
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**Laurence Rockey**

Head of Strategy and Communications

## **Committee Members**

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Councillors Rose (Convener) and Child; John Anzani.

Please note that Alan Williamson, Pension Board Employer representative, Jim Anderson, Pension Board Members representative and the Independent Professional Observer will also be invited to attend and participate in the meeting.

## **Information about the Pensions Audit Sub-Committee**

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The Pensions Audit Sub Committee consists of 2 Councillors and 1 external member and is appointed by the City of Edinburgh Council in its separate capacity as administering authority of the Lothian Pension Fund. The Pensions Audit Sub Committee usually meets 3 times a year.

Meeting will be via conference call. Attendance at the meeting will be monitored by Susan Handyside.

The Committee [Term of Reference](#) and [Procedural Standing Orders](#).

## **Pension Board Members**

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Alan Williamson, Brian Robertson, Darren May, Jim Anderson, Lesley Henderson, Sharon Dalli, Thomas Carr-Pollock and Tom Howorth.

## **Information about the Pension Board**

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The Pension Board consists of 10 members, 5 members from the employer bodies and 5 members from trade unions representing members within the pension funds as set out in the regulations.

The role of the Pension Board is to help ensure that the operation of the pension funds is in accordance with the applicable law and regulation. All Pension Board members attend the Pensions Committee meeting and two members of the Pension Board also attend the Pensions Audit Sub-Committee.

More details regarding the role of the board can be found at the [LPF website](#)

## **Independent Professional Observer**

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Andy McKinnell

## **Information about the Independent Professional Observer**

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The Independent Professional Observer is appointed by the Lothian Pension Fund to help strengthen the Lothian Pension Fund's governance. The role is to provide independent observations to the Pensions Audit Sub-Committee and Pension Board.

The purpose of the role is to enhance the scrutiny of the decision making and provide the Sub-Committee and Board with additional experience and knowledge impartial from the Lothian Pension Fund's Officers.

## **City of Edinburgh Council Oversight**

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The City of Edinburgh Council has statutory responsibility to administer the Lothian and Scottish Homes pension funds. In order to most effectively carry out that function (and to reflect the separate statutory responsibilities, and regulation, of the pension funds) the City of Edinburgh Council has delegated management responsibility for the pension funds to the Lothian Pension Fund Group and its two arms-length companies LPFE Limited and LPFI Limited. Critical parent oversight continues to be carried out by the Pensions Committee, Stephen S. Moir (Executive Director of Resources, The City of Edinburgh Council) and Laurence Rockey (Head of Strategy and Communications, The City of Edinburgh Council) to ensure that its statutory function is being properly carried out.

## **Lothian Pension Fund Senior Leadership Team**

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The senior leadership team responsible and accountable for the business and activities of the Lothian Pension Fund Group are:

Doug Heron, Chief Executive Officer  
Bruce Miller, Chief Investment Officer  
Struan Fairbairn, Chief Risk Officer  
John Burns, Chief Finance Officer  
Helen Honeyman, Head of People and Communications

## **Further Information and Contact**

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If you have any questions about the agenda or meeting arrangements, please contact Susan Handyside, Governance Manager, Lothian Pension Fund, Atria One, 144 Morrison Street, Edinburgh EH3 8EX, Tel 0777 137 8238, email [susan.handyside@edinburgh.gov.uk](mailto:susan.handyside@edinburgh.gov.uk)

The agenda, minutes and public reports for this meeting can be viewed via the City of Edinburgh Council [committee portal](#).



# Minutes

## Pensions Audit Sub-Committee of the Pensions Committee

**2.00pm, Tuesday 10 December 2019**

**Present:**

Councillors Rose (Convener) and Child; John Anzani.

**Pensions Board Members:**

Jim Anderson

**Independent Professional Observer**

Andy McKinnell

### 1. Minutes

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**Decision**

To approve the minute of the Pensions Audit Sub-Committee of the Pensions Committee of 24 September 2019 as a correct record.

### 2. Agenda Planning

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An overview of potential reports for future Pensions Committee and Pensions Audit Sub-Committee meetings for December 2019 and March 2020 was presented.

**Decision**

- 1) To note the agenda planning document.
- 2) To note that the Pension Board were invited to comment on agenda items during Committee meetings.
- 3) To note there may be a requirement for an additional meeting of the Audit Sub-Committee in March 2020 to consider Internal Audit plans.

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

### 3. EU Tax Claims and Other Income Tax Recoveries

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A summary was provided on activity on EU and other special tax claims made on behalf of the Lothian Pension Fund. During the period since the last report, no additional claims had been paid and the amount recovered to date remained at £1.37m.

Progress was also reported on outstanding claims. The main developments were further progress with the Manninen and Manufactured Overseas Dividend claims and tax had made additional Fokus claims in Germany and Denmark on a no win no fee basis.

#### **Decision**

To note the report.

(References – Pensions Audit Sub-Committee 11 December 2018 (item 3); report by the Executive Director of Resources, submitted)

### **4. Investment Income Review Cross Border Withholding Tax**

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Information was provided on a benchmarking assurance review prepared by Deloitte into the effectiveness of the procedures in place to manage the tax exposure on the investment income of the Lothian Pension Fund and the Scottish Homes Pension Fund.

The review showed that Northern Trust was generally applying the correct withholding tax rates on investment income. Recovery claims were being processed and reclaims received but Deloitte had advised that the time taken appeared to be longer than the market standard for refunds particularly for Switzerland and Germany.

A summary of opportunities and issues identified was provided.

#### **Decision**

To note the report.

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

### **5. Global Custody Services Performance**

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Key performance indicators for the 12-month period ended 30 September 2019 provided by the Lothian Pension Fund's custodian, Northern Trust, were presented.

The data concluded that Northern Trust's services were currently meeting the needs of the Fund and Scottish Homes Pension Fund.

#### **Decision**

To note the report.

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

### **6. Lothian Pension Fund ICT Update**

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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 Pensions Committee on 26 June 2019, an update was provided on the implementation of the Lothian Pension Fund ICT pathway.

### **Decision**

To note the update on the implementation of the Lothian Pension Fund ICT pathway.

(References – Pensions Committee 24 September 2019 (item 9); report by the Executive Director of Resources, submitted)

## **7. Risk Management In-Depth Review**

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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 Lothian Pension Fund's operational risk register, as at 30 October 2019, was presented which set out all the risk identified and assessed by officers on an ongoing basis, the degree of risk associated in each case and the Fund's action to mitigate these risks.

### **Decision**

To note the operational risk register and quarterly risk overview as at 30 October 2019.

(References – Pensions Committee 26 June 2019 (item 5); report by the Executive Director of Resources, submitted)

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## **Pensions Audit Sub Committee** **2.00pm, Tuesday, 23 June 2020**

### **Agenda Planning**

#### **Item number 5.1**

#### **1. Recommendations**

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The Pensions Audit Sub Committee (Committee) is requested to:

- 1.1 note the agenda planning document; and
- 1.2 note that the Pension Board members are invited to comment on agenda items during Committee meetings.

#### **Struan Fairbairn**

Chief Risk Officer, Lothian Pension Fund

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# Agenda Planning

## 2. Executive Summary

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- 2.1 This report and the agenda planning 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 and the annual cycle.
- 2.2 There will, of course, be specific matters and papers which need to be brought to the attention of the committees in addition to those set out herein.

## 3. Background

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- 3.1 In order for the Committee and Pension Board to gain an overview of the content of future meetings, and also an awareness of the annual cycle of items, 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.
- 3.3 As a result of the COVID-19 lock down the Pension Committee and Audit Sub Committee were cancelled in March.
- 3.4 The City of Edinburgh Council's (CEC) Leadership Advisory Panel (LAP), acting for the CEC in its capacity as the Administering Authority for the Fund approved three urgent March agenda items in the interim; The LPF Operational Plan and Budget, the Discretions Policy and the revised Administration Strategy.
- 3.5 The March Committee papers were circulated on 26 March 2020, to the Pensions Committee and the Pension Board with an update on the urgent papers. A follow up communication confirming the papers had been approved was issued to Committee and Board members on 11 April 2020.
- 3.6 In agreement with the Convenor of the Pensions and Audit Sub Committee the remainder of the papers have been included as part of the June Committee meeting, to be held by video conference.

## 4. Main Report

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- 4.1 The proposed agendas for the next two meetings are set out below, based on the usual Committee cycle plus any additional and intra-cycle requests. This includes the Annual LPF Group Governance Update which has been deferred and will now be presented to committee in September.

### September 2020

<b>Pensions Committee</b>	<b>Audit Sub Committee</b>
<ul style="list-style-type: none"><li>• Referrals / recommendations from Pensions Audit-Sub Committee</li><li>• Employer Covenant Review</li><li>• Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Fund, including the Annual Report by External Auditor</li><li>• Annual LPF Group Governance Update</li><li>• Employers Participating in Lothian Pensions Fund</li><li>• Lothian Pension Fund Contract Awards Report</li><li>• Operating Plan Update</li><li>• Risk Management Summary</li><li>• ICT Update</li></ul>	<ul style="list-style-type: none"><li>• Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Fund, including the Annual Report by External Auditor</li><li>• Annual LPF Group Governance Update</li><li>• Pensions Data Quality</li><li>• Irrecoverable overpayment of pensions – decisions made under delegated authority</li><li>• Fraud Prevention</li><li>• Risk Management Summary</li><li>• ICT Update</li></ul>

### December 2020

<b>Pensions Committee</b>	<b>Audit Sub Committee</b>
<ul style="list-style-type: none"><li>• Referrals / recommendations from Pensions Audit-Sub Committee</li><li>• Annual Report by External Audit</li><li>• Benchmarking</li><li>• Stewardship and Engagement</li><li>• Operating Plan Update</li><li>• Risk Management Summary</li></ul>	<ul style="list-style-type: none"><li>• Annual Report by External Audit</li><li>• EU Tax Claims and Other Income Tax Recoveries</li><li>• Investment Income Review-Cross-Border Withholding Tax</li><li>• Global Custody Services Performance</li><li>• Risk Management: In-depth review</li></ul>

## Future Pensions Committee and Audit Sub Committee dates:

Please note that although rooms have been reserved for the Pension Committee and Audit Sub Committee an update on whether the meetings will go ahead at the venue or be conducted remotely will be communicated nearer the time.

<b>Pensions Committee</b>	<b>Pensions Audit Sub Committee</b>
<ul style="list-style-type: none"><li>• Tuesday, 29 September 2020, 2.00pm, Dunedin Room, City Chambers.</li><li>• Wednesday, 9 December 2020, 2.00pm, Dunedin Room, City Chambers.</li><li>• Wednesday, 17 March 2021, 2.00pm, Dunedin Room, City Chambers.</li><li>• Wednesday, 23 June 2021, 2.00pm, Dunedin Room, City Chambers.</li></ul>	<ul style="list-style-type: none"><li>• Monday, 28 September 2020, 2.00pm, Dunedin Room, City Chambers.</li><li>• Tuesday, 8 December 2020, 2.00pm, Mandela Room, City Chambers.</li><li>• Tuesday, 22 June 2021, 2.00pm, Diamond Jubilee Room, City Chambers.</li></ul>

## 5. Financial impact

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5.1 None.

## 6. Stakeholder/Regulatory Impact

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6.1 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.

6.2 There are no adverse governance, compliance or regulatory implications as a result of this report.

## 7. Background reading/external references

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7.1 None.

## 8. Appendices

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Appendix 1 – LPF’s Annual Agenda Planning Cycle

## APPENDIX 1

Frequency	Pensions Committee	Audit Sub Committee	Month
Annually	Audit Plans (Internal and External)	<i>Draft internal audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee.</i>	March
	Policies and Strategies Update (including revised Pension Administration Strategy biennial from March 2016)	N/A	March
	Operating 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 LPF Group Controls and Compliance	June 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

Frequency	Pensions Committee	Audit Sub Committee	Month
	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
<b>Semi Annually</b>	Employers Participating in Lothian Pension Fund	N/A	March & September
	Lothian Pension Fund Contract Awards Report	N/A	March & September
<b>3 Times per year</b>	Operating Plan Update	N/A	March, September & December
	Referrals / recommendations from Pensions Audit-Sub	N/A	June, September & December
<b>Quarterly</b>	Risk Management Summary	Risk Management Summary	March, June, September and December
<b>Every 3 years</b>	Actuarial Valuation: LPF SHPF Funding Strategy Statement		December or March
<b>As required</b>	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	





## **Pensions Audit Sub Committee 2.00pm, Tuesday, 23 June 2020**

### **Summary of March Committee Reports**

#### **Item number 5.2**

#### **1. Recommendations**

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The Pensions Audit Sub Committee (Committee) is requested to:

- 1.1 note the outstanding March Committee reports re-circulated and formally tabled within this report.

#### **Struan Fairbairn**

Chief Risk Officer, Lothian Pension Fund

Contact: Susan Handyside, Governance Manager, Lothian Pension Fund

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## Summary of March Committee Reports

### 2. Executive Summary

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- 2.1 This report looks to formally table several papers that Committee have received but would have normally considered and noted in the March 2020 cycle of meetings. The report provides a brief overview and details the background in relation to the fuller update provided by LPF for Committee and Pension Board members.

### 3. Background

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- 3.1 Due to COVID-19 and the rapid onset of lock down during March 2020, the Pensions Committee and Audit Sub Committee meetings due to take place that month were cancelled.
- 3.2 The City of Edinburgh Council's (CEC) Leadership Advisory Panel (LAP), was given urgency powers in accordance with it's Scheme of Delegation to approve items on behalf of the Council.
- 3.3 The LAP, acting on behalf of CEC as Administering Authority, approved three urgent items on behalf of the Pensions Committee; The LPF Operational Plan and Budget, the Discretions Policy and the revised Administration Strategy.
- 3.4 The March Committee papers pack was circulated on 26 March 2020, to the Committee and the Pension Board. The communication highlighted the papers were to be approved by LAP and those that were to be deferred until June. A follow up note was provided by the LPF Independent Professional Observer regarding the papers to be approved by LAP on 30 March 2020. An update confirming the papers had been approved was issued to Committee and Board members on 11 April 2020.
- 3.5 On the 23 April 2020 the LAP formally agreed the interim arrangements for CEC which included resuming the Pensions Committee as from June 2020.

### 4. Main Report

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- 4.1 In agreement with the Convenors of the Pensions and Audit Sub Committees the outstanding papers from March were re-circulated to the Committee and Pension Board via email on 26 May 2020.
- 4.2 Committee and Board members were asked to review the papers and provide feedback and queries on any aspect of the reports, in advance of the Committee in June to enable the outstanding papers to be consolidated into one paper and noted in June with only a mind to any significant comments or concerns. That is to ensure

that the focus at the June meetings, being held by video conference, is on the most immediate business of the Fund, but of-course without dismissing any material issues that members may have around the March business.

4.3 Andy McKinnell provided feedback on the reports and held a feedback session during the internal training session for any other queries or clarification on the topics included in this paper on the 8 June.

4.4 The table below sets out the outstanding March Committee agenda items:

<b>Report</b>	<b>Action</b>
Risk Management Summary	To be noted as part of this summary report.
Global Custodian – Due Diligence	To be noted as part of this summary report.
Internal Audit Report	Presented separately to Committee in June
Internal Audit Plan	Presented separately to Committee in June
External Audit Plan	Presented separately to Committee in June

## **5. Financial impact**

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5.1 None.

## **6. Stakeholder/Regulatory Impact**

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6.2 The Fund is liaising with the Pensions Regulator, in conjunction with other matters, to ensure that it is aware of the circumstances around its March cycle. Committee have also received an update on governance and risk management separately in the June papers.

6.3 There are no other adverse governance, compliance, or regulatory implications as a result of this report.

## **7. Background reading/external references**

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7.1 Leadership Advisory Panel – [Tuesday 31 March 2020](#) .

7.2 Leadership Advisory Panel – [Thursday 23 April 2020](#).

## **8. Appendices**

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Appendix 1 – Summary of March Committee Reports - Outstanding Committee Papers  
(public agenda)

Appendix 2 – Summary of March Committee Reports - Outstanding Committee Papers  
(private agenda)



## **Pensions Audit Sub Committee 10.00am, Monday, 23 March 2020**

### **Risk Management Summary**

#### **Item number 5.5**

#### **1. Recommendations**

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The Pensions Audit Sub Committee (Committee) is requested to:

- 1.1 note the Quarterly Risk Overview and the LPF group's approach to risk management.

#### **Struan Fairbairn**

Chief Risk Officer, Lothian Pension Fund

Contact: Susan Handyside, Governance Manager, Lothian Pension Fund

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# Risk Management Summary

## 2. Executive Summary

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- 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

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- 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 the action taken to mitigate those risks (the Operational Risk Register); and
  - 3.1.2 produce a summary report of the risk register for the Committee and the Pensions 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

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- 4.1 The Operational Risk Register is issued to the Conveners of the Committee and the Pensions Committee and the Independent Professional Observer on a quarterly basis. It is also submitted annually to the Committee for a detailed review.
- 4.2 The Quarterly Risk Overview, as at 17 February 2020, is set out in Appendix 1 to this report for consideration.
- 4.3 The risk management process for the LPF group is integrated within all of the group's governance and controls. In particular, the Committee should be aware of LPF's:
- 4.3.1 *Assurance Mapping Process and Overview (LPF Group Controls and Compliance report)*: which is managed by the Senior Leadership Team (SLT) and presented to the Committee annually.
  - 4.3.2 *Third Party Supplier Management Framework*: which is managed and overseen on an ongoing basis by the SLT.

- 4.3.3 *Internal Capital Adequacy Assessment Process (ICAAP)*: which is managed on an ongoing basis by the SLT and overseen by the LPFI board.
- 4.3.4 *ICT Oversight and Governance Procedures*: which are managed by the ICT Oversight Group on an ongoing basis and overseen by the SLT.
- 4.3.5 *People and HR Procedures*: which are managed by the People Group on an ongoing basis and overseen by the SLT and the LPFE board.
- 4.3.6 *Investment Controls and Parameters (LPF Group Controls and Compliance report)* : which are now automated on the Front Office system, managed by SLT and overseen by the LPFI board and JISP (with annual reporting to Committee).
- 4.3.7 *Overall review of Governance and the LPF Group Structure*: managed by SLT and overseen annually by the Committee and Pensions Committee.

## **5. Financial impact**

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

## **6. Stakeholder/Regulatory Impact**

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- 6.1 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.
- 6.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.

## **7. Background reading/external references**

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- 7.1 None.

## **8. Appendices**



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Appendix 1 – Quarterly Risk Summary, as at 17 February 2020

## QUARTERLY RISK OVERVIEW





17 February 2020




### UPDATE ON MOST NOTABLE RISKS

Risk & Reference Number	Update	Trend / RAG
<p>Failure of IT systems used in the fund with serious consequences for investment management, benefit administration and oversight activities <b>(7)</b></p>	<p>Whilst the overall ICT service received is good, LPF continues to experience delays and associated actions are tracked via monthly supplier performance reporting. Operational issues are, to some extent, being managed by liaising directly with LPF's ICT relationship manager in the Council and escalating relevant issues. Critically, key supplier management assurances, particularly around performance and security, are being followed up on, to ensure they continue to meet LPF's requirements. <i>Since the date of the risk meeting, additional key assurance has been provided and a verbal updated will be provided to Committee on this.</i></p> <p>Although the risk is static this quarter work on mitigating this risk continues with ongoing monthly ICT governance and oversight meetings at a senior level; with the purpose of raising awareness of issues and ICT governance and security progress, as well as tracking progress of the procurement of a new IT Managed Service provider.</p> <p>In addition, 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 this quarter and completion by all staff monitored.</p> <p>It is anticipated that existing supplier management and implementation of LPF's Digital Strategy will result in a steady reduction of this risk over the coming quarters.</p>	<p>Static</p> 
<p>Members' confidential data is lost or made public. Breach of Data Protection Act. <b>(12)</b></p>	<p>As reported last quarter, in order to strengthen LPF'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. LPF will otherwise continue to mitigate this risk by continuing manual checks until the process is automated.</p>	<p>Static</p> 

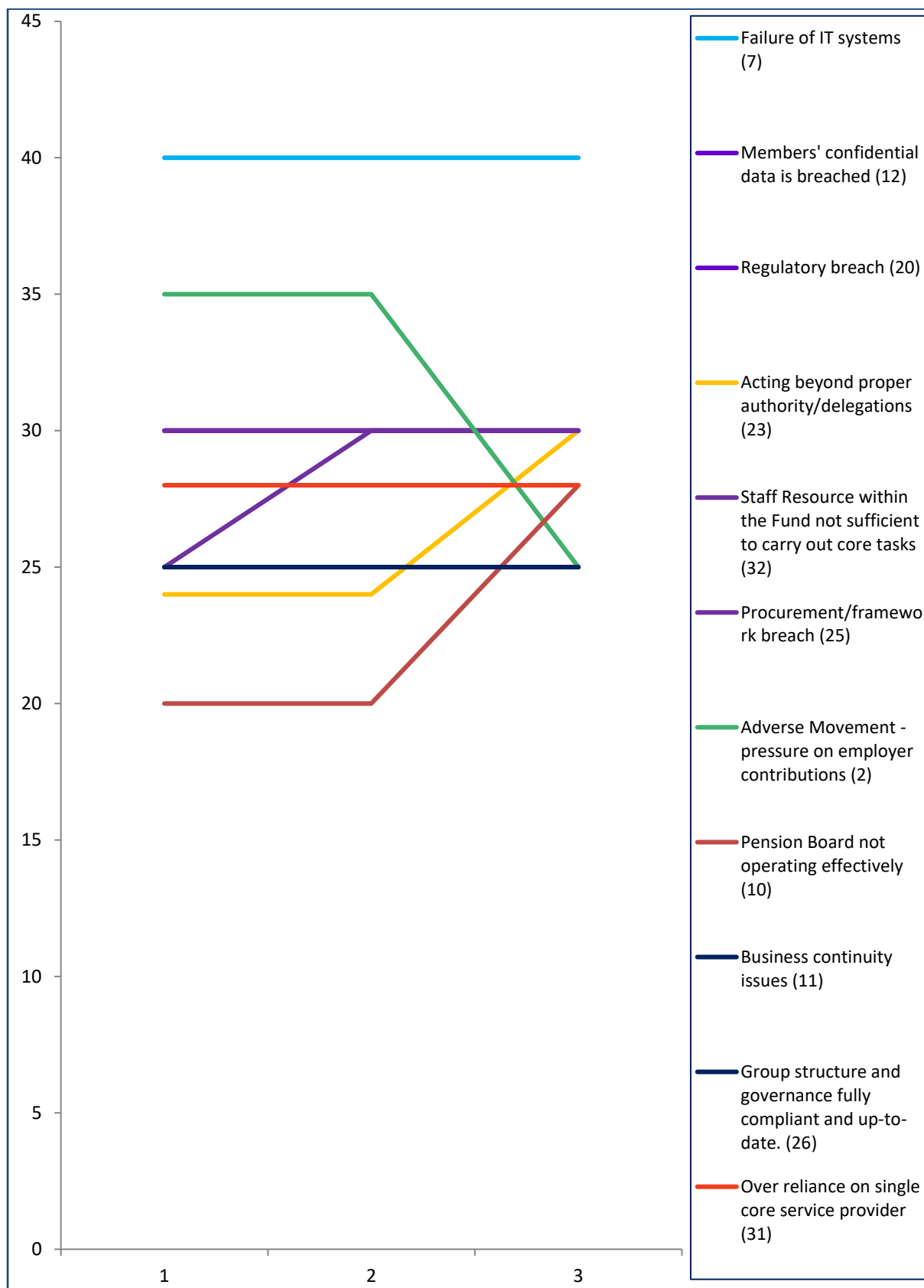


Risk & Reference Number	Update	Trend / RAG
Regulatory breach (20)	<p>LPF continues to be engaged in a compliance readiness project to ensure it is well placed for additional regulations that will come into scope on LPFI providing extended services to collaborative partners (c.Q2 2020). This also now includes the impact of the Competition 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). LPF are meeting with the FCA on 3 March 2020, as part of a wider industry group, to discuss the impact on LGPS collaborative structures.</p> <p>BDO continues to be instructed to carry out on-site regulatory compliance audits, tied to a detailed Compliance Monitoring Programme, of LPFI in order to ensure assurance in this area.</p> <p>As part of implementing the organisational structure in respect of SM&amp;CR, all members of the LPF group will have reviewed and redesigned job descriptions put in place in a new format during Q2 2020. There are a number of ongoing actions to be addressed during the course of the next 12 months, and which tie in with the 2019 Organisational Design Review. The next formal deadline for the completion of actions is December 2020.</p> <p>As above, LPF'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 LPF has sufficiently addressed key aspects of its Digital Strategy. In particular, the ICT transformation will support key strategic initiatives, including the implementation of a new document management system.</p>	<p><b>Static</b></p> 
Acting beyond proper authority/delegations. (23)	<p>LPF is looking to update and refresh its delegations to take account of: (i) Organisational Review appointments and updates, (ii) the new property team, (iii) SM&amp;CR implementation, (iv) the LPF Governance Review, and (v) the implementation of the new Front Office system. In addition LPF intends to improve employee communications, raise awareness of scheme of delegation requirements and update the new website to ensure its group governance structures are clearer.</p> <p>Due to the outstanding actions the risk has been increased until they are complete, although there has been no breach in existing delegations.</p>	<p><b>Increase</b></p> 

Risk & Reference Number	Update	Trend / RAG
Procurement/framework breach <b>(25)</b>	<p>LPF is 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.</p> <p>The risk is static due to the enhanced impact the procurement regime has on LPF’s developing business model (sitting unusually within all of the financial services, pensions and public sector regimes).</p>	<p>Static</p> 
Staff Resource within the Fund not sufficient to carry out core tasks in conjunction with active or anticipated projects. <b>(32)</b>	<p>This risk remains at amber due to the additional resource attributable to significant strategic initiatives such as the implementation of the Digital Strategy and new Front Office System, the office move and the implementation and refinement of the staff organisational review. Preparation work has also begun for the triennial actuarial valuation.</p>	<p>Static</p> 
Pension Board does not operate effectively to detriment of the Fund (e.g. due to lack of attendance/participation or not maintaining sufficient levels of knowledge, skill and/or expertise.) <b>(10)</b>	<p>The Pension Board currently has two vacancies. The continued requirement to fill these vacancies, and recent levels of turnover, has presented a continuity challenge for LPF and the Pension Board itself.</p> <p>The Pension Board will be discussing a proposal by LPF to reduce the number of board members to 8 (4 member/4 employer) to mitigate this issue.</p>	<p>Increase</p> 
Over reliance on single service provider for core functions, potential leading to loss of service on the collapse or withdrawal of that provider. <b>(31)</b>	<p>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 LPF.</p>	<p>Static</p> 

Risk & Reference Number	Update	Trend / RAG
<p>Adverse change in non-investment actuarial assumptions cause either funding levels to fall or requiring higher employer contributions <b>(2)</b></p>	<p>LPF 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.</p> <p>The above work combined with ongoing monitoring of funding levels and the engagement with smaller employers to put in place bespoke arrangements to help manage affordability issues, as well as the robust controls now in place, has reduced the current impact of this risk, albeit it is still not within appetite.</p>	<p><b>Decrease</b></p> 
<p>Business continuity issues <b>(11)</b></p>	<p>LPF continues to work towards a new business continuity management standard (BCMS), ISO 22301.</p> <p>The business continuity risk remains static and is expected to reduce once LPF has completed (i) the Office Relocaiton (c.Q3 2020), and (ii) the transition to a new ICT supplier (c.Q4 2020/Q1 2021). However, LPF does anticipate short term spikes in this risk coinciding with each of those projects.</p>	<p><b>Static</b></p> 
<p>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 <b>(26)</b></p>	<p>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 LPF Governance Review. In addition, LPF continues to monitor the resourcing of certain internal teams on which it relies for intra-group services.</p>	<p><b>Static</b></p> 

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



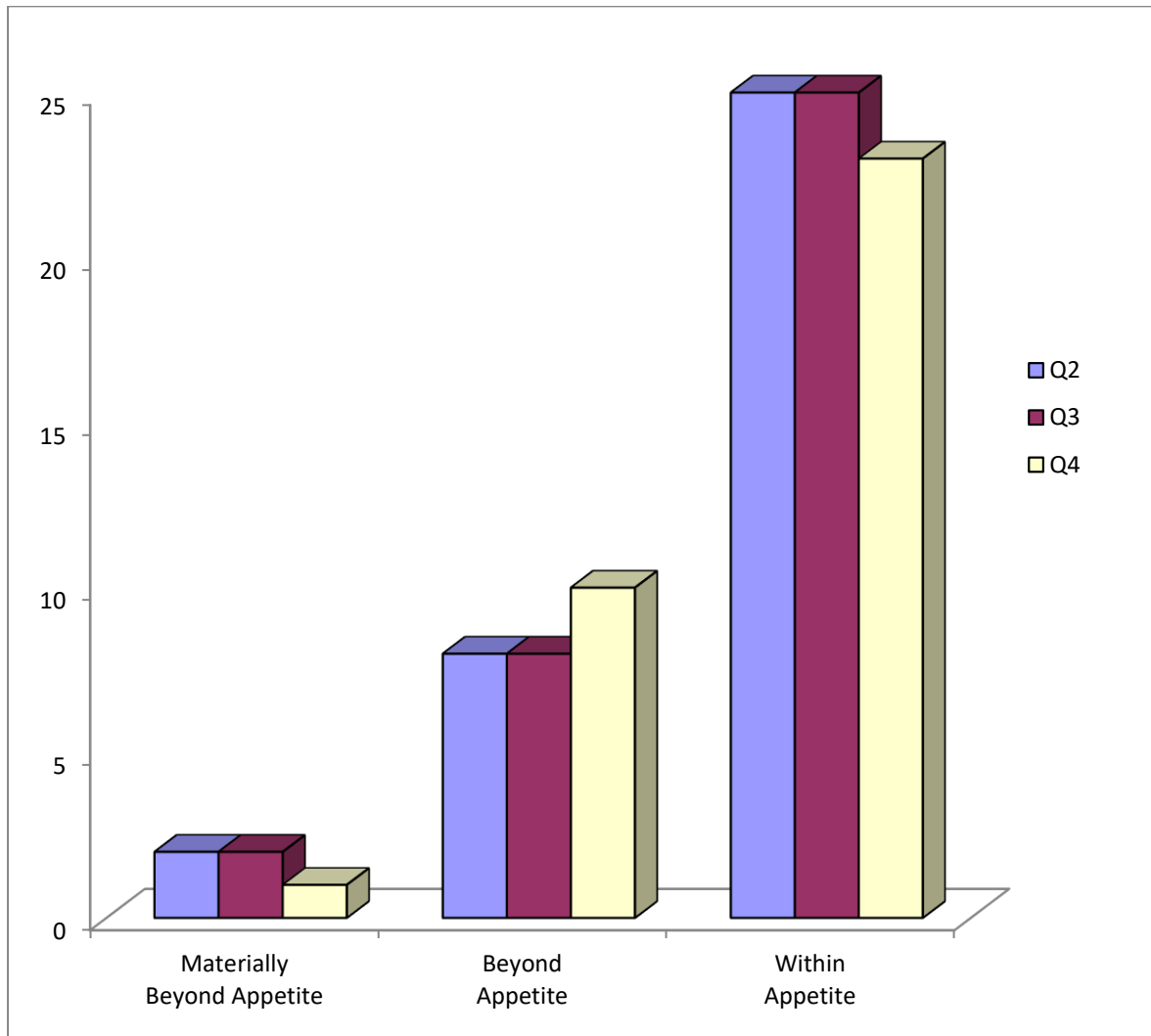
Please note that:  
 Risk 12, 20, 25, 32 share the same score  
 Risks 11, 26 share the same score

## OTHER KEY POINTS

	Comments
<b>New notable risks</b>	The risk management group agreed that the current procurement breach risk (25) should be split into two risks to monitor the risk associated with both (i) breach of the procurement regulations, and (ii) any adverse impact of the procurement regime on the delivery of LPF's business strategy. The new risks will be reported in Q2's risk update.
<b>Other new risks</b>	None.
<b>New controls</b>	<p>Formal review of strategy and investment assumptions as part of triennial actuarial valuation. (1)</p> <p>Funding Strategy Statement includes alignment of higher risk employers to Councils as appropriate. (3)</p> <p>Talent and succession planning are regular agenda items at Senior Leadership Team (SLT) meetings. (4)</p> <p>Appropriate HR policies in place and job descriptions reviewed on an ongoing basis to ensure fit for purpose and aligned to group strategy. (6)</p> <p>LPF has continued to monitor the developments around the Coronavirus and put in place appropriate processes around staff travelling to/returning from affected areas (whether work or personal) and in-office procedures, whilst also communicating to staff current recommendations and best practice to minimise exposure to them and LPF. LPF continues to monitor the position closely and in particular with respect to whether it may require to put in place any restrictions around non-essential UK business travel or attendance at events, ICT reliance around increased homeworking capabilities, isolation protocols etc. (11)</p> <p>Contract refresher as part of ongoing supplier management. (13)</p> <p>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)</p> <p>Annual e-signature of compliance policy acceptance. (16)</p> <p>Pensions Committee and Board code of Conduct in place and updated. (18)</p> <p>New investment front office trading system in place (11, 16, 17, 20)</p> <p>Regular review of headcount structure and resource levels at people group. (32)</p>
<b>Eliminated risks</b>	Risk 8 (adverse employer decisions around employees without considering fund impact/strain) has been removed from the register.

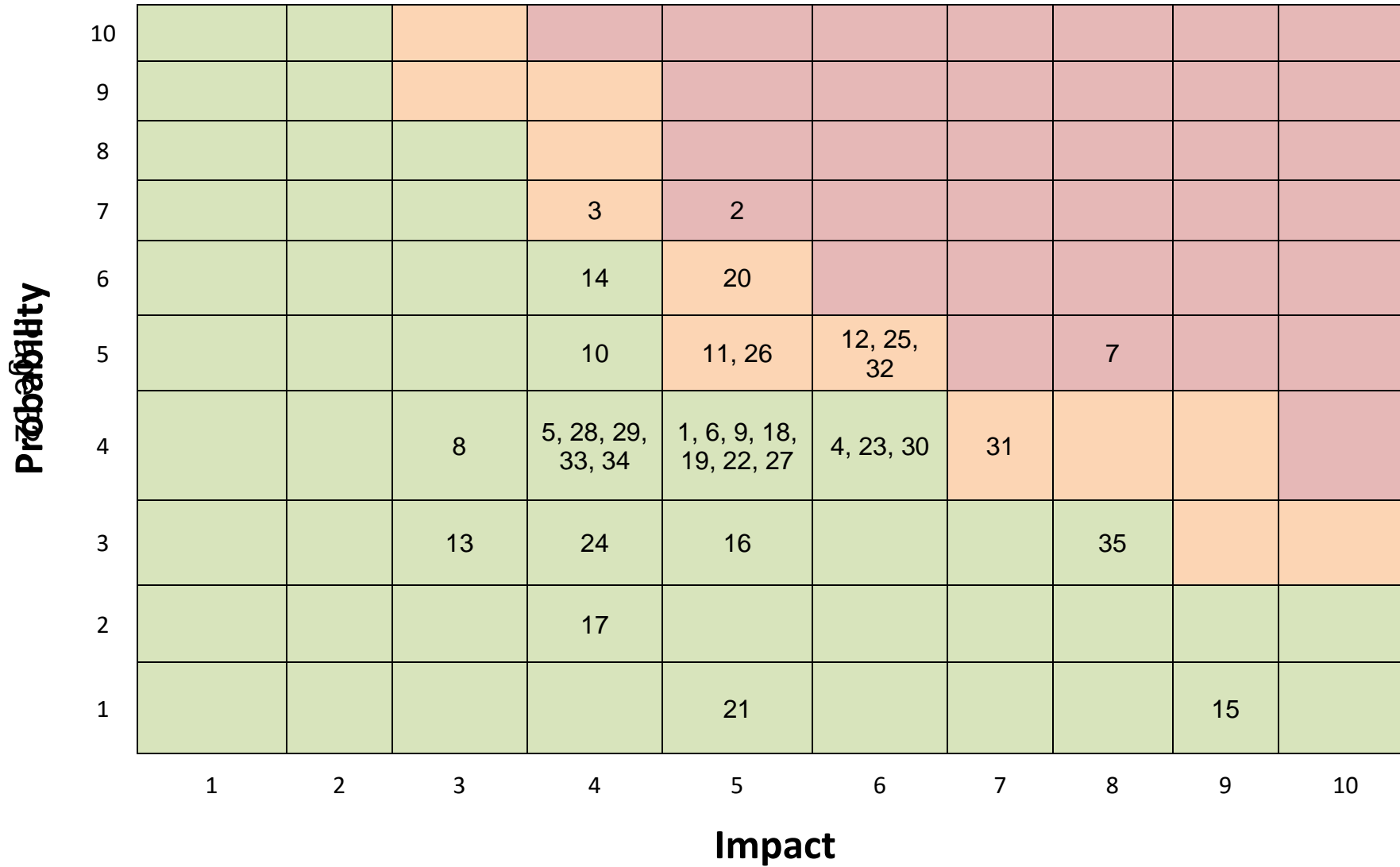
	Comments
	<p>This remains a key area managed and overseen by LPF's existing employer team, but has been deemed not to be of a sufficiently strategic nature to warrant inclusion in the risk register. Note that critical employer matters continue to be covered by many of the other monitored risks, including specifically risks 1, 2, 3 and 29.</p>
<p><b>Notable initiatives / actions</b></p>	<p>Recruitment of staff for Compliance, Investments and Pensions Administration teams ongoing. (4)</p> <p>Independent IT Consultant is currently being procured to review the funds digital strategy. (7)</p> <p>LPF'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)</p> <p>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)</p> <p>Phase 2 of the implementation of processes and procedures for the new Investment Management System to be finalised during Q1 2020. (7) <i>This was finalised shortly after the risk meeting.</i></p> <p>Review of Pension Board composition and engagement with the Chair and board on proposed changes to the constitution around membership. (10)</p> <p>Planning underway to mitigate any transitional risks associated with the proposed property move. (11)</p> <p>Procurement processes and services being reviewed as part of the ongoing Governance Review. (19)</p> <p>Delegations to be updated to incorporate recent work on new business strategies. (23)</p> <p>Review of all health and safety policies and procedures to be completed. (33)</p>
<p><b>Material litigation</b></p>	<p>None.</p>

**ALL RISKS: STATUS OVERVIEW**



QUARTER 3

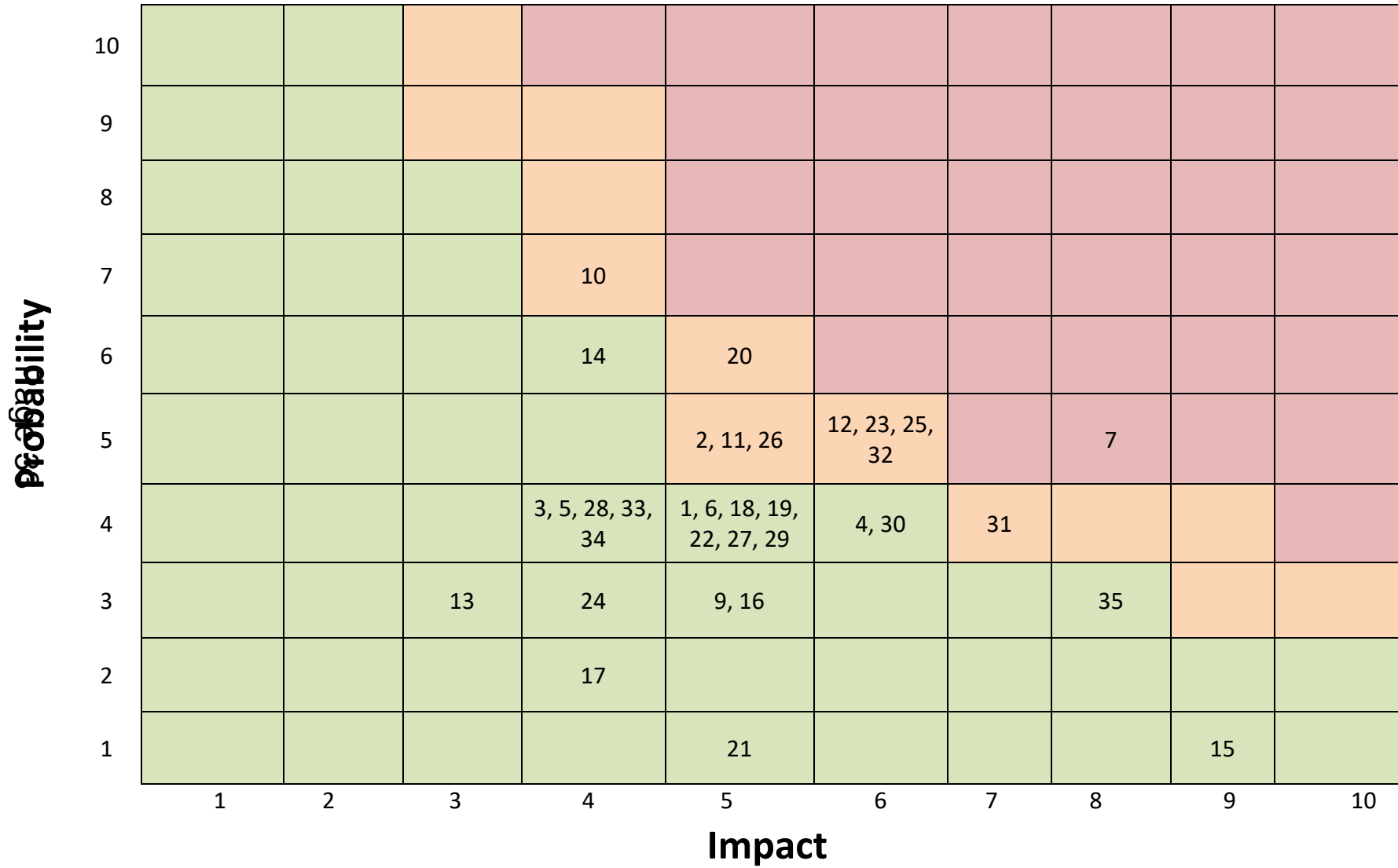
2019/20 ALL RISKS: IMPACT AND PROBABILITY OVERVIEW





**QUARTER 4**




**2019/20 ALL RISKS: IMPACT AND PROBABILITY OVERVIEW**



**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 Pension fund assets	24	Inappropriate use of pension fund monies
6	Staff Negligence	25	Procurement/framework breach <b>to be split into two risks.</b>
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	<i>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. <b>To be removed.</b></i>	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 fines 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 enough to prevent cyber-attacks or minimise their impact
17	Portfolio transition issues		
18	Disclosure of confidential information		
19	Material breach of contract		

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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

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

Description	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	Q4 2019/20 Total
Loss due to stock lending default (13)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Risk of incorrect pension payments (14)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Late payment of pension (15)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Market abuse by investment team (16)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Portfolio transition issues (17)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Disclosure of confidential information (18)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Material breach of contract (19)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Regulatory breach (20)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
FOI process in accordance with law (21)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Incorrect communication with members (22)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Acting beyond proper authority/delegations (23)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Inappropriate use of pension fund monies (24)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●

Description	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	Q4 2019/20 Total
Procurement/framework breach (25)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Group structure and governance fully compliant and up-to-date. (26)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Claim or liability arising from shared services (27)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Unauthorise access to PensionsWEB (28)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Incorrect data from Employers leading to fines (29)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Inadequate contractual protection for services (30)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Over reliance on single core service provider (31)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Staff Resource within the Fund not sufficient to carry out core tasks (32)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Breach of Health and safety regulations (33)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Inadequate, or failure of, supplier and other third-party systems (including IT and data security). (34)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●
Cybersecurity protections and/or back-up not sufficient to prevent/minimise cyber-attacks. (35)	●	●	●	●	●	●	●	●	●	●	●	●	●	●	●

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End of Summary of March Committee Reports

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by virtue of paragraph(s) 6, 9 of Part 1 of Schedule 7A  
of the Local Government(Scotland) Act 1973.

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## **Pensions Audit Sub-Committee** **2.00pm, Tuesday, 23 June 2020**

### **Lothian Pension Fund - Internal Audit Opinion and Annual Report for the Year Ended 31 March 2020**

#### **Item number 5.3**

#### **1. Recommendations**

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The Pensions Audit Sub-Committee (Committee) is requested to:

- 1.1 note the Internal Audit opinion for Lothian Pension Fund (LPF) for the year ended 31 March 2020, and
- 1.2 refer the Internal Audit opinion to the Pensions Committee for noting.

#### **Lesley Newdall**

Chief Internal Auditor

Legal and Risk Division, Resources Directorate

E-mail: [lesley.newdall@edinburgh.gov.uk](mailto:lesley.newdall@edinburgh.gov.uk) | Tel: 0131 469 3216

# Lothian Pension Fund - Internal Audit Opinion and Annual Report for the Year Ended 31 March 2020

## 2. Executive Summary

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- 2.1 This report details Internal Audit's (IA) annual opinion for Lothian Pension Fund (LPF) for the year ended 31 March 2020. Our opinion is based on the outcomes of the three audits included in the LPF 2019/20 IA annual plan, and the status of open and overdue IA findings as at 31 March 2020.
- 2.2 IA considers that the LPF control environment and governance and risk management frameworks are generally adequate but with enhancements required and is therefore reporting an 'amber' rated opinion (see Appendix 1), with our assessment towards the middle of this category.
- 2.3 This assessment remains unchanged in comparison to the 2018/19 IA opinion.
- 2.4 The key themes emerging from the outcomes of the three completed 2019/20 audits highlight the need for LPF to ensure the continued effectiveness of their third party supplier relationship management framework, and focus on the adequacy of cloud based system controls for systems provided and maintained by external suppliers that are used by LPF to support their ongoing investment and fund administration activities.
- 2.5 This report is a component part of the overall annual assurance provided to LPF, as there are a number of additional assurance sources that the Committee should consider when forming their own view on the design and effectiveness of the control environment and governance and risk management frameworks within LPF.

## 3. Background

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- 3.1 The Public Sector Internal Audit Standards (PSIAS) provide a coherent and consistent internal audit framework for public sector organisations. Adoption of the PSIAS is mandatory for IA teams within UK public sector organisations, and PSIAS require annual reporting on conformance.
- 3.2 It is the responsibility of the Council's Chief Internal Auditor to provide an independent and objective annual opinion on the adequacy and effectiveness of LPF's control environment and governance and risk management frameworks in line with PSIAS requirements. The opinion is provided to the Pensions Audit Sub-Committee, and should be used to inform the LPF Annual Governance Statement.

- 3.3 Our opinion is based on the outcome of LPF audits completed in the 2019/20 financial year, and the status of open internal audit findings as at 31 March 2020.
- 3.4 Given LPF's dependence on the City of Edinburgh Council for a number of support services (most notably Digital Services in partnership with CGI for provision network; security; and technology support services), we have also considered the outcomes of relevant work performed on the Council's control environment and governance and risk management frameworks. The Council's 2019/20 annual IA opinion is currently scheduled for presentation to the Governance, Risk, and Best Value Committee meeting in August 2020.

## 4. Main Report

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### 4.1 2019/20 Internal Audit Opinion

- 4.1.1 IA considers that the LPF control environment and governance and risk management frameworks are generally adequate but with enhancements required and is therefore reporting an 'amber' rated opinion (see Appendix 1), with our assessment towards the middle of this category.
- 4.1.2 This opinion reflects some moderate areas of weakness in the LPF control environment and governance and risk management frameworks identified from the audits performed, and the risks associated with open IA findings that may put the achievement of organisational objectives at risk.
- 4.1.3 This opinion is subject to the inherent limitations of IA (covering both the control environment and the assurance provided over controls) as set out in Appendix 2.
- 4.1.4 IA is not the only source of assurance provided to LPF as there are a number of additional assurance sources (for example, external audit who provide assurance on the LPF financial statements and key financial controls) that the Committee should consider when forming their own view on the design and effectiveness of the LPF control environment and governance and risk management frameworks.

### 4.2 Audit outcomes

- 4.2.1 Three IA reviews were completed during the year, with one assessed as 'Effective' (green); one assessed as 'Some Improvement Required' (amber); and one assessed as 'Significant Improvement Required' (red).

#### **Charles River Project – pre-implementation testing – Effective (green)**

- 4.2.2 Implementation of the Charles River Investment Management Solution was a significant technology project for LPF, and our review confirmed that the control environment and governance and risk management frameworks established by LPF to support completion of system and user acceptance testing prior to system

implementation were adequately designed and operating effectively, enabling LPF to proceed with a 'soft launch' on 14 October 2019.

- 4.2.3 One medium (amber) rated IA finding was raised in relation to post implementation operational processes and controls that would normally be designed and implemented prior to live system implementation. The most significant of these reflected the need for LPF to review the service organisation control (SOC 2) assurance report provided by the supplier to confirm that it did not include any adverse system control gaps that could impact ongoing use of the system, and the need to confirm the appropriateness of both LPF and system supplier remote user access profiles.

#### **Pension Entitlement Calculations – Some Improvement Required (amber)**

- 4.2.4 Whilst minor control weaknesses were identified in the design and effectiveness of the control environment established to support the completeness and accuracy of pension entitlement calculations performed by LPF using the Aquila Heywood Altair system, the established controls provide reasonable assurance that risks are being managed, and that LPF's objective to accurately perform pension entitlement calculations in line with applicable legislative and regulatory requirements should be achieved.
- 4.2.5 Our review covered the period 1 April to 31 December 2019, and during this time, the high rated finding raised in the Pension Tax audit (completed in April 2018) that highlighted the need for LPF to obtain independent assurance from Aquila Heywood in relation to the ongoing accuracy of Altair system code supporting pension tax calculations remained open. As the risks associated with this finding were also relevant to the system code supporting pension entitlement calculations, these were considered in determining the overall 'some improvement required' report rating.
- 4.2.6 Two low rated findings were raised reflecting the need for LPF to perform ongoing holistic user profile reviews across the full population of Altair system modules to confirm that no toxic user profile combinations exist that could result in potential exposure to the risk of fraud; and the need to update procedure manuals to support consistent application of workarounds performed in response to legislative and regulatory changes that have not yet been incorporated in the Altair system.

#### **Settlement and Custodian Services – Significant Improvement Required (red)**

- 4.2.7 As some significant and moderate control weaknesses were identified in the design and effectiveness of Lothian Pension Fund's (LPF) supplier management controls supporting delivery of settlement and custodian services by Northern Trust (NT), only limited assurance can be provided that the risks associated with these outsourced services (including custodial credit risk) are being managed, and that Lothian Pension Fund's objectives in relation to compliant and effective settlement and custodian services supporting ongoing management of their funds should be achieved.

4.2.8 One high; two medium and one low rated findings were raised highlighting the need to ensure that

- the current custodian contract is refreshed or re-procured;
- relevant regulatory requirements and risks specifically associated with outsourced services are recorded and effectively managed through established supplier management arrangements;
- appropriate contractual agreements are established to support custodian remote accesses arrangements to systems owned and hosted by another LPF supplier;
- there is effective ongoing oversight of LPF's access to the custodian system; and
- custodian system security controls are aligned with the UK Government's National Cyber Security Centre cloud security principles.

### **4.3 Status of Internal Audit Findings as at 31 March 2020**

4.3.1 LPF had a total of 2 overdue IA findings (1 high and 1 medium) as at 31 March 2020 that relate to reviews completed as part of the 2017/18 and 2019/20 annual plans.

4.3.2 LPF management has prioritised their focus on overdue findings with significant progress evident, as 5 of the 6 overdue findings as at 31 March 2019 were closed by 31 March 2020, with the remaining high rated finding closed in May 2020.

4.3.3 Evidence had been provided by LPF on 31 March 2020 to support closure of the 2017/18 high rated Pension Tax finding. The finding was then closed in May 2020 following management's acceptance of the residual risk associated with limited ongoing supplier assurance on the adequacy and effectiveness of key controls supporting the cloud based pensions administration system used by LPF. Further detail is included at Appendix 4.

### **4.4 Comparison to prior year**

4.4.1 An amber rated opinion was reported in 2018/19 with IA's assessment towards the middle of this category, and this assessment remains unchanged for the 2019/20 financial year.

4.4.2 A direct comparison between annual Internal Audit opinions is not always possible as the scope of the audits included in the annual plans and the risks associated with open and overdue IA findings will vary in line with the changing LPF risk profile.

4.4.3 The 2018/19 IA amber rated opinion was directly attributable to the volume, significance, and age of open and overdue IA findings as at 31 March 2019, as the outcomes of the three audit reviews completed in the 2018/19 financial year were assessed as adequate with only 3 findings raised (1 medium; 1 low; and 1 advisory).

4.4.4 In contrast, whilst significant progress is evident with closure of overdue findings, the outcomes of the three LPF audits completed in the 2019/20 financial year were assessed as red (significant improvement required); amber (some improvement

required); and green (effective) with a total of 7 (1 high; 3 medium; and 3 low) IA findings raised. Consequently, the main driver of the 2019/20 amber rated opinion has been the outcomes of these reviews.

#### **4.5 Internal Audit Independence and Conformance with Public Sector Internal Audit Standards**

- 4.5.1 PSIAS require that IA must be independent and that internal auditors must be objective in performing their work. To ensure conformance with these requirements, IA has established processes to ensure that both team and personal independence is consistently maintained and that any potential conflicts of interest are effectively managed.
- 4.5.2 We do not consider that we have faced any significant threats to our independence during 2019/20, nor do we consider that we have faced any inappropriate scope or resource limitations when completing our work.
- 4.5.3 IA has fully conformed with PSIAS requirements during the period 1 April 2019 to 31 March 2020.

### **5. Financial impact**

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- 5.1 There are no direct financial impacts arising from this report, although failure to close IA findings raised and address the associated risks in a timely manner may have some inherent financial impact where associated financial risks have been identified.

### **6. Stakeholder/Regulatory Impact**

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- 6.1 IA findings are raised as a result of control gaps or deficiencies identified during audits. If agreed management actions are not implemented to support closure of Internal Audit findings, LPF will be exposed to the risks set out in the relevant IA reports.

### **7. Background reading/external references**

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- 7.1 [Public Sector Internal Audit Standards](#)

## 8. Appendices

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- Appendix 1 Internal Audit Annual Opinion Definitions
- Appendix 2 Limitations and responsibilities of internal audit and management responsibilities
- Appendix 3 LPF reviews completed between 1 April 2019 and 31 March 2020
- Appendix 4 Status of LPF Internal Audit Findings as at 31 March 2020
- Appendix 5 Final report – Pension Entitlement Calculations
- Appendix 6 Final report – Settlement and Custodian Services

# Appendix 1 – Internal Audit Annual Opinion Definitions

The PSIAS require the provision of an annual Internal Audit opinion, but do not provide any methodology or guidance detailing how the opinion should be defined. We have adopted the approach set out below to form an opinion for Lothian Pension Fund.

We consider that there are 4 possible opinion types that could apply to LPF. These are detailed below:

<p><b>1 Adequate</b></p> <p><i>An adequate and appropriate control environment and governance and risk management framework is in place enabling the risks to achieving organisation objectives to be managed</i></p>	<p><b>2 Generally adequate but with enhancements required</b></p> <p><i>Areas of weakness and non-compliance in the control environment and governance and risk management framework that that may put the achievement of organisational objectives at risk</i></p>
<p><b>3 Significant enhancements required</b></p> <p><i>Significant areas of weakness and non-compliance in the control environment and governance and risk management framework that puts the achievement of organisational objectives at risk</i></p>	<p><b>4 Inadequate</b></p> <p><i>The framework of control and governance and risk management framework is inadequate with a substantial risk of system failure resulting in the likely failure to achieve organisational objectives.</i></p>

Professional judgement is exercised in determining the appropriate opinion, and it should be noted that in giving an opinion, assurance provided can never be absolute.



## **Appendix 2 - Limitations and responsibilities of internal audit and management responsibilities**

### **Limitations and responsibilities of internal audit**

The opinion is based solely on the internal audit work performed for the financial year 1 April 2019 to 31 March 2020. Work completed was based on the terms of reference agreed with management for each review. However, where other matters have come to our attention, that are considered relevant, they have been considered when finalising our reports and the annual opinion.

There may be additional weaknesses in the LPF control environment and governance and risk management frameworks that were not identified as they were not included in the 2019/20 LPF annual internal audit plan; were excluded from the scope of individual reviews; or were not brought to Internal Audit's attention. Consequently, management and the Committee should be aware that the opinion may have differed if these areas had been included, or brought to Internal Audit's attention.

Control environments, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making; human error; control processes being deliberately circumvented by employees and others; management overriding controls; and the impact of unplanned events.

### **Future periods**

The assessment of controls relating to LPF is for the year ended 31 March 2020. Historic evaluation of effectiveness may not be relevant to future periods due to the risk that:

- the design of controls may become inadequate because of changes in operating environment, law, regulation or other areas; or
- the degree of compliance with policies and procedures may deteriorate.

### **Responsibilities of Management and Internal Audit**

It is Management's responsibility to develop; implement; and maintain effective control environments and governance and risk management frameworks that are designed to prevent and detect irregularities and fraud. Internal audit work should not be regarded as a substitute for Management's responsibilities for the design and operation of these controls.

Internal Audit endeavours to plan its work so that it has a reasonable expectation of detecting significant control weaknesses and, if detected, performs additional work directed towards identification of potential fraud or other irregularities. However, internal audit procedures alone, even when performed with due professional care, do not guarantee that fraud will be detected. Consequently, internal audit reviews should not be relied upon to detect and disclose all fraud, defalcations or other irregularities that may exist.

## Appendix 3 - LPF reviews completed in 2019/20 and 2018/19

2019/20 Annual Plan	Findings				Report Rating
Review	High	Medium	Low	Advisory	
Charles River Project – pre-implementation system testing	-	1	-	-	Effective
Pension entitlement calculations	-	-	2	-	Some Improvement Required
Settlement and custodian services	1	2	1	-	Significant Improvement Required
<b>Total Findings Raised</b>	<b>1</b>	<b>3</b>	<b>3</b>	<b>-</b>	
<i>Total 18/19 (3 reports)</i>	-	1	1	1	

2018/19 Annual Plan	Findings				Report Rating
Review	High	Medium	Low	Advisory	
Unlisted investment valuations and application of fund administration fees and charges	No findings raised				Adequate
Stock Lending	No findings raised				Adequate
Unitisation	-	1	1	1	Adequate
<b>Total Findings Raised</b>	<b>-</b>	<b>1</b>	<b>1</b>	<b>1</b>	

## Appendix 4 – LPF Overdue Internal Audit Findings as at 31 March 2020

Review	High	Medium	Low	Status - 31 <sup>st</sup> March 2020	Days / Months Overdue at 31/03/20	Status – 15th May 2020
Pension Tax	1	-	-	<p>Overdue - original due date was 23/04/18</p> <p>Finding was proposed for closure by LPF on 31st March 2020, however the final outcomes did not fully address the risks raised in the original finding.</p> <p>A risk acceptance document was subsequently prepared and signed by the LPF CEO; Head of Finance and Executive Director of Resources.</p> <p>This was received by IA on 8 May 2020 and the finding was then closed.</p>	18 months / 535 working days	Closed 08/05/20
Charles River Project	-	1	-	<p>Overdue - original due date was 14/02/2020</p> <p>Finding was proposed for closure on 6 March 2020, but was not closed by IA as not all agreed management actions had been completed.</p>	1 month / 33 working days	Overdue
<b>Total</b>	<b>1</b>	<b>1</b>	<b>-</b>	<p><b>2 findings were overdue at 31 March 2020</b></p> <p><b>Evidence had been provided to IA for both findings, however further action was required to support closure.</b></p>		
<i>Total 18/19</i>	<i>3</i>	<i>1</i>	<i>2</i>	<p><i>All findings were overdue at 31 March 2019</i></p> <p><i>Evidence had been provided to IA for 2 High and 1 Low rated findings.</i></p>		

# *The City of Edinburgh Council*

## Internal Audit

### Lothian Pension Fund: Pension Entitlement Calculations

Final Report

6 March 2020

RES1912

Overall report rating:

<b>Some improvement required</b>	Whilst some control weaknesses were identified in the design and / or effectiveness of the control environment and / or governance and risk management frameworks, they provide reasonable assurance that risks are being managed, and that Lothian Pension Fund's objectives should be achieved.
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This internal audit review is conducted for the Lothian Pension Fund under the auspices of the 2019/20 internal audit plan approved by the Pensions Audit Sub Committee in March 2019. The review is designed to help Lothian Pension Fund assess and refine its internal control environment. It is not designed or intended to be suitable for any other purpose and should not be relied upon for any other purpose. The City of Edinburgh Council accepts no responsibility for any such reliance and disclaims all liability in relation thereto.

The internal audit work and reporting has been performed in line with the requirements of the Public Sector Internal Audit Standards (PSIAS) and as a result is not designed or intended to comply with any other auditing standards.

Although there are a number of specific recommendations included in this report to strengthen internal control, it is management's responsibility to design, implement and maintain an effective control framework, and for the prevention and detection of irregularities and fraud. This is an essential part of the efficient management of the Lothian Pension Fund. Communication of the issues and weaknesses arising from this audit does not absolve management of this responsibility. High and Critical risk findings will be raised with senior management and Pensions Committee members as appropriate

# 1. Background and Scope

## Background

This review was undertaken as part of the 2019/20 internal audit plan approved by the Lothian Pension Fund (LPF) Pensions Committee in March 2019.

### Applicable legislation and regulations

The [Finance Act 2004](#) (part 4) requires pension schemes (including public service pension schemes) to appoint an administrator to administer ongoing pension scheme activities.

Pension scheme administrators have a number of responsibilities, including calculation of pension entitlements in accordance with current pension legislation, and providing details to scheme members.

Calculation of pension entitlements is covered by the following legislation and guidance:

- [The Local Government Pension Scheme \(Scotland\) Regulations 2018](#)
- [The Local Government Pension Scheme \(Transitional Provision and Savings\) \(Scotland\) Regulations 2014](#)

### Lothian Pension Fund (LPF) Pension Administration Model

Pension schemes can either perform their own administration activities with established in house teams, or alternatively outsource these responsibilities to an external third-party administrator, whilst remaining accountable for the risks associated with ongoing administration activities. Where pension fund administration activities are outsourced, organisations must implement appropriate supplier performance oversight arrangements to provide assurance on the adequacy and effectiveness of the supplier's key pension fund administration controls.

LPF's administrative activities are performed by an established in house team (circa 18 employees), using the web based Altair pensions administration system provided by [Aquila Heywood](#) (AH) to support calculation of member pension entitlements. Consequently, it is important to ensure ongoing compliance with the Council's [protocol for externally hosted "Cloud" ICT Services](#).

It is also important to note that the accuracy of pension entitlement calculations is dependent on member information, e.g. pensionable pay, provided to LPF by its employers.

### Pension Entitlement Calculations

The main types of pension entitlement calculations performed by LPF are:

- **Retirals** – calculation of the pension benefit accrued by a member at their planned retirement date.
- **Deaths** – calculation of pension benefits at the time of a member's death including the value of ongoing pension payments to beneficiaries (where relevant).
- **Transfers (in and out)** – calculation of the value of funds at a point in time when a member requests the transfer of funds into or from another scheme.
- **Refunds** – calculation of the value of cash refunds for members with less than two years membership.
- **Aggregations** – calculation of a consolidated fund value where members are entitled to aggregate their funds where concurrent roles result in more than one pension scheme entitlement.

- **Miscellaneous** - a number of miscellaneous calculations are also performed to provide information to members on the impacts associated with additional pension contributions, and member option choices.

### **Manual Pension Entitlement Calculations**

Whilst Aquila Heywood is contractually required to update system codes to reflect regulatory changes (for example, changes in applicable pension legislation or changes to tax rates), instances occur where this is not achieved in sufficient time and workarounds are required to support calculation of entitlement calculations in the Altair system.

Where system workarounds are implemented, it is essential that LPF procedure manuals and documents are updated to ensure that the total population of workarounds (detailed in a document referred to as the 'Known Error List' – KEL produced by Aquila Heywood) are consistently applied.

The known error list as at 25 February included a total of 97 non calculation errors relating to (for example) disclosures and statements included in member correspondence; and 411 known calculation errors where workarounds are currently required.

LPF management has advised that KELs that remain unresolved for a period by the supplier typically relate to calculations that are not performed frequently; apply to a restricted membership cohort; or have no material impact on the calculation, with significant KELS prioritised for rectification in the next software release.

### **Scope**

The objective of this review was to assess the design adequacy and operating effectiveness of the key controls established to ensure the completeness and accuracy of both system and manual pension entitlement calculations performed by LPF.

The review will also provide assurance in relation to the following LPF risks:

- Risk of incorrect pension payments
- Regulatory breaches
- Incorrect communication with members
- Limited or incorrect data from employers leading to incorrect valuation of liabilities /benefit payments / fines from Pensions Regulator

Testing was performed across the period 1 April to 31 December 2019.

Our areas of audit focus as detailed in our terms of reference are included at Appendix 2.

### **Limitations of Scope**

The following areas were specifically excluded from the scope of this review at the request of LPF:

- Adequacy of AH key performance measures in relation to ongoing maintenance and accuracy of pensions entitlement calculations performed in the Altair system, and LPF performance monitoring.
- Timeliness of completion and provision of pension entitlement calculations in line with applicable regulatory requirements.

Reperformance testing to confirm the accuracy of pension entitlement calculations was limited to a sample of 105 calculations (45 retiral; 30 death; and 30 transfers) including 20 manual calculations performed by LPF as supplementary validation of the calculations.

It was not possible to validate a larger sample of calculations using data analytics as Aquila Heywood could not provide a system extract of the full population of pensions calculations for the period reviewed.

### Reporting Date

Our audit work concluded on 25 February 2020, and our findings and opinion are based on the conclusion of our work as at that date.

## 2. Executive summary

Total number of findings: 2

Summary of findings raised	
Low	1. Review of Altair system user access profiles
Low	2. Ongoing maintenance of procedure manuals

### Opinion

#### Some Improvement Required

A high rated finding reflecting the need for LPF to obtain independent assurance from Aquila Heywood in relation to the ongoing accuracy of Altair system code supporting pensions tax calculations was raised in the Pensions Tax audit completed in April 2018. The risks associated with this finding are also relevant to the Altair system code supporting pensions entitlement calculations, and these current risks have been considered in determining the overall 'some improvement required' report rating.

Whilst some new minor control weaknesses were identified in the design and effectiveness of the control environment established to support the completeness and accuracy of pension entitlement calculations performed by Lothian Pension Fund (LPF), they provide reasonable assurance that risks are being managed, and that LPF's objective to accurately perform pension entitlement calculations in line with applicable legislative and regulatory requirements should be achieved.

Consequently, 2 low rated Internal Audit findings have been raised.

The first low rated finding highlights a minor control weakness in relation to Altair system user access profiles, as LPF does not currently perform ongoing holistic user profile reviews across the full population of Altair system modules and users to confirm that there are no inappropriate or 'toxic' user profile combinations that could result in exposure to the potential risk of fraud. Whilst some compensating controls have been established, these are not adequately designed to identify any potentially fraudulent transactions resulting from inappropriate access to the Altair system.

Whilst appropriately designed processes have been established to ensure that procedure manuals are updated to demonstrate the workarounds to be performed where legislative and / or regulatory changes have not yet been incorporated into the Altair system code, these processes are not consistently applied and evidenced. Recalculation of a sample of 105 pension entitlement calculations (including some where system workarounds were required) did not identify any material errors, confirming that LPF team members are aware of the workarounds that should be applied to ensure that calculations remain aligned with currently applicable regulatory and / or legislative requirements. Consequently, a low rating has been applied to this finding.



Further information on the findings raised is included at Section 3.

### **Progress towards closure of the high rated finding on Altair code supporting system calculations**

In response to the previously raised high rated finding highlighting the need for independent assurance from Aquila Heywood in relation to the ongoing accuracy of Altair system calculations, LPF management agreed that appropriate ongoing assurance would be requested from Aquila Heywood.

Whilst this high rated finding has not yet been closed, management has advised that progress is being made despite significant challenge from Aquila Heywood, and that the ongoing assurance requested from them will cover all calculations performed by the Altair system (including pension entitlement calculations). LPF management is currently towards a completion date of 13 March 2020 to either reach agreement on this matter with Aquila Heywood, or (alternatively) accept the risks associate with lack of provision of independent assurance on the ongoing accuracy of Altair system calculations.

## **3. Detailed findings**

### **1. Review of Altair system user access profiles**

**Low**

Whilst LPF reviews a monthly change log that highlights any changes to individual Altair user profiles, there is currently no evidence of a holistic review of user profiles across the full population of Altair system modules and users to confirm that no inappropriate or 'toxic' system user profile combinations exist.

Management has confirmed that existing Altair user access is assessed prior to authorising changes to user profiles to ensure that the change requested will not result in any potentially inappropriate access across Altair system modules, however this assessment is not documented.

It is acknowledged that LPF employees would not be able to create new member details on the system as this information is provided by employers, and management has advised that appropriate 'know your customer' validation checks are performed to confirm the identity of all new members.

Management has also advised that compensating controls operate that are designed to prevent LPF employees from making unauthorised adjustments (including calculating pensions entitlements) to connected member accounts, with the most relevant the requirement for all employees to provide details of any connected persons (for example, close relatives) who are also LPF scheme members.

Where connected persons exist, their member accounts are locked on the Altair system and cannot be accessed by the relevant connected LPF employee. It should be noted that the effectiveness of this control is limited as it is dependent on full disclosure by LPF employees, and that locked accounts were not tested during the audit as its existence was confirmed by management when finalising the draft report.

Whilst the connected persons control (if operating effectively) would prevent connected LPF employees from calculating pensions entitlements for connected members, there are currently no established controls to detect instances of inappropriate amendments to member records where these connections have not been disclosed, or where potentially toxic user profile across Altair system modules has not been identified.

Management has also confirmed that all payments are subject to independent review and validation prior to their release.

### **Risks**

The potential risks associated with our findings are:

- Toxic user profile combinations across Altair system modules are not identified and resolved;
- The existing change log control would not identify toxic user profiles resulting from changes to user profiles made over a number of months; and
- LPF employees have access to connected LPF members.

### 1.1 Recommendation: Review of Altair system user access profiles

1. LPF management should assess and clearly define any potential toxicity scenarios in relation to Altair system access.
2. LPF management should also engage with Aquila Heywood (the Altair system provider) to ascertain whether a system report can be generated that includes details of the full population of user profiles across all Altair system modules.

If this report can be provided, then:

- ongoing reviews of holistic user profiles across Altair should be implemented (at least quarterly) to assess whether any potentially inappropriate or toxic user access profiles exist.
- where user profiles indicate inappropriate segregation of duties or toxic combinations, appropriate action should be taken to ensure that these are addressed.
- the outcomes of this review should be documented, including details of any changes made to user profiles.

If a system report cannot be generated, then:

- a manual check of a sample of individual users should be performed each month that reviews access to Altair modules for each individual user to confirm whether these appropriate.
- the monthly check should cover the full population of Altair users within one year.
- where user profiles indicate inappropriate segregation of duties or toxic combinations, appropriate action should be taken to ensure that these are addressed.
- the outcomes of these reviews should be documented, including details of any changes made to user profiles.

### Agreed Management Action: Review of Altair system user access profiles

1. Altair role profiles will be reviewed and aligned as far as possible on to ensure standardisation on a 'least access' privilege basis;
2. Toxicity scenarios will be assessed and mitigating controls documented.
3. A risk based Altair entitlement review process will be implemented with all employees covered at least once per year.

**Owner:** Stephen Moir, Executive Director of Resources

**Contributors:** Hugh Dunn, Head of Finance; Doug Heron, Chief Executive, Lothian Pension Fund (LPF); John Burns, Chief Finance Officer, LPF; Struan Fairbairn, Chief Risk Officer, LPF.

**Implementation Date:**

30 September 2020

### 1.2 Recommendation: Connected user access rights

1. A review should be performed to confirm that connected LPF employees cannot access connected member accounts included in the LPF connected persons log.
2. Where connected LPF employee user profiles have been subject to change, a check should be performed following implementation of the change to confirm that the employee cannot access connected member accounts.

### Agreed Management Action: Connected user access rights

The Internal Audit recommendation will be implemented as detailed above.

**Owner:** Stephen Moir, Executive Director of Resources

**Contributors:** Hugh Dunn, Head of Finance; Doug Heron, Chief Executive, Lothian Pension Fund (LPF); John Burns, Chief Finance Officer, LPF; Struan Fairbairn, Chief Risk Officer, LPF.

**Implementation Date:**

30 September 2020

### 2. Ongoing maintenance of procedure manuals

Low

Whilst an appropriately designed process has been established to support ongoing maintenance of procedure manuals and inclusion of workarounds to be applied to address known system errors, it is not consistently applied. Specifically:

- there is no clearly documented list detailing ownership of individual procedure manuals and supporting documentation.
- version control logs for procedure manuals are not consistently updated to reflect changes made.
- evidence of independent review of changes to confirm their accuracy is not consistently recorded. We noted that evidence was available to support independent review of 8 changes completed across circa 122 procedure manuals and supporting documents.

This finding has been assessed as low reflecting that reperformance of a total of 45 retiral; 30 death; and 30 transfer pension entitlement calculations that included a sample of 20 manual calculations did not identify any material differences, providing assurance that workarounds applied as a result of known system errors were consistently and effectively applied across the limited sample tested.

### Risk

The potential risks associated with our findings are that inaccurate pensions entitlement calculations could be performed if workarounds are not applied to address 'known errors' as procedure manuals and documentation have not been updated in alignment with the known errors list.

### 3.1 Recommendation: Ongoing maintenance of procedure manuals

Management should ensure that the requirement to follow the established process for ongoing maintenance of procedure manuals is reinforced across LPF teams involved in calculating pensions entitlements and should implement sample based spot checks to confirm that procedures detailed on the known errors log have been updated and reviewed and supporting version control documentation updated.

### 3.1 Agreed Management Action: Ongoing maintenance of procedure manuals

The Internal Audit recommendation will be implemented as detailed above.

**Owner:** Stephen Moir, Executive Director of Resources

**Contributors:** Hugh Dunn, Head of Finance; Doug Heron, Chief Executive, Lothian Pension Fund (LPF); John Burns, Chief Finance Officer, LPF; Struan Fairbairn, Chief Risk Officer, LPF.

**Implementation Date:**

30 September 2020

# Appendix 1: Basis of our classifications

Finding rating	Assessment rationale
<b>Critical</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Critical</b> impact on the operational performance; or</li> <li>• <b>Critical</b> monetary or financial statement impact; or</li> <li>• <b>Critical</b> breach in laws and regulations that could result in material fines or consequences; or</li> <li>• <b>Critical</b> impact on the reputation of the organisation which could threaten its future viability.</li> </ul>
<b>High</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Significant</b> impact on operational performance; or</li> <li>• <b>Significant</b> monetary or financial statement impact; or</li> <li>• <b>Significant</b> breach in laws and regulations resulting in significant fines and consequences; or</li> <li>• <b>Significant</b> impact on the reputation of the organisation.</li> </ul>
<b>Medium</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Moderate</b> impact on operational performance; or</li> <li>• <b>Moderate</b> monetary or financial statement impact; or</li> <li>• <b>Moderate</b> breach in laws and regulations resulting in fines and consequences; or</li> <li>• <b>Moderate</b> impact on the reputation of the organisation.</li> </ul>
<b>Low</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Minor</b> impact on operational performance; or</li> <li>• <b>Minor</b> monetary or financial statement impact; or</li> <li>• <b>Minor</b> breach in laws and regulations with limited consequences; or</li> <li>• <b>Minor</b> impact on the reputation of the organisation.</li> </ul>
<b>Advisory</b>	<p>A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.</p>

Please see the [Internal Audit Charter](#) for full details of opinion ratings and classifications.

## Appendix 2: Areas of audit focus

The areas of audit focus and related control objectives included in the review are:

Audit Area	Control Objectives
Supplier management	<ol style="list-style-type: none"> <li>1. Roles and responsibilities for Aquila Heywood (AH) and LPF in relation to pension entitlement calculations and quality assurance are clearly specified in the AH contract.</li> <li>2. LPF has appropriate ongoing assurance from AH to confirm that:               <ul style="list-style-type: none"> <li>• pension entitlement calculations included in Altair are aligned with applicable legislative and regulatory requirements;</li> <li>• controls applied to support calculation amendments are effective;</li> <li>• all calculation amendments are tested prior to release into the live environment; and</li> <li>• security controls (including user access) to the areas of the system that include pension entitlement calculations are effective.</li> </ul> </li> <li>3. Where assurance reports received highlight any issues or emerging risks, these are addressed with AH in a timely manner.</li> <li>4. LPF receives advice from AH providing details of calculations that have not been updated in line with recent legislative or regulatory changes, including a “Known Errors List (KEL)”.</li> </ol>
Internal processing	<ol style="list-style-type: none"> <li>1. LPF has established processes to identify any legislative or regulatory changes that impact pension entitlement calculations, and confirm with AH whether and when these changes will be updated in the Altair system.</li> <li>2. Details of calculations that have not been updated in the Altair system and need to be performed manually are communicated to all relevant LPF employees.</li> <li>3. The LPF pension administration team receives appropriate induction and ongoing training in relation to pension entitlement calculations.</li> <li>4. The process for any manual calculation of pension entitlements that may be required is documented and updated in a timely manner to reflect any applicable regulatory or legislative changes.</li> <li>5. Appropriate control procedures have been established to confirm the accuracy of data input to the Altair system for system-based entitlement calculations, and the accuracy of any manual entitlement calculations.</li> <li>6. The risks associated with pension entitlement calculations have been identified, assessed, and recorded and appropriate controls established to ensure that they are effectively managed.</li> </ol>

IT security	<ol style="list-style-type: none"><li>1. LPF Access rights to the Altair system are restricted to appropriate users based on their roles in relation to pension entitlement calculations.</li><li>2. Regular user access reviews are performed by LPF to confirm that segregation of duties remains appropriate and toxic user access combinations do not exist.</li></ol>
Validity of calculations	The sample of pension entitlement calculations selected for testing have been completed and accurately performed and communicated to members.

## Appendix 6

# *The City of Edinburgh Council*

## Internal Audit

### Lothian Pension Fund Settlement and Custodian services

Final Report

11<sup>th</sup> June 2020

RES1913

Overall report rating:

**Significant  
improvement  
required**

Significant and / or numerous control weaknesses were identified, in the design and / or effectiveness of the control environment and / or governance and risk management frameworks. Consequently, only limited assurance can be provided that risks are being managed and that Lothian Pension Fund's objectives should be achieved.

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This internal audit review is conducted for the Lothian Pension Fund under the auspices of the 2019/20 internal audit plan approved by the Pensions Audit Sub Committee in March 2019. The review is designed to help Lothian Pension Fund assess and refine its internal control environment. It is not designed or intended to be suitable for any other purpose and should not be relied upon for any other purpose. The City of Edinburgh Council accepts no responsibility for any such reliance and disclaims all liability in relation thereto.

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Although there are a number of specific recommendations included in this report to strengthen internal control, it is management's responsibility to design, implement and maintain an effective control framework, and for the prevention and detection of irregularities and fraud. This is an essential part of the efficient management of the Lothian Pension Fund. Communication of the issues and weaknesses arising from this audit does not absolve management of this responsibility. High and Critical risk findings will be raised with senior management and Pensions Committee members as appropriate



# 1. Background and Scope

## Background

A pension fund custodian is typically an approved bank; depositary; member of a recognised clearing exchange; a regulated clearing firm; or a firm whose permitted activities include safeguarding and administration of investment assets and client monies by pension funds on behalf of their members. The custodian maintains the investment assets (for example electronic share certificates) and client monies in named segregated client accounts with appropriate record keeping services to minimise the potential risk of loss, most notably in the event of the custodian's insolvency, or through fraud, poor administration, or negligence. Custodian record keeping responsibilities involve maintaining client accounts and recording subsequent asset purchases, sales and client money transfers. Custodian responsibilities can also include management of the collection of dividends, interest payments and foreign exchange transactions; corporate actions; proxy voting; and class actions associated with investment assets held on behalf of clients.

A number of custodian firms also offer investment transaction settlement services. All custodian arrangements should be supported by appropriate contractual arrangements that specify the roles and responsibilities (including ongoing regulatory compliance) of both the custodian and the client, with appropriate ongoing supplier management arrangements established to ensure that the custodian continues to meet its contractual and regulatory obligations.

## Applicable regulations

Custodian firms are required to comply with the EU Markets in Financial Instruments Directive 2014 legislation that regulates firms who provide services to clients linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives), and the associated Capital Requirements Directive IV (CRD IV) EU legislation that specifies the prudential rules for banks, building societies and investment firms.

## Lothian Pension Fund (LPF) custodian arrangements

LPF has appointed Northern Trust (NT) to act as its custodian and provide investment transaction settlement activities, and these arrangements are supported by a contract that was signed in 2011.

Supplier management arrangements have been established and management has advised that these include receipt of an annual Service Organisation Control report 1 (SOC 1) that provides assurance in relation to NT's financial controls, and that a SOC 2 assurance report on operational controls in relation to availability, security, processing integrity, confidentiality and privacy has been requested and received.

There are currently two types of SOC reports available in relation to both controls over financial reporting (SOC 1) and operational (SOC 2) controls. A type 1 report covers only the design of the controls at a specified point in time, whilst a type 2 report confirms whether the controls have operated effectively for a specified period of time.

The contract also provides for an annual oversight visit to NT by LPF. LPF visited NT in November 2019 and reviewed the NT processes for maintaining LPF assets; reconciliations; trade recording; receipts; and settlement.

All LPF investment transactions, with the exception of private markets, are advised to NT through the Charles River Investment Management Solution web based platform implemented in November 2019,

with settlement arrangements and NT custodian activities performed through the web based NT Passport system that can be accessed remotely by LPF.

As LPF uses two web based platforms to support the NT investment transaction settlement process and custodian activities, it is important to ensure ongoing compliance with the Council's protocol for externally hosted "Cloud" ICT Services.

LPF Management has also advised that

- Northern Trust is a US corporation which conducts its business through its US operations and its various US and non-US branches and subsidiaries. As at 31 December 2019, it had assets under custody of \$8.50 trillion. It is subject to extensive regulation under state and federal laws in the US and in each of the jurisdictions in which it does business.
- the duration of LPF's contract with NT was extended by 2 years in light of the Scottish Ministers' structural review of the Local Government Pension Schemes in Scotland. NT granted enhanced commercial terms (namely a fee reduction) to LPF for s extension period.
- over the period between 2011 and present, LPF has engaged with NT on an ongoing basis, as part of its supplier management processes and otherwise, to update and refresh this arrangement where necessary and commercially pragmatic, and in some cases include additional services to the master custody agreement.
- key performance indicators have recently been established in relation to NT's management of corporate actions (for example voting at investment company AGMs) on their behalf.

## Scope

The objective of this review was to assess the design adequacy and operating effectiveness of the key supplier management controls supporting delivery of settlement transaction and custodian services to LPF by NT during the period 1 April to 31 December 2019, and effective ongoing management of custodial credit risk (the risk of loss associated with any potential NT failure).

## Limitations of Scope

The following areas were specifically excluded from the scope of this review:

- stock lending services provided by NT for LPF as these services were covered in the stock lending audit completed in May 2019;
- LPFI business activities;
- Managed broker services provided by NT.

## Reporting Date

Our audit work concluded on 25<sup>th</sup> April 2020, and our findings and opinion are based on the conclusion of our work as at that date.

## 2. Executive summary

Total number of findings: 4

Summary of findings raised	
High	1. Northern Trust Contract
Medium	2. Regulatory and Risk Management Oversight
Medium	3. System Access and Security
Low	4. Northern Trust Supplier Management

### Opinion

As some significant and moderate control weaknesses were identified in the design and effectiveness of Lothian Pension Fund's (LPF) supplier management controls supporting delivery of settlement and custodian services by Northern Trust (NT), only limited assurance can be provided that the risks associated with these outsourced services (including custodial credit risk) are being managed, and that Lothian Pension Fund's objectives in relation to compliant and effective settlement and custodian services supporting ongoing management of their funds should be achieved.

Consequently, one High; two Medium; and one Low rated findings have been raised. These highlight the need to ensure:

- that appropriate contractual agreements are established to support current practice where NT remotely accesses systems owned and hosted by another LPF supplier to perform settlement and custodian activities (finding 1)
- that the current NT contract is refreshed or re-procured (finding 1)
- that relevant regulatory requirements and risks specifically associated with the outsourced services are recorded and effectively managed through established supplier management arrangements (finding 2)
- effective ongoing oversight of LPF user access to the NT system (finding 3)
- alignment of NT system security controls with the UK Government's National Cyber Security Centre cloud security principles (finding 3)
- that minor control weaknesses in existing NT supplier management arrangements are addressed (finding 4).

### Lothian Pension Fund Management Response

We welcome the review from Internal Audit on our approach to oversight of custody arrangements and thank the team for their work. There are a number of clear and sensible findings in this review and we are committed to providing an appropriately urgent response to these. There are other points, including some aspects of the contract standards with NT, where we would ideally make changes but where market practice does not support such provisions, or the costs of achieving the changes in the relatively short remaining duration outweigh the benefits. We do not consider that these points represent material legal exposures for us and, subject to further analysis, we expect we will accept these points as ideas for us to include in our work with others in local government pensions schemes (LGPS) as we set the framework for a joint-procurement exercise to be known as the new Norfolk Framework for custody. Should the agreed

LGPS contract terms not include these then we will return to Internal Audit to provide notice of this when we enter into the new agreement. For clarity, we do not believe that these points individually or in aggregate represent a material risk to our assets being in safe custody.

However, the most significant finding in the report and the driver of it being returned as “red” relates to a potential contractual gap where NT are able to access the front office trading system, as they must do to provide the managed broker service, without evidence of there being a contractual protection in place for LPF such that in the event they proceeded to create their own instruction then we may rely on broad rather than specific contractual provisions for any claims that arose. This is now under investigation and we will complete this no later than 30 June and ordinarily would have done so before the reporting date but the timing of this falls against other significant and time-sensitive priorities for LPF and it will take time to investigate between LPF, Charles River and Northern Trust in order to determine the existence and extent of any gap. While we investigate we acknowledge the potential gap as highlighted by Internal Audit.

Notwithstanding the comments above, we will be further reflecting on the whole report from Internal Audit to develop our action plan and will ensure that Internal Audit and Audit Committee receive our plan as soon as we are able to produce it. The Fund is operating with substantial limitations to resource and the context of Covid-19 and the timing of this audit falling close to year-end has substantially impacted our ability to develop these plans any sooner. For avoidance of doubt, we will return to Committee in September with a fully developed plan and this will be structured to align to the convention of references in this report.

### Areas of good practice

The following areas of good practice were also identified during our review:

- **supplier assurance reports** - a financial controls (Service Organisation Control report (SOC) 1) report dated September 2019 that covered both the design (type 1) and operating effectiveness (type 2) of key NT financial controls was received during the NT site visit in December 2019, and subsequently reviewed by LPF management to confirm that there were no significant control gaps.
- **annual site visit** – the annual NT site visit is comprehensive with extensive advance preparation evident by both LPF and NT. This involves completion of a pre visit questionnaire by NT and review of a custodian benchmarking report provided by NT that (together with the outcomes of weekly supplier management meetings) enables LPF to select relevant areas of focus for the site visit. Action plans are also prepared to address any areas of concern identified during the site visit with progress monitored at ongoing supplier management meetings.
- **settlement oversight** – LPF uses comprehensive checklists to support effective ongoing monitoring of trades settled by NT.

## 3. Detailed Findings

### 1. Northern Trust Contract

High

Our review of the current Northern Trust (NT) contract agreed in 2011 supporting settlement and custodian services delivered to Lothian Pension Fund (LPF) confirmed that:

1. **Relationships with other LPF suppliers** – LPF implemented a new cloud based trading system in October 2019 that is owned and hosted by Charles River. NT has direct access to this system to support completion of straight through settlement and custodian activities on behalf of LPF. This new arrangement does not appear to be covered by the existing NT contract, and LPF

management has not yet been able to confirm whether the security; data protection; and legal risks associated with this arrangement have been addressed.

2. **Regulatory requirements** - the contract refers to Financial Services Authority (now Financial Conduct Authority) regulations that do not apply to LPF and makes no reference to any other applicable requirements (for example Local Government Pension Scheme regulations 2018 and relevant European Union Directives). Additionally, the contract does not include any detailed clauses in relation to the requirement to ensure ongoing compliance with regulations, and does not detail the recourse available to LPF in the event of potential regulatory breaches. For example:
  - Section 19 of the contract (Page 14) includes a high level reference to the Financial Conduct Authority Client Asset Sourcebook (CASS) regulations, whilst section 19.2 includes a high level and brief reference to the Custodian having established procedures in accordance with Financial Services Authority (now the Financial Conduct Authority) requirements.
3. **Custodian obligations** - the contract is high level and does not clearly specify NTs specific custodian obligations, with NT's responsibilities implied and not detailed, for example
  - Section 6.2 specifies that the Custodian will process settlements in accordance with accepted industry practices, whilst section 6.3 gives the custodian the right to decline acceptance or custody of certain assets on behalf of LPF.
  - Section 7.1 specifies that the custodian will use all 'reasonable means' to advise on Corporate actions whilst sections 7.2 to 7.8 include limited detail on how corporate actions will be processed by NT.
  - Section 7.9 states that the custodian may provide information (MI) on performance targets and (7.10) that they shall agree to hold periodic performance reviews.
4. **Key performance measures** – New key performance indicators were agreed with Northern Trust in January 2020, however these were in place during the period of our review (1 April to 31 December 2019) and have not yet been incorporated into the NT contract. Management has advised that agreement on key performance indicators and supporting performance information was confirmed in meetings between LPF and NT that included the LPF Chief Executive Officer and the Senior Vice President of NT.
5. **Assurance reports** - system and organisation controls (SOC) annual assurance reports are provided by NT to LPF, however the requirement to provide these or other relevant assurance reports is not specified in the contract.
6. **Continuous improvement** – there is no contractual requirement for NT to support LPF with implementation of continuous improvement initiatives to improve the efficiency and effectiveness of custodian services. [

## Risks

The potential risks associated with our findings are:

- LPF is exposed to legal risks in relation to Northern Trust (NT) access to the Charles River investment management system.
- the structure of the Northern Trust (NT) contract focuses on limiting potential NT liabilities and does not provide the same level of legal protection to Lothian Pension Fund (LPF).
- NT could stop providing ongoing performance and assurance information to LPF as these requirements have not yet been contractually agreed.

- penalties for poor performance and / or regulatory breaches cannot be applied. continuous improvement opportunities may not be implemented.

### 1.1 Recommendations: Northern Trust relationships with other LPF suppliers

- LPF management should review existing contractual arrangements to confirm whether the technology security; data protection; and legal risks associated with Northern Trust's (NT) access to the Charles River investment management solution are appropriately covered.
- Where existing contractual arrangement do not cover the risks associated with these system access arrangements, new contractual arrangement should be established and agreed between all relevant parties.

### 1.1 Agreed Management Actions: Northern Trust relationships with other LPF suppliers

This is now under investigation but the timing of this falls against other priorities for LPF and it will take time to investigate between LPF, Charles River and Northern Trust in order to determine the existence and extent of any gap. We are investigating this as a priority and, for now, acknowledge the potential gap as highlighted by Internal Audit.

**Owner:** Stephen Moir, Executive Director of Resources

**Contributors:** Hugh Dunn, Head of Finance; Doug Heron, Chief Executive, Lothian Pension Fund (LPF); John Burns, Chief Finance Officer, LPF; Struan Fairbairn, Chief Risk Officer, LPF.

**Implementation Date:**

Investigation to be completed by 30 June 2020

**Date for implementation of contractual arrangements (action 2) to be agreed (if required) following completion of investigation.**

### 1.2 Recommendations: Northern Trust Contract

Management has confirmed that a potential re-procurement / refresh of the Northern Trust (NT) contract is being considered. As part of the contract refresh process, management should ensure that the contract includes:

- the requirement to ensure ongoing compliance with all relevant regulations that apply to delivery of custodian services, including any future regulatory changes.
- details of NT's specific custodian obligations.
- the process and penalties to be applied in the event of any regulatory breaches or failure to achieve agreed performance measures.
- agreed key performance indicators and details of the management information required to support ongoing assessment of NT performance against these.
- the requirement to provide LPF with annual assurance reports, and details of their specification.
- the requirement to support LPF with any continuous improvement activities in relation to ongoing provision of custodian services.

### 1.2 Agreed Management Actions: Northern Trust Contract

We consider that the contract includes appropriate detail in line with standard industry practice and as would have been market norms in 2011. We will seek updates and enhancements where the benefit of doing so in the residual contract term outweighs the costs involved, and otherwise we will seek to

achieve additional protections and clarifications during the re-tender, as you would expect for any periodic re-tendering of a long-term critical service arrangement

**Owner:** Stephen Moir, Executive Director of Resources

**Contributors:** Hugh Dunn, Head of Finance; Doug Heron, Chief Executive, Lothian Pension Fund (LPF); John Burns, Chief Finance Officer, LPF; Struan Fairbairn, Chief Risk Officer, LPF

**Implementation Date:**

30 June 2022

## 2. Regulatory and risk management oversight

Medium

Review of the established Lothian Pension Fund (LPF) regulatory and risk management oversight processes confirmed that:

1. LPF does not currently maintain a schedule of all relevant regulatory requirements applicable to settlement and custodian activities performed by both LPF and Northern Trust (NT), for example, as detailed in Local Government Scheme (LGPS) regulations and other applicable European Union Directives. Additionally (as noted in finding 1 above) NT regulatory obligations are not clearly specified in the current contract or supporting contract addendums and documentation, and the contract is aligned with Financial Conduct Authority regulations that do not apply to LPF.
2. whilst the LPF risk register includes a generic supplier management risk, specific risks relevant to outsourced custodian services and supporting action plans identified from the annual NT site visit have not been recorded in departmental risk registers.

### Risks

The potential risks associated with our findings are:

- Lothian Pension Fund (LPF) is unable to confirm that custodian services are delivered and performed in line with applicable regulatory requirements (for example, Local Government Pension Scheme requirements).
- LPF is unable to confirm that all relevant custodian services risks (including those identified from NT support management meetings and site visits) are recorded in departmental risk registers that then flow through to the LPF organisational risk register.

### 2.1 Recommendations: Regulatory and risk management oversight

1. Lothian Pension Fund (LPF) should maintain details of all relevant regulatory requirements that are applicable to custodian activities and confirm (via the established supplier management process and review of agreed regulatory key performance measures) that these continue to be applied by Northern Trust (NT).
2. LPF should record the specific risks associated with delivery of custodian services by NT. Any new and emerging risks and actions to address them identified at regular supplier management meetings and site visits should also be recorded, with resolution progress monitored at ongoing supplier management meetings. Any significant custodian risks should also be escalated for inclusion in the LPF risk register.

### 2.1 Agreed Management Actions: Regulatory and risk management oversight

Management consider that our risk management process adequately takes into account and considers custodian risk within LPF when that is appropriate. It does this through monitoring key suppliers, regulatory breaches and other associated risks which are purposefully focused on LPF's own business. We can evidence appropriate risks having been identified, actioned and monitored over time, however, LPF does not seek to include all granular operational risks identified by sub-groups or specific supplier management processes but does have sufficient governance in place to ensure that where those risks are sufficiently material, they are escalated through the risk group for consideration and potential inclusion in the register. LPF's LR&C team are also involved in NT supplier management at appropriate junctures.

A further response to this finding will be provided as part of the fully developed plan in response to the audit that will be prepared by 30 September 2020

**Owner:** N/A – further action to be agreed (where appropriate) following completion of the plan in response to the audit to be prepared by 30 September 2020.

**Contributors:** N/A

**Implementation Date:**  
N/A

### 3. System Access and Security

Medium

Review of Lothian Pension Fund's (LPF) user access management controls in relation to 26 users (20 of these are LPF employees) with access to the Northern Trust (NT) Passport system confirmed that:

- user access reports detailing LPF employee user profiles and system access rights for LPF employees are currently provided annually by NT for review by LPF.
- no evidence is retained to confirm that LPF employee user profiles and system access rights are reviewed by an appropriate LPF senior manager, with details of actions taken to address any potential concerns.
- One unnamed user (access profile LHPPFXX) had not logged on to the system since 20 December 2012, whilst user profile LHPPFZ8 has no recorded last log on date.
- User profile LHPPFNT is described as 'Northern' and has not accessed the system since 13 January 2019. Additionally, the e mail address associated with this account is that of an LPF employee.
- Two user profiles were noted that did not relate to named LPF employees (LHPPFZ8 and LHPPFXX).

#### Alignment with National Cyber Security cloud security principles

The UK Government's National Cyber Security Centre (NCSC) website requires all public sector organisations review their service provider compliance with their 14 [cloud security principles](#) (published in November 2018) and perform a gap analysis to determine the extent and potential impact of any residual risks and actions required to address them. This gap analysis has yet been performed by Lothian Pension Fund (LPF) in relation to Northern Trust (NT).

Whilst the service organisation control (SOC) reports currently provided to LPF by NT are not specifically aligned with the NCSC principles, much of the content included in SOC 2 type 1 and 2 reports would provide assurance on the NCSC requirements.

#### Risks



The potential risks associated with our findings are:

- Lothian Pension Fund (LPF) employees may have potentially inappropriate access to the Northern Trust (NT) passport system, with an associated risk of fraud.
- Inappropriate Passport system access rights are not identified and addressed in a timely manner.
- LPF is unable to demonstrate that NT (and potentially other system suppliers not included within the scope of this review) has appropriate security controls that are aligned with National Cyber Security Centre (NCSC) cloud security principles

### 3.1 Recommendations: System access controls

1. Northern Trust (NT) should be requested to provide Lothian Pension Fund (LPF) with system access reports at least quarterly, with this requirement specified in the refreshed contract (refer recommendation 1.1).
2. Review of appropriateness of user profiles and system access rights should be performed and recorded by an appropriately independent LPF senior manager.
3. LPF employees with edit and authorise access rights should be reviewed, and appropriate action taken to change access rights where these are not considered appropriate. Where review outcomes confirm that both edit and authorise access rights are required, the rationale supporting this requirement should be recorded and retained.
4. Users who have not accessed the system in the last financial year should be removed.
5. Management should investigate user profiles that do not relate to named LPF employees to understand who can use these profiles and the levels of access they provide to the system. Where these user profiles are not required, they should be removed, or the rationale supporting their ongoing use recorded and retained.

### 3.1 Agreed Management Actions: System access controls

1. Agree with recommendation, access reports will be requested and reviewed quarterly. Whilst this review has been undertaken annually, it is accepted that formal evidence should be retained.
2. Agreed – this action will be implemented as recommended.
3. Agreed – this action will be implemented as recommended.
4. Agreed – all non LPF user profiles will be reviewed and removed.

**Owner:** N/A – implementation date to be agreed (where appropriate) following completion of the plan in response to the audit to be prepared by 30 September 2020.

**Contributors:** N/A

**Implementation Date:**  
N/A

### 3.2 Recommendations: National Cyber Security cloud security principles mapping

1. A mapping exercise should be performed by Lothian Pension Fund (LPF) to determine whether Northern Trust (NT) Passport system controls are aligned with the National Cyber Security cloud security principles; identify any potential gaps; and advise NT of any remedial action required to ensure alignment.
2. LPF management should consider whether a similar mapping is required for other cloud based systems provided by third party suppliers to support ongoing delivery of LPF services. Where this is required, the mapping should be performed; gaps identified; and suppliers advised of any remedial action required to ensure alignment.

### 3.2 Agreed Management Actions: National Cyber Security cloud security principles mapping

Proceed as recommended with caveat that equivalent international or other jurisdiction standards will be deemed acceptable.

**Owner:** Stephen Moir, Executive Director of Resources

**Contributors:** Hugh Dunn, Head of Finance; Doug Heron, Chief Executive, Lothian Pension Fund (LPF); John Burns, Chief Finance Officer, LPF; Struan Fairbairn, Chief Risk Officer, LPF

**Implementation Date:**

30 June 2021

### 4. Northern Trust Supplier Management

Low

Review of Lothian Pension Funds (LPF's) established Northern Trust (NT) supplier management arrangements confirmed that:

- 1. Timing and adequacy of NT assurance reports** – during their site visit to LPF in December 2019, LPF received and reviewed:
  - a financial reporting controls (Service Organisation Control report (SOC 1)) report that covered both the design and operating effectiveness of key NT financial controls dated September 2019.
  - an operational controls (SOC 2) assurance report dated November 2018 that provided assurance on only the design of NT operational (non-financial) controls, and not their effectiveness. This report was used to provide assurance to pensions committee in March 2020.
  - whilst no significant findings were identified in the NT SOC reports, there was no evidence of LPF review of these reports other than the reference provided in the March 2020 update to Pensions Committee.
- 2. Key performance measures (KPIs)** – quarterly key performance indicator (KPI) reports are provided by NT to LPF, however, there is currently no evidence of review by LPF to confirm the accuracy of the reports.
- 3. Weekly supplier meetings** - an action log is produced detailing agreed actions from weekly LPF and NT meetings, however no record of decisions taken at the meetings in relation to performance; service improvements; accuracy of KPI reports; and other relevant service matters is maintained.

#### Risks

The actual / potential risks associated with our findings are:

- Pensions Committee did not receive assurance on the effectiveness of Northern Trust (NT) non-financial operating controls.
- LPF is unable to provide evidence of their management review of Northern Trust (NT) service organisation control (SOC) reports in the event of subsequent NT regulatory breaches or reviews.
- there is no record of decisions taken at ongoing supplier management meetings.
- retrospective legal advice is required in relation to decisions taken at supplier management meetings.

#### 4.1 Recommendations: Supplier Management

1. requirements in relation to the nature and timeframes for provision of service organisation control (SOC) reports (for example SOC 1 and 2 type 1 and type 2 reports to be provided by a specified

date) should be agreed with Northern Trust (NT) and reflected in the NT contract (as per recommendation 1.1 above).

2. management review of SOC reports and details of any follow-up action taken with NT should be recorded and retained, even when the reports do not include any significant findings.
3. a process should be established to review the accuracy of key performance indicators provided by NT to confirm that they continue to be accurately calculated.
4. details of decisions taken at NT supplier management meetings should be logged.

#### 4.1 Agreed Management Actions: Supplier Management

We consider that the approach taken to our oversight of NT is more robust than is indicated here. Beyond this point, we will conduct an internal review on the effectiveness of the arrangements for documenting service review meetings and due diligence reviews, but we believe substantial and effective reviews have been undertaken and appropriate action points raised.

**Owner:** N/A – further action to be agreed (where appropriate) following completion of the plan in response to the audit to be prepared by 30 September 2020.

**Contributors:** N/A

**Implementation Date:**  
N/A

# Appendix 1: Basis of our classifications

Finding rating	Assessment rationale
<b>Critical</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Critical</b> impact on the operational performance; or</li> <li>• <b>Critical</b> monetary or financial statement impact; or</li> <li>• <b>Critical</b> breach in laws and regulations that could result in material fines or consequences; or</li> <li>• <b>Critical</b> impact on the reputation of the organisation which could threaten its future viability.</li> </ul>
<b>High</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Significant</b> impact on operational performance; or</li> <li>• <b>Significant</b> monetary or financial statement impact; or</li> <li>• <b>Significant</b> breach in laws and regulations resulting in significant fines and consequences; or</li> <li>• <b>Significant</b> impact on the reputation of the organisation.</li> </ul>
<b>Medium</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Moderate</b> impact on operational performance; or</li> <li>• <b>Moderate</b> monetary or financial statement impact; or</li> <li>• <b>Moderate</b> breach in laws and regulations resulting in fines and consequences; or</li> <li>• <b>Moderate</b> impact on the reputation of the organisation.</li> </ul>
<b>Low</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Minor</b> impact on operational performance; or</li> <li>• <b>Minor</b> monetary or financial statement impact; or</li> <li>• <b>Minor</b> breach in laws and regulations with limited consequences; or</li> <li>• <b>Minor</b> impact on the reputation of the organisation.</li> </ul>
<b>Advisory</b>	<p>A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.</p>

Please see the [Internal Audit Charter](#) for full details of opinion ratings and classifications.

## Appendix 2: Areas of audit focus

The areas of audit focus and related control objectives that were included in the review are:

Audit Area	Control Objectives
Northern Trust contractual arrangements	<p>1. Roles and responsibilities for Northern Trust (NT) and LPF in relation to transaction settlements and custodian services are clearly specified in the NT contract. These should include but not be limited to the requirements for NT to:</p> <ul style="list-style-type: none"> <li>□ settle all completed trades in a timely manner with notification of settlement provided to LPF;</li> <li>□ record all completed trades on the NT system and record details of investment assets and client monies in appropriately named and segregated LPF client accounts;</li> <li>□ provide periodic statements (at a frequency agreed with LPF) detailing the value of all safe custody assets and client monies held by NT on behalf of LPF;</li> <li>□ reconcile client investment assets held in custody with LPF records at a frequency agreed with LPF;</li> <li>□ perform asset reconciliations in comparison to NT safe custody records to confirm the physical existence and completeness of all assets held on behalf of LPF;</li> <li>□ provide appropriate compensation (as agreed with LPF) for any losses associated with any shortfalls in client assets identified from the ongoing assets reconciliation process;</li> <li>□ accurately allocate all investment income and charges (dividend and interest income and tax charges) against the designated LPF client accounts;</li> <li>□ effectively manage all corporate actions associated with LPF investments based on an agreed approach with LPF; and</li> <li>□ accurate calculation and application of NT service fees in line with agreed contractual rates.</li> </ul> <p>2. The contract includes appropriate clauses in relation to ongoing compliance with applicable regulatory requirements and the recourse available to LPF in the event of a NT regulatory breach</p>
Ongoing supplier management	<ol style="list-style-type: none"> <li>1. A framework of key performance measures (KPIs) has been established that is aligned with contractual roles and responsibilities in relation to NT investment transaction settlements and custodian services.</li> <li>2. NT KPI performance is regularly monitored by LPF with any instances of underperformance addressed in a timely manner</li> <li>3. LPF receives SOC 1 assurance reports from NT at least annually which confirm that key financial controls supporting the investment transaction settlement and custodian processes are adequately designed and operating effectively.</li> <li>4. Where assurance reports received highlight any issues or emerging risks, these are addressed with NT in a timely manner.</li> <li>5. the scope of the annual LPF NT site visit is determined by LPF and communicated to NT in advance of the visit. This includes appropriate evidence based review and oversight to confirm that the key controls associated with transaction settlement and</li> </ol>

	<p>custodian services are appropriately designed and operating effectively, and that concerns identified from previous visits have been addressed.</p> <p>6. Any concerns identified from the site visit are discussed with NT and appropriate action taken to ensure that these are addressed, with LPF advised when these are completed.</p>
Internal processing	<p>1. LPF maintains appropriate trade settlement and investment assets records that are regularly updated to reflect all transactions and regularly reconciled with NT records.</p> <p>2. All team members involved in maintaining LPF trade settlement and investment asset records have been appropriately trained in the process and also in use of the NT system.</p> <p>3. The risks associated with transaction settlement for fixed interest securities and custodian processes have been identified, assessed, and recorded and appropriate controls established to ensure that they are effectively managed.</p>
IT security	<p>1. LPF Access rights to the NT Passport system are restricted to appropriate users based on their roles in relation to the settlement and custody processes.</p> <p>2. Cloud protocols are in accordance with best practice and Council policy.</p>



## **Pensions Audit Sub Committee**

### **2.00pm, Tuesday 23 June 2020**

### **Lothian Pension Fund – Proposed Internal Audit plan for 2020/21**

**Item number 5.4**

#### **1. Recommendations**

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The Pensions Audit Sub Committee (Committee) is requested to:

- 1.1 review and note the Lothian Pension Fund 2020/21 Internal Audit plan; and
- 1.2 refer the Internal Audit plan to the Pensions Committee for approval.

**Lesley Newdall**

Chief Internal Auditor

Legal and Risk Division, Resources Directorate

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# Lothian Pension Fund – Proposed Internal Audit plan for 2020/21

## 2. Executive Summary

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- 2.1 The purpose of this paper is to present the Lothian Pension Fund (LPF) proposed Internal Audit plan (the plan) for the period 1 April 2020 to 31 March 2021 to the Committee for approval.
- 2.2 A total of three reviews and ongoing IA follow up on implementation of previously raised findings are included in the proposed plan which is in line with Internal Audit coverage in previous years. It should also be noted that LPF also may be included within the scope of any relevant City of Edinburgh Council (the Council) thematic reviews included in the Council's 2020/21 IA plan.
- 2.3 Whilst no targeted review of the LPF risk management framework has been performed in the last five years, it is proposed that combined review of the LPF risk management and the new assurance framework that is currently being developed and implemented is performed in financial year 2021/22.
- 2.4 Public Sector Internal Audit Standards (PSIAS) specify that the purpose, authority, and responsibility of Internal Audit (IA) must be formally defined in an Internal Audit Charter (the "Charter") that is periodically reviewed and presented to senior management and the board for approval. The Council's IA charter that was approved by the Council's Leadership Advisory Panel in March 2020 fulfils this requirement.

## 3. Background

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- 3.1 The LPF IA plan is driven by PSIAS requirements; LPF's organisational objectives and priorities; and an assessment of the risks that could prevent LPF from meeting those objectives and providing pension services to employers and members.
- 3.2 PSIAS specifies that the risk-based plan must take into account the requirement to produce an annual internal audit opinion. Consequently, IA work performed must be appropriately scoped to cover the organisation's most significant risks, with an appropriate depth of testing performed to provide sufficient assurance on the control environment, governance and risk management frameworks to support provision of the opinion.
- 3.3 PSIAS also specifies that internal audit activity must evaluate the effectiveness of risk management processes and contribute to their improvement.
- 3.4 The methodology used to create the LPF IA plan is the same as that applied when developing the City of Edinburgh Council's (the Council) 2020/21 IA annual plan, that



will be presented to the Governance, Risk, and Best Value Committee together with the IA charter for approval in August 2020. The Council IA plan also includes the IA days required to deliver the LPF 2020/21 plan

- 3.5 The plan has been developed with the LPF senior management team to ensure that Internal Audit (IA) assurance activity is focused on the most relevant risks for LPF.
- 3.6 The current Internal Audit co-source arrangement with PwC will continue be used in 2019/20 where the required skills sets are not available within the IA team.
- 3.7 It should also be noted that Internal Audit is not the sole source of assurance provision for LPF, as a number of additional external third line assurance providers are engaged (in addition to the annual external audit review of LPF's financial statements) to provide assurance across the full population range of LPF risks. Details of these additional assurance providers are included in the LPF Assurance Map that was presented to the Pensions Audit Sub Committee in June 2019 that illustrates how assurance is provided from all sources across the full population of LPF's risks

## **4. Main Report**

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### **4.1 Preparation and content of the proposed plan**

- 4.1.1 The areas proposed for inclusion in the plan were identified by considering the key risks included in the LPF risk register as at October 2019, and discussions with the LPF management team.
- 4.1.2 The October 2019 risk register included a total of 35 risks. Of these, 3 risks were rated red (materially beyond appetite with urgent resolution required); 7 amber (beyond appetite with resolution required) and 25 green (within appetite and will be monitored). The three red rated risks related to reduced funding levels caused by adverse changes in non-investment actuarial assumptions requiring higher employer contributions; failure of technology systems used by LPF; and adequacy of resources to support current or planned projects.
- 4.1.3 Whilst the proposed Internal audit reviews planned for the year to 31 March 2021 will provide assurance on two of the red rated risks included in the LPF risk register (failure of technology systems and adequacy of resources to support current or planned projects), the LPF assurance map should provide further details on coverage of the remaining risks by other independent assurance providers.

4.1.4 The scope of the three reviews planned for the year to 31 March 2021 are detailed below:

	Audit Scope	Planned days
1.	<p><u>Employer Cessation Strategies, Valuations, and Exit Calculations</u></p> <p>The audit will consider the adequacy of LPF funding strategies (including use of suspension notices) to support affordable employer cessations where non local government employers (for example charitable sector employers and trusts) have requested to leave the fund.</p> <p>The audit will also consider the completeness and accuracy of cessation valuations, exit payments and credits and will confirm that these are aligned with Local Government Pension Scheme (Scotland) Regulations 2018 (section 61).</p> <p>This audit is not aligned with risks included in the October 2019 LPF risk register, but has been highlighted as a high risk area by management.</p>	25
2.	<p><u>Bulk Transfers</u></p> <p>This audit will consider the design adequacy and operational effectiveness of processes established by LPF to support consolidation of employer funds managed by LPF, and the completeness and accuracy of any associated financial / valuation adjustments.</p> <p>The review will also assess the design and effectiveness of processes established to confirm the completeness and accuracy of consolidated member records.</p> <p>Work will be performed in two parts, with a review of LPF plans to support the transfer in April 2020, and an assessment of the effectiveness of the transfer process in June 2020.</p> <p>This audit is not aligned with risks included in the October 2019 LPF risk register, but has been highlighted as a high risk area by management.</p>	25
3.	<p><u>LPF Technology Model Development</u></p> <p>This review will assess the proposed design of the new LPF technology model to confirm that the new solution includes appropriate connectivity; network security; information and data security; and resilience controls, and appropriate business continuity arrangements to support the ongoing management and administration of LPF funds.</p> <p>This audit is aligned with the red technology general resilience and the green cybersecurity protections risks included in the LPF risk register.</p> <p>This audit will provide assurance on two red rated LPF risks - failure of technology systems used by LPF; and adequacy of resources to support current or planned projects</p>	15

	<p><u>Follow up</u></p> <p>Ongoing follow up to confirm that agreed management actions have been effectively implemented and sustained to support closure of previously raised IA findings.</p>	10
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## 4.2 Risk Management

- 4.2.1 Whilst sufficient information is generally collated across multiple audits to provide an understanding of the effectiveness of risk management processes to support the annual opinion, IA typically also performs targeted risk management audits to assess and provide assurance on the adequacy and effectiveness of the risk management framework across the entire organisation.
- 4.2.2 It is important to note that no specific audit of the established LPF risk management framework has been performed during the last five years.
- 4.2.3 LPF management has advised that they are in the process of designing and implementing a new self-assurance process that will provide LPF management with ongoing assurance on the effective management of risks, including compliance with applicable regulations.
- 4.2.4 Recognising that the development and implementation of this assurance is underway, and that it will directly link with the established risk management framework, it is proposed that a combined review of the LPF risk management and assurance framework is performed in financial year 2021/22.

## 4.3 Council wide thematic IA reviews

- 4.3.1 It should be noted that LPF may also be included within the scope of any relevant Council wide thematic reviews included in the 2020/21 IA plan that will be presented to the Governance, Risk and Best Value Committee for approval on 24 March 2020.

## 5. Financial impact

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- 5.1 The estimated costs associated with delivery of the LPF 2020/21 IA plan are £50,000.
- 5.2 IA has implemented use of time sheets to support accurate time recording on audits. Costs applied to LPF for the 2019/20 plan year will be based on actual time spent as recorded in IA time sheets and will be discussed and agreed with LPF management.

## 6. Stakeholder/Regulatory Impact

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- 6.1 The LPF management team were consulted when developing the 2020/21 IA plan.

## **7. Background reading/external references**

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7.1 [Public Sector Internal Audit Standards](#)

## **8. Appendices**

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8.1 None



## **Pensions Audit Sub Committee 2.00pm, Tuesday, 23 June 2020**

### **External Audit Annual Plan 2019/20 by Scott-Moncrieff**

#### **Item number 6.5**

#### **1. Recommendations**

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The Pensions Audit Sub Committee (Committee) is requested to:

- 1.1 note the planned programme of work to support the statutory audit 2019/20. This is shown at Appendix 1 - "Group External Audit Annual Plan 2019-20" by Scott-Moncrieff;
- 1.2 note that suitable provision has been made in the approved budget 2019-20 for the audit fee; and
- 1.3 note that progress against the Group External Audit Annual Plan 2019-20 will be reported to future meetings of the Committee and the Pensions Committee.

#### **John Burns**

Chief Finance Officer, Lothian Pension Fund

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

E-mail: [john.burns@edinburgh.gov.uk](mailto:john.burns@edinburgh.gov.uk) | Tel: 0131 469 3711

# External Audit Annual Plan 2019/20 by Scott-Moncrieff

## 2. Executive Summary

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- 2.1 Scott-Moncrieff, the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2019/20. This is shown in full at Appendix 1.
- 2.2 Scott-Moncrieff representative(s) will present the Group External Annual Audit Plan 2019-20 to Committee.

## 3. Background

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- 3.1 The Accounts Commission appointed Scott-Moncrieff as external auditor of the funds for the five-year period 2016/17 to 2020/21.
- 3.2 The External Audit Plan is reported annually to Committee by the external auditor, Scott-Moncrieff.
- 3.3 At its meeting on 20 March 2017, Pensions Committee agreed to:
  - 3.3.1 note that there is sufficient separation between Scott-Moncrieff's payroll, taxation advisory and audit services, and that it does not affect the firm's ability to provide an independent audit; and
  - 3.3.2 approve that non-audit services around taxation advice continue to be provided by the external auditor to the Lothian Pension Fund Group (the LPF Group).

## 4. Main Report

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- 4.1 Scott-Moncrieff, the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2019/20. This is provided in full at Appendix 1.
- 4.2 Progress against the plan will be reported to future meetings of the Committee and thereafter the Pensions Committee.

## 5. Financial impact

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- 5.1 The expected audit fee for 2019/20 is £46,418, which represents a very small increase of 0.2% from 2018/19.

- 5.2 The LPF Group has accepted the proposed audit fee of £46,418 for 2019/20 and suitable provision has been made in the 2019/20 budget.

## **6. Stakeholder/Regulatory Impact**

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- 6.1 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.
- 6.2 There are no adverse health and safety, governance, compliance or regulatory implications arising from this report. External audit is a critical part of the LPF Group's governance and assurance.

## **7. Background reading/external references**

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- 7.1 The responsibilities of Scott-Moncrieff, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, as approved by the Auditor General for Scotland and the Accounts Commission.

## **8. Appendices**

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Appendix 1 – “Group External Audit Annual Plan 2019-20” by Scott-Moncrieff.

# *Lothian Pension Funds*

*Group External Audit Annual Plan 2019/20*

March 2020







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# *1. Introduction*

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## Introduction

1. This document summarises the work plan for our 2019/20 external audit of Lothian Pension Fund and the Scottish Homes Pension Fund (collectively referred to as the “Funds”).
2. The core elements of our work include:
  - an audit of, and provision of a specified audit opinion, on the 2019/20 annual report and accounts;
  - consideration and reporting on the Funds’ arrangements on the four audit dimensions: financial sustainability, financial management, governance and transparency, and value for money; and
  - any other work requested by Audit Scotland including the contribution to performance audits (including overview reports, performance audit reports, and impact reports).

### Audit appointment

3. The Accounts Commission is an independent body appointed by Scottish Ministers responsible for securing the audit of local authorities and other local government bodies. The Commission’s work is governed mainly by the Local Government (Scotland) Act 1973.
4. Audit Scotland is an independent statutory body that provides the Accounts Commission with the services required to carry out their statutory functions, including monitoring the performance of auditors through a quality control process.
5. The Accounts Commission has appointed Scott-Moncrieff as external auditor of the Funds for the five year period 2016/17 to 2020/21. This document comprises the audit plan for 2019/20 and summarises:
  - the responsibilities of Scott-Moncrieff as the external auditor;
  - our audit strategy;
  - our planned audit work and how we will approach it;
  - our proposed audit outputs and timetable; and

- background to Scott-Moncrieff and the audit management team.

### Confirmation of independence

6. International Standards on Auditing in the UK (ISAs (UK)) require us to communicate on a timely basis all facts and matters that may have a bearing on our independence.
7. Scott-Moncrieff is also responsible for the audit of the financial statements of the subsidiaries of Lothian Pension Fund, LPFE Ltd and LPFI Ltd. In addition to the audit of the subsidiaries, Scott-Moncrieff provides accounts preparation, corporation tax services and ad hoc VAT advice to both LPFE Ltd and LPFI Ltd. In 2019/20 non-audit fees are estimated to be approximately £9,000.
8. We have outlined the safeguards to our independence in Appendix 2. We confirm that we comply with FRC’s Ethical Standard. In our professional judgement, the audit process is independent, and our objectivity has not been compromised in any way.

### Adding value through the audit

9. All of our clients quite rightly demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to the Funds through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way we aim to help the Funds promote improved standards of governance, better management and decision making and more effective use of resources.

### Feedback

10. Any comments you may have on the service we provide, the quality of our work and our reports would be greatly appreciated at any time. Comments can be reported directly to any member of your audit team.

### Openness and transparency

11. While this plan is addressed to the Funds, it will be published on Audit Scotland’s website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).



## *2. Respective responsibilities of the auditor and the Funds*

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## Respective responsibilities of the auditor and the Funds

### Auditor responsibilities

#### Code of Audit Practice

12. The Code of Audit Practice (the Code) outlines the responsibilities of external auditors appointed by the Accounts Commission and it is a condition of our appointment that we follow it.

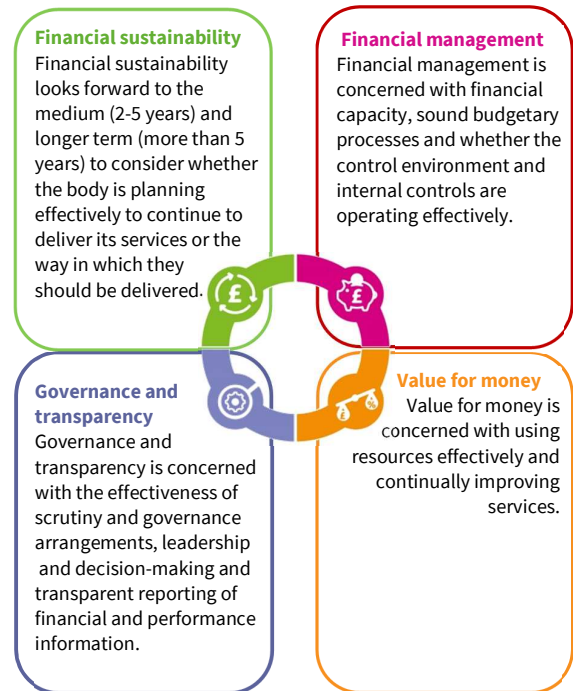
#### Our responsibilities

13. Auditor responsibilities are derived from statute, the Code, International Standards on Auditing (UK) (ISAs (UK)), professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities (paragraph 15). These are to:

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

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

### Exhibit 1: Audit dimensions of wider scope public audit



### Wider scope audit work

15. The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the financial statements, but providing audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.
16. The Code sets out four audit dimensions that frame the wider scope audit work into identifiable audit areas. These are summarised in Exhibit 1.
17. Our assessment takes into account the size, nature and risks of the organisation. Taking these factors into consideration, we have concluded that application of the full wider scope is appropriate for the Funds.



## Funds' responsibilities

18. The Funds' have primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance,

propriety and regularity that enable them to successfully deliver their objectives. The Funds' responsibilities are summarised in Exhibit 2.

## Exhibit 2 – Funds' responsibilities

Area	Funds' responsibilities
<p><b>Financial statements:</b> Annual accounts containing financial statements and other related reports should be prepared.</p>	<p>The Funds and the Chief Financial Officer have responsibility for:</p> <ul style="list-style-type: none"> <li>• preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation</li> <li>• maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures</li> <li>• maintaining proper accounting records</li> <li>• preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements</li> </ul>
<p><b>Financial sustainability:</b> Financial sustainability looks forward to the medium and longer term to consider whether the organisation is planning effectively to continue to fulfil its functions in an affordable and sustainable manner.</p>	<p>The Funds are responsible for putting in place proper arrangements to ensure the financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> <li>• Such financial monitoring and reporting arrangements as may be specified;</li> <li>• Compliance with any statutory financial requirements and achievement of financial targets;</li> <li>• Balances and reserves, including strategies about levels and their future use;</li> <li>• How the organisation plans to deal with uncertainty in the medium and long term; and</li> <li>• The impact of planned future policies and foreseeable developments on the financial position.</li> </ul>



Area	Funds' responsibilities
<p><b>Financial management:</b> Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p>	<p>It is the Funds' responsibility for ensuring that financial affairs are conducted in a proper manner. Management are responsible, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance.</p> <p>The Funds' are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at its disposal.</p> <p>It is the Funds' responsibility for establishing arrangements to prevent and detect fraud, error and irregularities, bribery and corruption and also to ensure that its affairs are managed in accordance with proper standards of conduct by putting appropriate arrangements in place.</p>
<p><b>Governance and transparency:</b> Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p>	<p>The Funds' are responsible for establishing arrangements to ensure the proper conduct of their affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Those charged with governance should be involved in monitoring these arrangements.</p> <p>The Funds' are also responsible for establishing effective and appropriate internal audit and risk management functions.</p>
<p><b>Value for money:</b> Value for money is concerned with the appropriate use of resources and ensuring continual improvement of services delivered.</p>	<p>The Funds' have a specific responsibility to ensure that arrangements have been made to secure best value. They are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.</p>



# 3. *Audit strategy*

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# Audit strategy

## Risk-based audit approach

19. We follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the Funds'. This ensures that our audit focuses on the areas of highest risk. Our audit planning is based on:

Discussions with senior officers at Lothian Pension Funds	Our understanding of the sector and its key priorities and risks	Attendance at the Pensions Committee
Guidance from Audit Scotland	Discussions with Audit Scotland and other auditors	Review of internal audit's plan and reports
Review of the Funds' corporate strategies and plans	Review of the Funds' corporate risk register	The outcomes of prior year audits

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

### Communications with those charged with governance

21. Auditing standards require us to make certain communications throughout the audit to those charged with governance. We have agreed with the Funds that these communications will be through the Pensions Committee.

### Professional standards and guidance

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

### Partnership working

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

### Audit Scotland

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

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

26. During the year we may also be required to provide information to Audit Scotland to support the national performance audits or provide information to support the assessment of the impact of specified published performance audit reports.



## Internal audit

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27. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the Funds' total audit resource. We will consider the findings of the work of internal audit within our audit process and look to minimise duplication of effort, to ensure the total audit resource to the Funds' is used efficiently and effectively.



# *4. Annual report and accounts*

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## Annual report and accounts

### Introduction

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

### Approach to audit of the financial statements

29. Our opinion on the annual accounts (financial statements) will be based on:

#### Risk-based audit planning

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

#### An audit of key systems and internal controls

31. We evaluate the key accounting systems and internal controls and determine whether they are adequate to prevent material misstatements in the financial statements.
32. The systems we review and the nature of the work we perform will be based on the initial risk assessment. We examine and test compliance with best practice and the Funds' own policies and procedures.
33. We take cognisance of any relevant internal audit reviews of systems and controls.
34. We update the risk assessment following our evaluation of systems and controls which ensures that we continue to focus attention on the areas of highest risk.

#### A final audit of the financial statements

35. During our final audit we will test and review the material amounts and disclosures in the financial statements. The extent of testing will be based on our risk assessment.
36. Our final audit will seek to provide reasonable assurance that the financial statements are free from material misstatement and comply with the

Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 (the Code).

#### Assurances from employers' auditors

37. As part of our audit of the financial statements of the Funds, we ask the auditors of a sample of employers within the Funds to conduct testing on employer and employee contributions and the control environment in place to ensure that the employer submissions are accurate.
38. These requests are made in line with Audit Scotland's Protocol for Auditor Assurances 2019/20 – Local Government Pension Schemes.

#### Independent auditor's report

39. Our opinion on whether the financial statements give a true and fair view of the financial position and the income and expenditure will be set out in our independent auditor's report which will be included in the annual report and accounts.
40. We also provide an opinion on the consistency of the information in the management commentary, annual governance statement and governance compliance statement.

#### Group accounts

41. Lothian Pension Fund prepares its financial statements on a group basis. The group consists of Lothian Pension Fund and two special purpose vehicles, LPFE Ltd and LPFI Ltd.
42. As part of our audit we will review the consolidation working papers to ensure the group accounts accurately reflect the merged activities of the Lothian Pension Fund, and both subsidiaries.

#### Materiality

43. Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement. We review our assessment of materiality throughout our audit.



- 44. Our initial assessment of materiality for each Fund is set out in the table below. The Funds hold significant investment assets, which form the largest part of the net asset statements for each pension fund. The primary business of the Funds is to hold sufficient assets to generate returns to meet future pension obligations. We consider that the net assets are of primary interest to the reader of the annual report and accounts. We therefore use net assets to inform our assessment of overall materiality.
- 45. ISA (UK) 320 states that in certain circumstances it is appropriate to set a materiality amount for particular classes of transactions for which lesser amounts than the overall materiality could influence the decisions of users of the accounts. We consider transactions when dealing with members (i.e. contributions and expenditure incurred providing payments to pensioners) to be of key interest to the users. This is reported in the first section of the Fund Account and contains information about the day to day operation of the Funds. We have therefore set a separate materiality based on the expenditure incurred for providing payments to pensioners.
- 46. Our initial assessment of overall materiality is based on approximately 1.5% of net assets. One of the main functions of LPF is to invest appropriately to fund the pensions of members. As a result, net assets are seen to be one of the principal considerations for users of the accounts.
- 47. Our initial assessment of dealings with members materiality is based on approximately 5% of expenditure. The main dealing with members that the Funds undertake is the collection of contributions and the payment of pensions and lump sums. Therefore, the income and expenditure of the Funds will be a principal consideration for users of the accounts.

Materiality (£million)		
	Overall	Dealing with members
Lothian Pension Fund (group) <sup>1</sup>	117	12
Lothian Pension Fund (single entity)	117	12
Scottish Homes Pension Fund	2.5	0.36

<sup>1</sup> Lothian Pension Fund group comprises Lothian Pension Fund, LPFE Ltd and LPFI Ltd

- 48. Performance materiality is the working level of materiality used throughout the audit. We use performance materiality to determine the nature, timing and extent of audit procedures carried out. We perform audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we perform a greater level of testing on the areas deemed to be at significant risk of material misstatement.
- 49. Performance materiality is set at a value less than overall materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of the uncorrected and undetected misstatements exceed overall materiality.

Performance materiality (£million)		
	Overall	Dealings with members
Lothian Pension Fund (group) <sup>1</sup>	76	7.8
Lothian Pension Fund (single entity)	76	7.8
Scottish Homes Pension Fund	1.6	0.23

- 50. We will also report any misstatements identified through our audit that fall into one of the following categories:
  - All material corrected misstatements;
  - Uncorrected misstatements for the group and LPF with a value in excess of £250,000, SHPF with a value in excess of £125,000; and
  - Other misstatements below the £250,000 threshold that we believe warrant reporting on qualitative grounds.

**Key audit risks in the financial statements**

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



## Exhibit 3 – Key audit risks in the financial statements

### Management override

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

52. In response to this risk we will review the Funds' accounting records and obtain evidence to ensure that any significant transactions outside the normal course of business are valid and accounted for correctly. We will adopt data analytics techniques to review and test aspects of this key audit risk. We will review the key accounting estimates, judgements and decisions made by management.

### Revenue recognition

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

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

### Risk of fraud in the recognition of expenditure

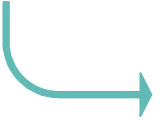
In 2016, the Public Audit Forum issued Practice Note 10 "*The Audit of Public Sector Financial Statements*" which applies to the audit of public sector financial statements for periods commencing after June 2016. This Practice Note recognises that most public sector bodies are net spending bodies and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

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




## Valuation of investments

The Funds held investments of £7.789 billion as at 31 March 2019, of which 34% (£2.639 billion) were classified as level 2 or level 3 financial instruments, meaning the valuation was not based on unadjusted quoted prices in active markets. Judgements are taken by the Investment Managers to value those investments whose prices are not publicly available. Investments of this nature are complex, difficult to value and include a significant degree of judgement from the investment manager. The material nature of this balance means that any error in judgement could result in a material valuation error.

- 
55. In response to this risk we will review the design and implementation of controls present at the scheme for ensuring the accurate valuation of investments. We will review the qualifications of the fund managers as experts in accordance with ISA 500.
  56. For a sample of investments, we will confirm the prices quoted to fund manager reports and independent pricing sources. We will assess the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments.

## Accounting for investment properties

LPF hold a portfolio of investment properties which as at the 31 March 2019 was valued at £475.4 million. During 2018/19, this portfolio was managed by Standard Life. In 2019/20, the management of this investment has been moved in-house. The management of the properties will be undertaken by JLL, along with the fund accounting for the portfolio. Fund accounting for a portfolio the size of LPF's has not been undertaken by JLL before now. The material nature of this portfolio means that an error in accounting treatment could result in a material error.

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57. In response to this risk, we will review the fund accounting for the investment property portfolio, and the controls in place to ensure their accurate accounting.



# 5. *Wider scope*

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## Introduction

58. As described in section 2, the Code frames a significant part of our audit responsibilities in terms of four wider scope audit dimensions. As part of our annual audit we consider and report against these four dimensions:
- financial sustainability
  - financial management
  - governance and transparency; and
  - value for money.
59. Our planned audit work against the four dimensions is risk based and proportionate. Our initial assessment builds upon our work in prior years to develop an understanding of the Funds' key priorities and risks. In 2019/20, Audit Scotland has also identified the following wider scope risks, which we will consider during our audit as they relate to the Funds:
- Fraud and corruption in respect of the procurement function; and
  - EU withdrawal
60. At this stage of our audit planning, we have identified one significant risk to the wider scope of our audit in relation to financial sustainability (Exhibit 4).
61. We have not, at this stage, identified any significant risks in relation to the other dimensions. Audit planning however is a continuous process and we will report any identified significant risks, as they relate to the four dimensions, in our annual audit report. Exhibit 5 summarises our audit work in respect of each dimension.



## Exhibit 4 – Wider scope significant risk


### Financial sustainability: Market volatility

The Funds held investments of £7.789 billion as at 31 March 2019. Investment strategies are in place for each of the funds which outline the Funds approach to ensure that all members and their dependents receive their benefits when they become payable. The investment strategy was recently updated and approved by the Pensions Committee in December 2019.

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. 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.

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.

While it is noted that the Funds investment strategy is designed in such a way to withstand market volatility in the long term, we have noted that worldwide political events had a significant impact on the market in 2018 and 2019, with this volatility expected to continue in 2020. There is a risk that the value of investments is significantly impacted by events within the wider political environment.

- 
62. We will monitor the Funds approach to monitoring investment performance focusing on the identification of investment risk and the development of mitigating actions.
  63. We will review the Funds investment return performance against benchmark over the short, medium and long term. We will also consider performance against comparators from other Scottish Local Government Pension Funds.



## Exhibit 5 - Our audit approach to the wider scope audit dimensions



### Financial sustainability

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

Consideration	Our audit approach
<p>In 2018/19 we concluded that the Funds have effective arrangements in place to ensure the ongoing sustainability of the pension funds.</p> <p>The Funds produce an annual service plan and budget which focuses on the costs associated with dealings with members and covers a two year period of activity. In addition to this, the Funds prepare a Funding Strategy Statement and receive a triennial actuarial valuation which builds up a picture of the longer term financial pressures.</p> <p>Funding levels across the 2 funds improved following the 2017 actuarial valuation.</p>	<p>As part of our work on financial sustainability work in 2019/20 we will review, conclude and report on:</p> <ul style="list-style-type: none"> <li>• The arrangements in place for medium to long term financial planning, budgetary control and financial reporting;</li> <li>• Affordability for employers including the number of employer cessations and current membership levels of the Funds; and</li> <li>• Any findings from the Scheme Advisory Board’s consultation on the Review of the Structure of the Scottish Local Government Pension Fund.</li> </ul>




### Financial management

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

Consideration	Our audit approach
<p>In 2018/19 we concluded that the Funds have effective arrangements in place for financial management and the use of resources.</p> <p>The key financial indicator across pension funds in Scotland is the return on investments. Lothian Pension fund was above the national average in 2018/19.</p> <p>Both funds have met or exceeded the 5- and 10-year benchmarks however which indicate the investment portfolio is being managed appropriately.</p>	<p>During our 2019/20 audit we will review, conclude and report on the following:</p> <ul style="list-style-type: none"> <li>• Whether the Funds continue to have arrangements in place to ensure systems of internal control are operating effectively;</li> <li>• How the Funds have assured themselves that its financial capacity and skills are appropriate;</li> <li>• The effectiveness of the financial and budgetary control system in communicating accurate and timely performance; and</li> </ul>



Consideration	Our audit approach
<p>The performance of investments is monitored by the Pension Committee, who considers the investments control environment and performance over the annual committee cycle in line with a formal long term agenda plan.</p> <p>The Committee also monitors the budget for income and expenditure incurred when dealing with members. Both funds were in a net withdrawals position as at 31 March 2019. The reliance on investment income is therefore increased in order to meet the long term cash flow needs.</p>	<ul style="list-style-type: none"> <li>• Whether the Fund has established appropriate and effective arrangements for the prevention and detection of fraud and corruption.</li> </ul>



**Governance and transparency**

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

Consideration	Our audit approach
<p>The Pensions Committee, supported by an Audit Sub-Committee, has been delegated responsibility for governance by the City of Edinburgh Council, the administering authority.</p> <p>The Pensions Committee and Pensions Audit Sub-Committee meetings are held in public, papers are available in advance and minutes of the meetings are published on the City of Edinburgh Council’s website.</p>	<p>As part of our work on governance and transparency work in 2019/20 we will review, conclude and report on:</p> <ul style="list-style-type: none"> <li>• Whether the Funds can demonstrate that the governance arrangements in place are appropriate and operating effectively;</li> <li>• Whether induction arrangements for new Board members support effective scrutiny and challenge;</li> <li>• The transparency of decision-making, and on financial and performance reporting; and</li> <li>• The Funds’ preparations for the potential impact of Brexit.</li> </ul>



## Value for money

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

Consideration	Our audit approach
<p>Investments at the Funds are managed through a combination of external fund managers and the Funds' special purpose vehicles, LPFE Ltd and LPFI Ltd. The proportion of funds managed internally has increased over recent years which has resulted in investment management expenses reducing as a proportion of net investment assets.</p> <p>The Funds' performance is reviewed by an external provider on a monthly basis. The external provider compiles information covering monthly, quarterly, yearly and 3 yearly performance measures. This information is presented to the Investment Strategy Panel to allow for scrutiny investment performance of the Funds.</p> <p>The Funds' also focus on administrative performance and have developed a Service Plan covering the period 2018-2020. The Pensions Committee receive updates on the service plan at each meeting.</p> <p>The Funds also works collaboratively with other Local Government Pension Funds. It is hoped that collaborative structures will deliver efficiencies.</p> <p>The Funds make use of a range of service providers including investment managers, an actuary and a custodian.</p> <p>In line with City of Edinburgh Council procedures the Funds maintain a contract register and have considered the position of contracts in year. Where action has been required a tender process has been undertaken.</p>	<p>As part of our 2019/20 audit we will review, conclude and report on the following:</p> <ul style="list-style-type: none"> <li>• How the Funds' demonstrates a focus on improvement in the context of continuing and significant financial challenge;</li> <li>• How the Funds provide a clear link between investment decisions and actual performance achieved;</li> <li>• The effectiveness of working with partners including collaboration with Fife Council Pension Fund and Falkirk Council Pension Fund; and</li> <li>• Review the process for tendering for new providers and consider this against the value for money principles.</li> </ul>



# *6. Audit outputs, timetables and fees*

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## Audit outputs, timetable and fees

This section of our plan provides details of our audit outputs, timetable and proposed audit fees for the audit of the Funds.

Audit output	Format	Description	Target month
External audit plan	Report	This report sets out the scope of our audit for 2019/20.	March 2020
Independent Auditor's Report	Report	This report will contain our opinion on the financial statements, the governance compliance statement, annual governance statement and management commentary.	September 2020
Annual Report to the Funds and the Controller of Audit	Report	At the conclusion of each year's audit we issue an annual report setting out the nature and extent of our audit work for the year and summarise our opinions, conclusions and the significant issues arising from our work. This report pulls together all of our work under the Code of Audit Practice.	September 2020

### Audit outputs

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

	2019/20	2018/19
Auditor remuneration	£40,458	£40,458
Pooled costs	£3,680	£3,570
Audit support costs	£2,280	£2,310
<b>Total expected fee</b>	<b>£46,418</b>	<b>£46,338</b>

### Audit fee

66. Audit Scotland sets an expected fee for each audit carried out under appointment that assumes the body has sound governance arrangements in place, has been operating effectively throughout the year, prepares comprehensive and accurate draft accounts and meets the agreed timetable for audit. The expected fee is reviewed by Audit Scotland each year and adjusted if necessary based on auditors' experience, new requirements, or significant changes to the audited body.
67. As auditors we negotiate a fee with the audited body during the planning process. The fee may be varied above the expected fee level to reflect the circumstances and local risks within the body.
68. For 2019/20 we propose setting the audit fees at 5% above the expected fee level. This reflects the unique nature of the Funds and the level of risk this brings to the audit.
69. The expected fees for the Funds for the 2019/20 audits are as follows:

70. We will take account of the risk exposure of the Funds and the management assurances in place. We assume receipt of the draft working papers at the outset of our on-site final audit visit. If the draft accounts and papers are late, or agreed management assurances are unavailable, we reserve the right to charge an additional fee for additional audit work. An additional fee will be required in relation to any other significant exercises not within our planned audit activity.



## Audit timetable

71. A summary timetable, including audit outputs, is set out as follows:

<b>JAN 20</b>	●	Planning meeting to inform the 2019/20 audit
<b>FEB 20</b>	●	Interim audit visit including a review of key financial systems
<b>MAR 20</b>	●	Presentation of External Audit Plan to the Pensions Committee
<b>JUL 20</b>	●	Annual report and accounts presented for audit and final audit visit begins
<b>SEPT 20</b>	●	Annual audit report presented to the Pensions Committee and submitted to the Controller of Audit





# 7. *Appendices*

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## Appendix 1: Your audit management team

Scott-Moncrieff is one of Scotland's leading firms of auditors and business advisers. We are part of the fast-growing Cogital Group, giving us a both a UK-wide presence and international reach in 190 offices with 6,500 staff. Cogital Group is an innovator, investor and early adopter of technologies that provide continuous improvement to the service we provide our clients.

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

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

### Your audit management team



#### Nick Bennett

##### Audit Partner

[nick.bennett@scott-moncrieff.com](mailto:nick.bennett@scott-moncrieff.com)

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

Nick has responsibility for the delivery of the audit.



#### Gary Steel

##### Assistant Manager

[gary.steel@scott-moncrieff.com](mailto:gary.steel@scott-moncrieff.com)

Gary has over 7 years' external audit experience. He specialises in pension schemes and has significant experience in delivering external audit services to a range of pension schemes across both public and private sectors.

Gary will manage the onsite team and work alongside Nick to deliver the audit engagement.



## Emily Rodgers

### Associate

[emily.rodgers@scott-moncrieff.com](mailto:emily.rodgers@scott-moncrieff.com)

Emily joined the firm in 2017 as a public sector audit trainee and is due to complete her ICAS qualification in August 2020. She has experience delivering external audit services to a range of public sector bodies, including local government.

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



## Appendix 2: Confirmation of independence

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

In particular, FRC's Ethical Standards stipulate that where an auditor undertakes non audit work, appropriate safeguards must be applied to reduce or eliminate any threats to independence.

Scott-Moncrieff provides accounts preparation, corporation tax services and ad hoc VAT advice to LPFE Ltd and LPFI Ltd which are subsidiaries of Lothian Pension Fund. In 2019/20 non-audit fees are estimated to be approximately £9,000.

All tax services are provided by an independent tax partner and staff who have no involvement in the audit of the financial statements. The accounts are prepared from trial balances provided by LPFE Ltd and LPFI Ltd and no significant policies, disclosures, adjustments or estimates are decided by Scott-Moncrieff. In addition to this, Scott-Moncrieff also iXBRL tag the financial statements for submission to HMRC along with the corporation tax return. This tagging exercise is performed by an individual who is not involved in the audit of the financial statements.

We confirm that we comply with FRC's Ethical Standards. In our professional judgement, the audit process is independent and our objectivity has not been compromised in any way. In particular there are and have been no relationships between Scott-Moncrieff, the Funds', those charged with governance and senior management that may reasonably be thought to bear on our objectivity and independence.



## Appendix 3: Statement of understanding

### Introduction

The purpose of this statement of understanding is to clarify the terms of our appointment and the key responsibilities of Lothian Pension Fund and the Scottish Homes Pension Fund (collectively referred to as the “Funds”) and Scott-Moncrieff.

### Annual report and accounts

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

### Scope of audit

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

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

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

### Internal audit

It is the responsibility of the Funds to establish adequate internal audit arrangements. The audit fee is agreed on the basis that an effective internal audit function exists. We will liaise with internal audit to ensure an efficient audit process.

### Fraud and irregularity

In order to discharge our responsibilities regarding fraud and irregularity we require any fraud or irregularity issues to be reported to us as they arise. In particular we require to be notified of all frauds which:

- Involve the misappropriation or theft of assets or cash which are facilitated by weaknesses in internal control
- Are over £5,000

We also require a historic record of instances of fraud or irregularity to be maintained and a summary to be made available to us after each year end.

### Anti-money laundering

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 impose an obligation on the Auditor General to inform the National Crime Agency (NCA) if she knows or suspects that any person has engaged in money laundering or terrorist financing. Audit Scotland has extended this responsibility to the Accounts Commission in respect of local government.

We require the Funds to notify us on a timely basis of any suspected instances of money laundering so that we can inform Audit Scotland who will determine the necessary course of action.

### Ethics

We are bound by the ethical guidelines of our professional body, the Institute of Chartered Accountants in England and Wales.

### Fees

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

### Service

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



may also wish to bring the matter to the attention of the Institute of Chartered Accountants in England and Wales.

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

## **Reports**

During the course of the audit we will produce reports detailing the results and conclusions from our work. Any recommendations arising from our audit work will be included in an action plan. Management are responsible for providing responses, including target dates for implementation and details of the responsible officer.

## **Agreement of terms**

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



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## **Pensions Audit Sub Committee** **2.00pm, Tuesday, 23 June 2020**

### **LPF Unaudited Annual Report (and Financial Statements) 2020**

#### **Item number 5.6**

#### **1. Recommendations**

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The Pensions Audit Sub Committee (Committee) is requested to:

- 1.1 note the unaudited Annual Report (and Financial Statements) for the year ended 31 March 2020 for Lothian Pension Fund and Scottish Homes Pension Fund; and
- 1.2 highlight any points that it would like to raise at the Pensions Committee on 24 June 2020

#### **John Burns**

Chief Finance Officer, Lothian Pension Fund

Contact: Jason Koumides, Senior Finance Officer, Lothian Pension Fund

E-mail: [jason.koumides@edinburgh.gov.uk](mailto:jason.koumides@edinburgh.gov.uk) | Tel: 0131 529 6245

Pamela Bruce, Communications Partner – Members & Employers, Lothian Pension Fund

Email: [pamela.bruce@edinburgh.gov.uk](mailto:pamela.bruce@edinburgh.gov.uk) | Tel: 0131 529 4510

# LPF Unaudited Annual Report (and Financial Statements) 2020

## 2. Executive Summary

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- 2.1 The purpose of this report is to present the unaudited Annual Report (and Financial Statements) for the year ended 31 March 2020 for Lothian Pension Fund and Scottish Homes Pension Fund.
- 2.2 A copy of the unaudited Pension Funds' Annual Report 2020 is attached as Appendix 1.
- 2.3 In the context of sizeable falls in both the global and UK equity markets over the financial year, the Accounts show that the Lothian Pension Fund (Group) net asset valuation has decreased from £7,817m to £7,479m, a reduction of 4.3%. Given its mature membership profile and gilts investment strategy, the Scottish Homes Pension Fund has remained static at £166m.

## 3. Background

---

### Statutory provisions and accounting guidance

#### Local Government (Scotland) Act 1973

- 3.1 Section 95 of the Local Government (Scotland) Act 1973 states that "every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the authority has responsibility for the administration of those affairs". The Head of Finance serves as the Section 95 Officer for all of the City of Edinburgh Council's accounting arrangements, including those of the Pension Funds, however, this Section 95 responsibility has been delegated to the Chief Finance Officer, Lothian Pension Fund.
- 3.2 The Act stipulates that unaudited financial statements must be presented to the Council and the Controller of Audit within three months of the financial year end, that is 30 June. It is within the Pensions Committee's remit to consider the unaudited Annual Report for the pension funds. Reflecting Audit Scotland guidance, the Annual Report should be referred to full Council for the purpose of noting. The next such Council meeting is on 30 June 2020.

#### Financial statements 2019/20 – timetable; emergency dispensation by the Scottish Government

- 3.3 The Scottish Government considers that the provisions made in *The Coronavirus (Scotland) Act 2020* are sufficient to allow each local authority to determine its own revised timetable for Annual Accounts. The Act sets out that a "Scottish public authority must comply with the duty as soon as reasonably practicable". In that

regard Scottish Ministers consider that, at this time, it seems reasonable that a local authority publishes its Annual Accounts no later than 30 November 2020, and we are seeking local authority agreement on that. If the situation changes this date can be revisited as events unfold.

- 3.4 Lothian Pension Fund has not sought to utilise the provisions made in *The Coronavirus (Scotland) Act 2020* to revise the timetable for Annual Accounts.

#### **Accounting and other guidance**

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

“(1) An administering authority must, in relation to each year beginning on 1st April 2015 and each subsequent year, prepare a document (“the pension fund annual report”) which contains –

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

- (h) the current version of the statement referred to in regulation 56 (funding strategy statement);
- (i) the current version of the statement under regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (statement of investment principles);
- (j) the current version of the statement under regulation 59 (statements of policy concerning communications with members and Scheme employers); and
- (k) any other material which the authority considers appropriate “

- 3.6 Local authorities are required to account for pension funds in accordance with the applicable Code of Practice on Local Authority Accounting in the United Kingdom (the Code). The Code is based on approved accounting standards issued by the International Accounting Standards Board and interpretations of the International Financial Reporting Interpretations Committee, except where these are inconsistent with specific statutory requirements. The Code also draws on approved accounting standards issued by the International Public Sector Accounting Standards Board and the UK Financial Reporting Council where these provide additional guidance. The Code now requires that preparers have regard to Chartered Institute of Public Finance and Accountancy (CIPFA) guidance “Accounting for Local Government Pension Scheme Management Costs”.
- 3.7 In March 2016, CIPFA revised and updated this guidance. Whilst the underlying principle of transparency of investment cost remained unchanged, a degree of relaxation to full cost disclosure was introduced. Specifically, for complex “Fund of Fund” structures, “Investment costs incurred by a separate legal entity, or in respect of investment decisions over which the pension fund has no control, should not be included in the (Pension) Fund Account.....If pension funds wish to provide information about the total cost of Fund of Fund investments, this should be included as part of the Investments section in the Annual Report”.
- 3.8 The financial statements of Lothian Pension Fund and Scottish Homes Pension Fund continue to include full transparency of all investment management fees.
- 3.9 With the, FCA regulated, investment services company, LPFI Limited, commencing trading on 28 February 2017, consolidated financial statements have again been prepared for Lothian Pension Fund for the year ended 31 March 2020. These consolidated financial statements combine those of the Fund (the parent entity) and its controlled entities (the investment staffing company, LPFE Limited, and now also LPFI Limited) as defined in International Accounting Standard (IAS) 27.

## 4. Main Report

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### LPF Unaudited Annual Report 2020

- 4.1 A copy of the unaudited Annual Report (and Financial Statements) for the year to 31 March 2020 for Lothian Pension fund and Scottish Homes Pension Fund is attached as Appendix 1.
- 4.2 In considering the unaudited Pensions Funds' Annual Report, Committee should note the following:

#### Financial Summary

- 4.3 In the context of sizeable falls in both the global and UK equity markets over the financial year, the Accounts show that the Lothian Pension Fund (Group) net asset valuation has decreased from £7,817m to £7,479m, a reduction of 4.3%. Given its mature membership profile and gilts investment strategy, the Scottish Homes Pension Fund has remained static at £166m.

#### Contingent liabilities

- 4.4 **Age Discrimination in Public Service Pension Schemes**

On 13 May 2020, the Scottish Public Pensions Agency (SPPA) advised that:

“In December 2018, the Court of Appeal found that the transitional protections introduced to the judicial and firefighters' schemes during the reform of public service pensions in 2015 discriminated on grounds of age. The UK Government sought permission to appeal this decision but this was not granted, and on 15 July 2019 the UK Government issued a written ministerial statement to confirm that as transitional protection was provided in all public service schemes, the ruling had implications for all those schemes, including the Scottish Local Government Pension Scheme (SLGPS). Details of the Court of Appeal ruling, hereafter referred to as *McCloud*, are available..... Whilst initial proposals to address the specific discrimination in the SLGPS have been shared with the scheme advisory board, there remains uncertainty around the timing and changes needed in light of *McCloud*. ”The Fund's IAS26 reporting from its actuary, as disclosed in Note 23, takes into account the appeal decision. There remains significant uncertainty over the remedy to be applied and associated costs to Scottish LGPS funds.

#### Employer Cost Cap considerations

In the same communication of 13 May 2020, SPPA stated:

“The reforms introduced to public service pensions from 1 April 2015 (or a year earlier in the case of the local government scheme in England and Wales) also included a new cost control mechanism, known as the employer cost cap. The purpose of the mechanism was to introduce a way of sharing pension cost increases

and savings between the employer (ultimately often the taxpayer) and scheme members..... The first cost cap valuation for LGPS Scotland was due to take place at 31 March 2017. As you are aware, GAD commenced this process however it has not yet been completed, as the cost cap element of scheme valuations was suspended by the UK Government in early 2019 pending the resolution of McCloud. In a written ministerial statement on 25 March 2020, the Economic Secretary to the Treasury outlined the UK Government's intention to provide an update on the cost cap mechanism alongside proposals to address McCloud. We realise the challenges that actuaries face in considering the uncertainties in *McCloud* and the cost cap, particularly given the tight timescales for completing valuations. We regret that we are currently unable to suggest how provision might be made for any running of the cost cap process but hope to have more clarity in the next two months. We will write to administering authorities to provide an update at the earliest opportunity."

### **Governance**

- 4.5 The Annual Report includes an Annual Governance Statement which sets out details of how the Funds are governed and the internal controls that are in place to manage risk. This mirrors the requirement to have a similar statement within the Financial Statements of the Council.
- 4.6 The Annual Report also encompasses a Governance Compliance Statement, which is a requirement of the LGPS Regulations. Its purpose is to record the extent to which the constitutional governance arrangements comply with best practice guidance issued by the Scottish Public Pensions Agency.
- 4.7 Related to the Annual Governance Statement is the Statement of Responsibilities for the Statement of Accounts. This sets out the respective responsibilities of the Administering Authority and those delegated to the Chief Finance Officer, Lothian Pension Fund.
- 4.8 The funds have separate Actuarial Statements, prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2014. This provides a summary of the triennial valuation as at 31 March 2017, with commentary by the actuary of the experience over the subsequent years.

## **5. Financial impact**

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

## **6. Stakeholder/Regulatory Impact**

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- 6.1 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.
- 6.2 There are no adverse governance, compliance or regulatory implications as a result of this report.

## **7. Background reading/external references**

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- 7.1 None.

## **8. Appendices**

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Appendix 1 - Unaudited Annual Report (and Financial Statements) 2020 for Lothian Pension Fund and Scottish Homes Pension Fund

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

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

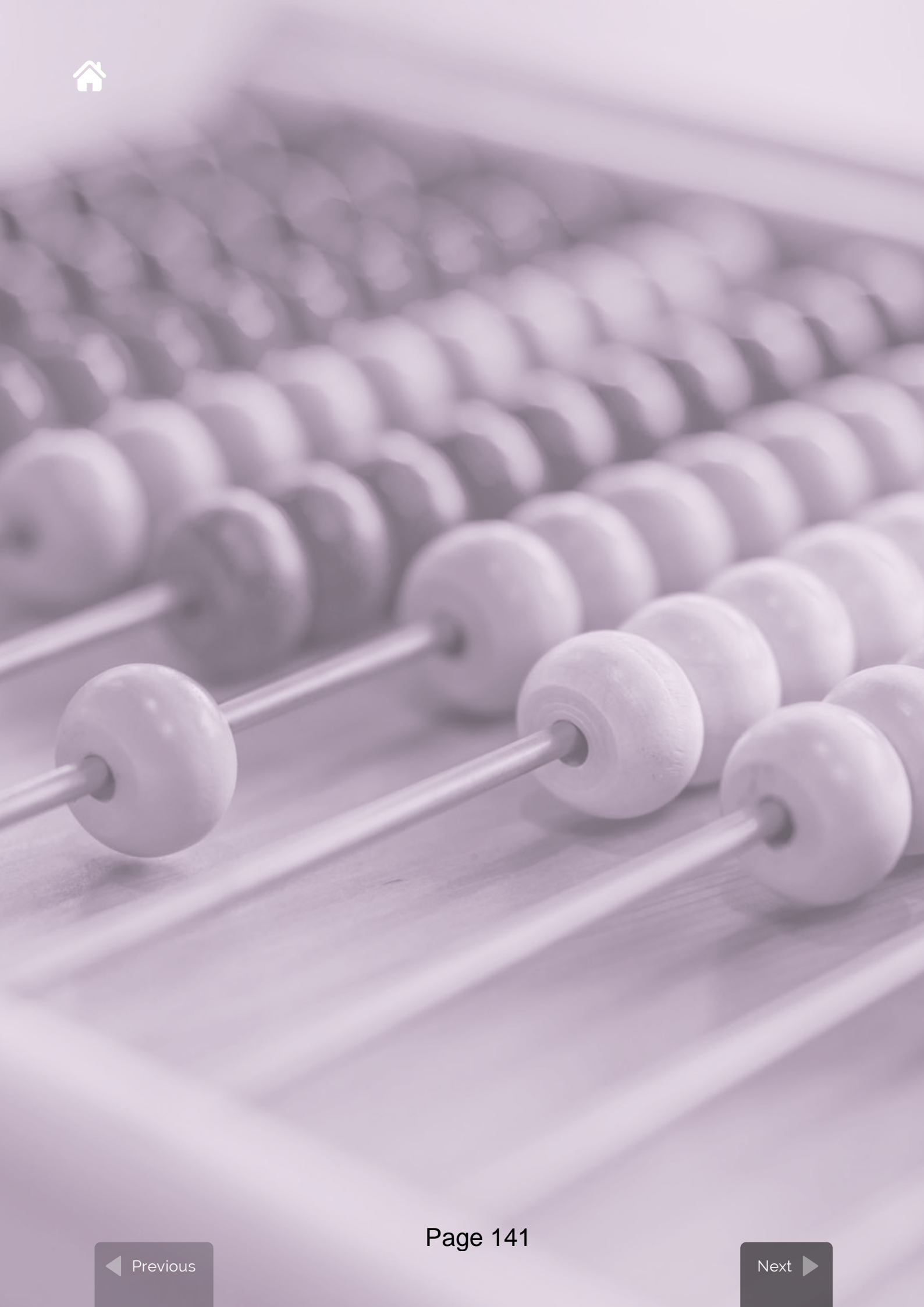


2019/20

UNAUDITED  
**ANNUAL REPORT**  
AND ACCOUNTS

**Lothian Pension Fund &  
Scottish Homes Pension Fund**







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## MANAGEMENT COMMENTARY / FOREWORD

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### Report by the Convener of the Pensions Committee

The end of this financial year has seen the world face an unprecedented situation with the Coronavirus affecting the lives of us all. During this period the team have shown professionalism and diligence to continue service delivery, and efforts continue to ensure this remains the case in the period that will follow. This challenging situation has affected some of the results reported in this publication and we have explained these areas and the effects throughout the report.



Turning to other issues, we still await further information on the Scheme Advisory Board in Scotland consultation on the LGPS structure started in 2018. Matters are progressing and we'll hear more about these in the future I am sure. We also await the specific remedies that follow the outcome of the McCloud case which relates to transitional protections given to scheme members in the judges and firefighters schemes which were found to be unlawful by the Court of Appeal on the grounds of age discrimination. In June 2019, it was announced that the Government had lost a case to appeal against the Court of Appeal ruling and the outcome of the case would apply to all public service schemes. While we wait for these remedies there continues to be an element of uncertainty on the value of liabilities.

At the end of the previous financial year the Fund appointed Doug Heron as Chief Executive Officer. During his first full year Doug and his leadership team have developed compelling plans for the Fund, supported by the Committee, and there are many examples of strategic progress including the implementation of a new front office system, a digital strategy for member service and the formation of a direct property investment team to manage the Fund's property assets internally.

The continued success of the Fund depends on the combined efforts of all and I would like to thank the Committee, Pension Board, employers and all the Fund's employees for their considerable work in delivering the service to members through difficult times.

### **Councillor Alasdair Rankin**

Convener, Pensions Committee



## MANAGEMENT COMMENTARY / FOREWORD

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### Report by the Convener of the Pensions Audit Sub-Committee

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

We met three times during the year with a fourth meeting in March 2020 being cancelled due to the Coronavirus measures put in place at that time. Key activities included considering the Annual Report and Accounts as well as audit reports from both internal and external audit. Risk, compliance, fraud and investment custodian services were also considered.

The Sub-Committee plays a valuable role within the governance of the pension funds by providing additional scrutiny which adds value to members and employers.



### Councillor Cameron Rose

Convener, Audit Sub-Committee

### Report by the Chair of the Pension Board

The Pension Board comprises five representatives from both employers and members. The Board's primary function is to assist the administering authority in ensuring effective and efficient governance and administration of the fund. This includes compliance with the LGPS regulations and any other relevant legislation and requirements imposed by the Pensions Regulator in relation to the scheme.

The Board's deliberations are, of course, augmented by both officers of the Fund (on their specific areas of expertise) and by the Fund's Independent Professional Observer.

The Board usually convenes four times a year, however, due to restrictions of the 'Coronavirus Pandemic' it has only managed to meet three times. Board members have maintained regular communication via email and retained access to relevant information despite restrictions on face-to-face meetings. I'm glad to report that this limitation has not had any major impact on its continuing work over the past year and that meetings will now continue to be held remotely in line with the usual governance arrangements for the Fund.



Members of the Pension Board (and the Pensions Committee) are required by the Regulator to undertake regular training to be able to effectively undertake their



## MANAGEMENT COMMENTARY / FOREWORD

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important role. This necessary training is delivered jointly for both Board and Committee whenever possible. In addition, each member can also attend Conferences and other pension related external training to broaden their pensions knowledge.

Based on the above requirement, I can confirm that this year Board members carried out over 300 hours of training, which highlights their dedication to the delivery of this important role.

Along with its usual primary functions, one of the Board's other key tasks this year has been actively seeking ways of broadening our links with the other Boards within the Scottish LGPS. To facilitate this objective, we invited members from the other Pension Boards to come along both to meet with us, observe our meetings and enable us to share ideas and good practice. This new initiative is ongoing and in the coming year we hope to develop these relationships further.

In addition to this 'outreach initiative', the Board also undertook an internal in-depth review of its present functionality. As a result, the Board was able to update and improve our original processes and procedures to ensure that we continue to effectively fulfil our key role to the Fund and all its members.

My two years as the Chair of the Pension Board have now come to an end and I'd like to thank all my colleagues on the Board (both past and present), the Committee and all the Fund's officers and colleagues for their assistance in enabling me to carry out this important role. It has been in equal measure both a challenge and a privilege.

In accordance with the Board's Constitution, Sharon Dalli (Employer Board Representative) has been elected and now takes over from me as the new Chair of the Board. I'm certain that going forward the Board will be in very capable hands.

**Jim Anderson**

Union representative and Chair of the Pension Board



## MANAGEMENT COMMENTARY / FOREWORD

### Report by the Independent Professional Observer

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



With more than 30 years of pension experience working with pension trustees on topics including investment, actuarial guidance and governance, I hold surgeries and provide quarterly updates to assist the Pensions Committee and Pension Board with their oversight of the pension funds, with funding, investment and collaboration being considered along with normal business of funds. To ensure that I'm available to assist all those involved in the governance of the Fund, I also attend the Pension Board meetings, the joint Investment Strategy Panel once a year and all of the LPF training events.

### Andy McKinnell

Independent Professional Observer

### WHAT OUR MEMBERS SAY:

'I have never received such a fantastic service. The staff were polite helpful and very professional.'





## MANAGEMENT COMMENTARY / FOREWORD

### We're proud to serve our key workers

Our vision and purpose is to deliver a valued retirement savings product for our members. Our 90,000 members all share a single common link: in their working lives, they serve or have served the public and we're incredibly proud of their work and their contribution to communities.



In our active membership we have 122 school crossing guards, 101 occupational therapists, 166 waste operatives and 558 social workers and we're working hard to provide them with a secure retirement. During the year we paid £252.4m in pensions to 31,500 pensioner members, or their dependants. We welcomed 7,489 new members and handled 60,000 enquiries with a 96% member satisfaction score.

During the year I was pleased to spend time in focus groups with our members and heard first-hand how much they value their LGPS benefits, the role we play in their lives and how they wish to see us develop as a fund. I took extensive notes from these sessions and the views shared form the basis of our plans for the years ahead.

### A challenging year

Benefits payable to our members are protected by statute and so remain secure whatever happens in the financial markets. The final months of our financial year saw unprecedented disruption in our lives as a result of COVID-19 and the effect of this disruption weighed on the financial markets too, impacting some of our risk assets. Further detail is included in later sections of this report, but members should be unconcerned by how such investment markets affect their benefits with us. Our funding levels remain strong and our long-term horizon and statutory protections mean benefits are in safe hands.



## MANAGEMENT COMMENTARY / FOREWORD

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Of course the impact was not just felt in the financial markets, but in every aspect of our lives. We're sorry to report that a number of members sadly died from this infection, and we have offered assistance to their family and friends through efficient administration, payment of grants to help with expenses, and in prompt commencement of any benefits payable to dependants. The team have worked from their homes since 17 March and have faced many personal challenges with home-schooling and caring for relatives. I have been deeply humbled by their efforts to serve our members in these difficult times and I thank all 72 of them for their work, their resolve and their fortitude.

At the date of this report we're closely monitoring public health guidelines and the various aspects of the response with a view to ensuring the Fund, its members and our colleagues are protected. As a result, we continue to work from our homes and have adapted many ways of working to ensure we have sufficient resilience to deliver on our critical activities which includes serving our members.

Our employers have also been deeply affected by disruption and many of them face a year of significant financial uncertainty as a result of lost income or unplanned expenses. We're in close dialogue with our employers concerning their membership and obligations to the scheme.



### Significant progress made

Despite the disruptions, 2019 / 20 was a year of significant progress for the team and there were many notable highlights. Within our team, we welcomed Helen Honeyman as Head of People and Communications, and Nicola Barrett and Lisa Pollock as we built a team to manage our directly held property assets internally, resulting in significant cost savings and increasing our level of control on how that strategy is executed. We also extended our investment partnerships with other LGPS funds and broadened the scope of the FCA authorisation for our investment firm, LPFI, establishing the potential for us to move beyond strategic advisory services to investment management.

On technology, we implemented an entirely paperless HR operating system, launched a new suite of websites, implemented member functionality to upload the documents we need, and we delivered an industry-leading investment order management system to streamline how our investment strategies are implemented. There's more to come here but I'm pleased with the momentum in our digital strategy.

Our new publication ENGAGE was launched in early 2020 with a positive reaction from stakeholders. We remain committed to being a responsible investor and we'll report on our key activities in this field in future issues of ENGAGE.





## MANAGEMENT COMMENTARY / FOREWORD

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### Complexity in the LGPS

The Local Government Pension Scheme (LGPS) forms a core part of the employee proposition within the public services managed in local government and members enjoy secure benefits aiding attraction and retention of employees. Over time and with a number of well-intentioned policy interventions, the regulations on which those benefits are based and administered have developed multiple layers, become confusing for most members, and created a need for LPF and other LGPS schemes to offer increasing amounts of individual guidance to members. Our aim here is to make the complex as simple as we can, and to provide clear information from which members can make decisions about how and when to access their benefits according to their own circumstances. A simpler scheme with fewer layers would increase the potential for administrator efficiency, lower the operating costs of the scheme and allow members to more easily understand, and assign value to the benefits to which they're entitled. Setting the rules is beyond our remit but we stand ready to support any Government led initiatives that intend to achieve this outcome.

With McCloud, the Court ruling that age protections are discriminatory, we await an agreed remedy from HM Government, but the likelihood is that most members will reset back to the old rules and have a choice to elect into the new rules if they're beneficial. Such election may not be required when the remedy is finalised, and the member can therefore back a number of horses. This is likely to see us collate additional data on individual circumstances, generate tens of thousands of calculations and supply parallel benefit schedules to members each year. Ready for this we've closely examined our resourcing levels and started the process to train additional administrators, but our sponsoring employers will also feel the effect and we remain exposed to any limitations in their resourcing or systems.

Beyond McCloud, we look back to the driver of the 2015 rule changes and note this was intended to contain the cost of the scheme to employers. Some of the savings are given up with McCloud and so we expect to see either future benefit reduction or additional member contributions towards the cost of their benefits. This may well be another new schedule to complicate things further, although we can be absolutely certain that it won't contain transitional age protections given the discrimination ruling.



## MANAGEMENT COMMENTARY / FOREWORD

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### The LGPS in Scotland

In 2018 the Scheme Advisory Board (SAB) launched a consultation on the future structure for the 11 LGPS Funds in Scotland. The responses can be viewed through the SAB website, with LPF indicating its support for a merger of like-minded funds to achieve a range of benefits. The SAB hasn't yet concluded its work but expects to conclude in the coming financial year. If the conclusion of this consultation is likely to impact our membership or create scope for us to merge with any other funds, we'll report in more detail as developments occur.

### An operating plan for the year ahead

At the beginning of the current financial year (2020/21) we published our Operating Plan which set out the work we'll do under six broad target outcomes. Behind each are specific targets and I look forward to reporting to you on this work when we present our report and accounts next year. The target outcomes are:

- Provide secure and affordable benefits for our members
- Reduce complexity
- Manage our risks
- Create a place where great work happens
- Influence the LGPS of the future
- Be responsible

Finally, we must recognise those in our governance structure, primarily our Board and Committee, for their challenge, scrutiny and counsel during the year. Through these bodies we're able to access deep pools of experience, perspective and ideas and we value all such contributions.



**Dr Stephen S Moir**  
Executive Director  
of Resources  
The City of  
Edinburgh Council  
24 June 2020



**Doug Heron**  
Chief Executive Officer  
Lothian Pension Fund  
24 June 2020



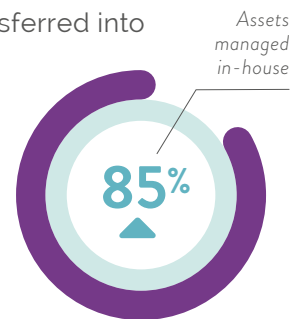
## GOVERNANCE AND RISK

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Lothian Pension Fund (LPF) administers the Local Government Pension Scheme (LGPS) in Edinburgh and the Lothians. We're a multi-employer scheme with over £7.5 billion assets and 98% funded at our last valuation in 2017, managing 87,900 records of 81,500 members and 80 employers. Lothian Pension Fund is the second largest LGPS fund in Scotland.

We also manage the Scottish Homes Pension Fund on behalf of the Scottish Government. This a closed fund and has 1,550 deferred and pensioner members with £0.16 billion investments. Members of Homeless Scotland Action were transferred into this fund recently.

Our investment team is unique in Scotland in holding FCA authorisation. We manage over 85% of assets in-house via internal equity, bond and other real asset portfolios (e.g. infrastructure, property and timberland investments).



We established a regulated investment company providing resourcing, operational support, governance and deal execution for our private markets and gained FCA authorisation in 2015. This enables collaboration with other LGPS funds on investment strategy, private markets, and listed and indirect property investments.

In March 2017, we became the first UK Local Government pension fund awarded accreditation for the Pensions Administration Standards Association and have held the Customer Service Excellence Award for the last 10 years.

The day-to-day running of LPF is carried out by a specialist team who undertake pension administration, accounting and investment functions.

Our comprehensive website provides easy access to all relevant pension information at [www.lpf.org.uk](http://www.lpf.org.uk). This includes the Annual Report and Accounts of the Fund, Statement of Investment Principles, Funding Strategy Statement and Pensions Administration Strategy and Pensions Discretions Policy.



## GOVERNANCE AND RISK

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### The Pensions Committee and Pensions Audit Sub-Committee

All LPF matters are overseen by the Pensions Committee of the Council, supported by the Audit Sub Committee, and its members act in a 'quasi trustees' capacity for the two funds.

The Pensions Committee normally hold four meetings and the Audit Sub Committee hold three meetings per year. However, the meetings to be held in March 2020 were cancelled due to the timing of the coronavirus pandemic. The Committee and Board nevertheless received a full cycle of papers for the March Committee, before certain critical items were approved at the Council's Leadership Advisory Panel under emergency powers. Notwithstanding any continued restrictions arising from the prevailing coronavirus pandemic, LPF's governance structures will now continue to operate as designed, with future meetings of the Committees and Board being held remotely until such time as they can revert to usual arrangements.

The table below shows the Committee members for the year 2019/20:

### COMMITTEE MEMBERS FROM 1 APRIL 2019 - 31 MARCH 2020

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PENSIONS COMMITTEE	PENSIONS AUDIT SUB COMMITTEE
Councillor Alasdair Rankin (Convener)	Councillor Cameron Rose (Convener)
Councillor Maureen Child	Councillor Maureen Child
Councillor Neil Ross	John Anzani (Member representative)
Councillor Steve Burgess (from June 2019)	
Councillor Cameron Rose	
Councillor Claire Miller (to June 2019)	
John Anzani (Member representative)	
Richard Lamont (Employer representative, VisitScotland)	



## GOVERNANCE AND RISK

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### The Pension Board

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

The role of the Pension Board is to help ensure that the operation of the Funds is in accordance with the applicable law and regulations. The Board attend all Pensions Committee meetings and two representatives also attend the Pensions Audit Sub-Committee meetings.

The membership comprises of ten members, five representatives appointed from the employer bodies and five representatives appointed by trade unions for the membership of LPF. The Pension Board membership for 2019/20 is shown in the table below. There were two vacancies as of 31 March 2020.

### MEMBER REPRESENTATIVES

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Jim Anderson	Unison (Chair)
Thomas Carr Pollock	GMB
Brian Robertson	Unite
Thomas Howorth	Unison
Vacancy	
Neil Reid	Unite (appointed 11/11/19 resigned 22/01/20)

### EMPLOYER REPRESENTATIVES

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Sharon Dalli	Police Scotland
Darren May	Scottish Water
Alan Williamson	Edinburgh College
Lesley Henderson	West Lothian Council (appointed 25/06/19)
Vacancy	
Sharon Cowle	Scottish Legal Complaints Commission (resigned 28/10/19)



## GOVERNANCE AND RISK

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The Committee and Board members must attend no less than 21 hours of training per year as outlined in LPF's training policy which is available on our website at [www.lpf.org.uk](http://www.lpf.org.uk).

All new members of the Pensions Committee and Pension Board attend induction training. Other training provided internally covered topics including governance, ESG, responsible investment, contribution stability mechanism and club vita.

Committee and Board representatives also attended external conferences including the LGC Seminar Scotland in October and the PLSA Conference in March.

All members of both the Pension Committee and the Pension Board achieved the required training hours during 2019/20 except for one Pension Committee member and one Pension Board member who joined the LPF governance arrangements later in the year. Pensions Committee members collectively attended 289 hours of training as at 31 March 2020 and members of the Pension Board undertook 318 training hours.

### Joint Investment Strategy Panel

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

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

The JISP advises the three pension fund administering authorities on implementation of their respective investment strategies. The assets of Lothian Pension Fund, Falkirk Council Pension Fund and Fife Council Pension Fund remain separate.

A process is currently ongoing to re-procure the independent advisers on the JISP and, as part of that process, the three funds will look to put in place three independent advisers on the JISP, in addition to advisers from LPF's regulated investment vehicle, LPFI Limited (LPFI).



## GOVERNANCE AND RISK

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### Lothian Pension Fund colleagues

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

LPFI is also wholly owned by the Council (in its capacity as administering authority for the Fund) and is supervised by a board of directors chaired by the Council's Head of Finance. Both the boards of LPFI and LPFE comprise an independent non-executive director (Leslie Robb). A further non-executive director for each of LPFE and LPFI is anticipated to be appointed in the coming financial year.



All the operations, costs and liabilities in relation to LPF, including those of LPFE and LPFI, are borne by LPF.

The day-to-day running of LPF is carried out by a specialist investment and pensions team. Our functions include investment, pension administration, employer liaison, data quality, customer support, accounting, people and communications, ICT oversight and governance, legal, risk and compliance and general business support.

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

### Over the year, the Senior Leadership Team (SLT) of the Lothian Pension Fund as at 31 March 2020 comprised:

- Doug Heron, Chief Executive Officer from February 2019
- Bruce Miller, Chief Investment Officer
- Struan Fairbairn, Chief Risk Officer, (Legal, Risk and Compliance)
- John Burns, Chief Finance Officer
- Mark Walton, Interim Head of People and Communications (until January 2020)
- Helen Honeyman, Head of People and Communications (from January 2020)

### And, senior officers directly involved in the funds oversight structure from the City of Edinburgh Council were:

- Dr Stephen S Moir, Executive Director of Resources (Chair of LPFE board)
- Hugh Dunn, Head of Finance (Chair of LPFI board)
- Katy Miller, Head of Human Resources (Director on LPFE board)



## GOVERNANCE AND RISK

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### Scheme Advisory Board

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

The membership of the Scheme Advisory Board comprises of seven representatives each from member and employers with a Joint Secretary to support each group. During the year, Councillor Rankin was a member and Chair of the Scheme Advisory Board and Fund officers have also advised the Board and Joint Secretaries. There's more information on the Scheme Advisory Board at [www.lgpsab.scot](http://www.lgpsab.scot).

### Risk Management

LPF has comprehensive risk management and assurance procedures in place across its business functions and group entities. These include maintaining a group risk appetite, risk register and assurance mapping process, in conjunction with other underlying business and compliance processes.

Our risk register is formally considered by the Risk Management Group quarterly but is also updated on an ad hoc basis where required. The Risk Management Group itself comprises senior officers of each function within the group, as well as the Senior Leadership Team (SLT).



The approved risk register is tabled and considered by SLT following sign-off to ensure additional oversight and ongoing engagement with any resulting actions. Those actions are tracked and followed up by the Legal, Risk and Compliance team, in conjunction with the wider business, on an ongoing basis. The risk register is also circulated to the conveners of the Pensions Committee and Audit Sub-Committee, Chair of the Pension Board and Independent Professional Observer on a quarterly basis, with summary analysis and reporting provided to those bodies each quarter. In addition, an in-depth risk report is provided to the Audit Sub Committee annually, which includes a review of the full register.





## GOVERNANCE AND RISK

Importantly, LPF's risk appetite and assurance structure are designed to 'flex' to ensure that they continue to be proportionate to the size and nature of our business, and also adhere to the following industry best practice principles:

- Ensure that our risk appetite aligns with our strategy and is set by the senior management team without undue influence
- Integrates risk as a key component of our management and decision-making processes
- Engenders an open, 'live' and engaged risk culture which seeks to pro-actively identify current and future risks for the business, simplifying layers of controls to ensure this is not stifled, and so...
- Not establish or perpetuate systems, controls or processes which are out of line with, or disproportionate to, the group's risk appetite
- Remain aligned to LPF's existing resources and organisational development
- Ensure an effective and independent risk and compliance function is maintained
- Ensure appropriate levels of separation and independence of each of the 'four lines of defence', as a general principle and in line with the standards of the UK regulated financial services sector
- Ensure appropriate levels of co-operation and information sharing across the 'four lines of defence'

As at 17 February 2020, the last meeting of the Risk Management Group in the year, the most significant risks (after taking account of risk reduction controls and as assessed using a score out of 100) are shown in the table below. Please note that these scores don't reflect the considerations of the additional meeting of the Risk Management Group held in April 2020 to consider COVID-19 impacts, which will be reported in next year's annual report.

Description	Impact	Probability	Risk Score
Adverse investment performance leading to pressure on employer contributions	5	4	<b>20</b>
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions	5	5	<b>25</b>
Failure of an employer to pay contributions causes either a significant fall in funding level or requires higher contributions from other employers	4	4	<b>16</b>
Failure of IT leading to poor ICT responsiveness, legal exposure and cost/risk implications	8	5	<b>40</b>
Colleague resource within the fund insufficient to carry out core task in conjunction with active or anticipated projects.	6	5	<b>30</b>



## GOVERNANCE AND RISK

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Separately, we maintain a detailed risk monitoring and assurance process for LPFI. That focuses on the specific risks associated with that entity and its regulated business as part of its Internal Capital Adequacy Assessment Process (ICAAP). The LPFI board has oversight of this process.

### Risk Assurance

LPF operate a bespoke assurance framework designed to ensure we have effective controls and oversight across the 'four lines of defence', being:

1. Business units
2. Control functions and internal oversight bodies
3. Internal audit
4. External audit and other external assurance

We maintain an assurance overview and mapping document which is updated on an ad hoc basis and reviewed annually by our Audit Sub Committee.

All this is designed to ensure that we meet our objectives, are adequately resourced, managed to high professional standards, meet legislative requirements and have high customer satisfaction.





WE'RE PROUD TO SERVE  
**101 OCCUPATIONAL  
THERAPISTS**





## INVESTMENT

### Investment markets

For the 12 months to 31 March 2020, UK equities (FTSE All Share) returned -18.5%, while global equities (MSCI ACWI, in GBP) returned -6.7%. The fall in global equities for sterling-based investors was mitigated by a weaker pound (global equities returned -10% in local currency terms). Sterling had strengthened over 2019 as UK political uncertainty cleared with the election of a majority Conservative government in December 2019. However, it then sold off sharply in March 2020 (along with risk assets) in response to the widening COVID-19 (coronavirus) pandemic. 12-month equity returns were dominated by the outsized moves in the first quarter of 2020 when UK and global equities (in sterling) returned -25.1% and -16.0%, respectively.

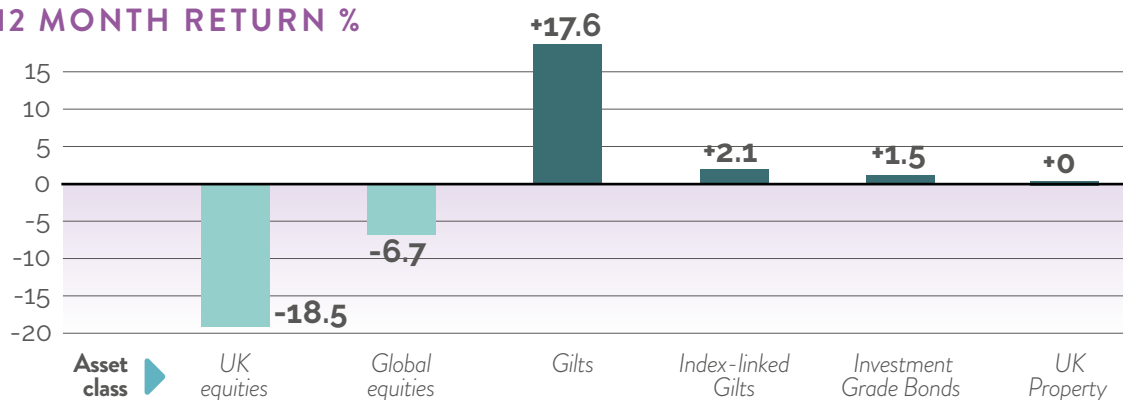


Government bond yields reached record lows in August 2019 as investors sought relative safety in the face of recession fears, in the process pushing the amount of negative yielding sovereign debt to an all-time high. However, the prospect of an initial trade agreement between the US and China buoyed risk assets and bond yields rose during the fourth quarter of 2019. Markets continued to perform strongly into early 2020, seemingly discounting any major economic impact from the January coronavirus outbreak in China. However, as international outbreaks emerged in mid-February, volatility rose.

At the beginning of March, Russia and Saudi Arabia started an oil price war as negotiations on production cuts to offset declining demand broke down. Combined with the increasing spread of the coronavirus pandemic, risk assets sold off sharply through to mid-March as equity market volatility rose to its highest level in the last 30 years. The Bank of England, the US Federal Reserve and other central banks reduced their benchmark interest rates close to zero to support their economies through the ongoing crisis. UK and US government bond yields ended the year to 31 March 2020 near their all-time lows.

The table below shows index returns over 12 months to 31 March 2020 for a range of asset classes.

### 12 MONTH RETURN %



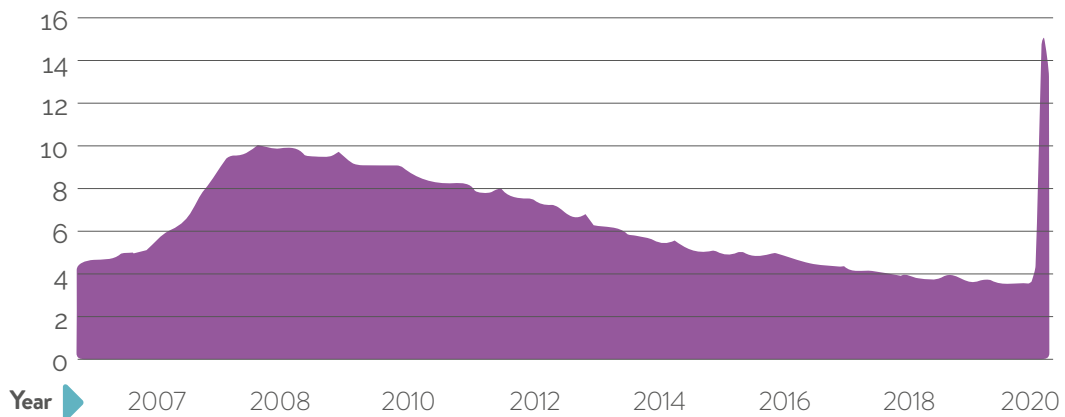
Source: Bloomberg and MSCI



## INVESTMENT

The speed and severity with which lockdowns have impacted economies is illustrated in the chart below, which shows the surge in the unemployment rate in the US from 3.5% in February to 14.7% in April, vastly exceeding the peak of 10% during the global financial crisis.

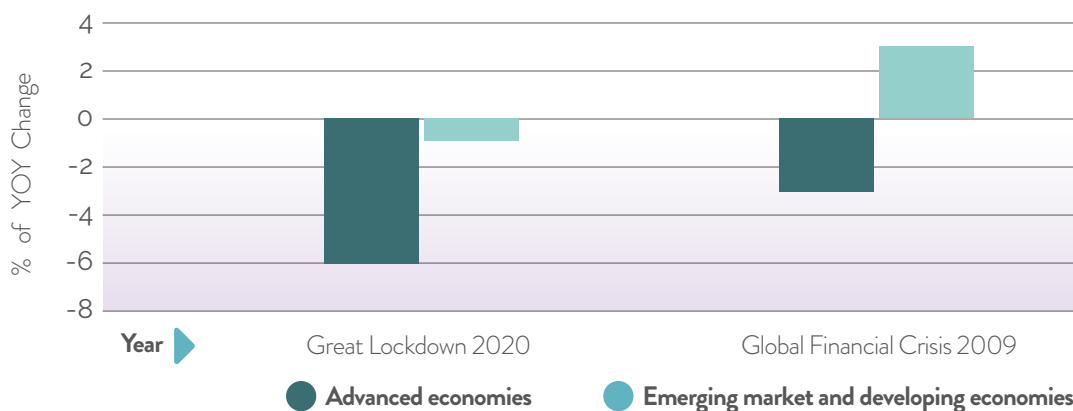
### USA UNEMPLOYMENT RATE (%)



Source: US Bureau of Labor Statistics, Bloomberg

The most recent April 2020 forecasts by the IMF (in the chart below) also indicate that the damage to global growth will be worse than the downturn of 2008/2009.

### REAL GDP GROWTH YEAR-ON-YEAR % CHANGE



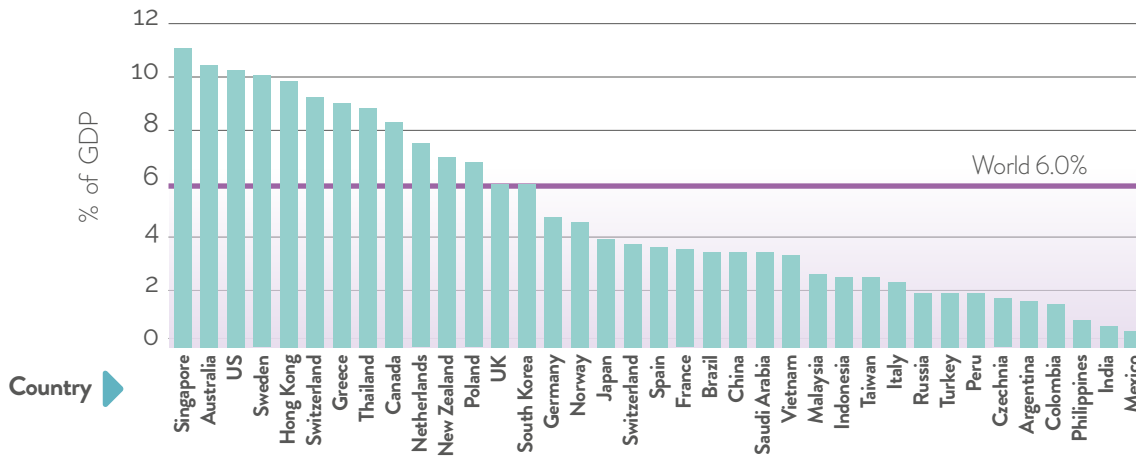
Source: IMF, blogs.imf.org, 14 April 2020



## INVESTMENT

As the coronavirus crisis has unfolded, the scale of monetary and fiscal stimulus and support announced by central banks and governments worldwide has been unprecedented; fiscal stimulus measures alone have been estimated at c6% of global GDP (see chart below). Markets have responded positively with equities bouncing (at end April 2020) almost +30% off their mid-March lows. The market reaction suggests that many believe that the support may be enough to offset the deeply negative economic and business impacts, enabling a quicker return to normalised economic activity than more cautious observers are projecting.

### NEW FISCAL STIMULUS MEASURES TO TACKLE COVID-19 IMPACT



Source: Macrobond, LGIM estimates, 24 April 2020

#### Investment strategies

The investment strategies for LPF reflect our long-term objective of maintaining an acceptable balance between contribution stability and the achievement of positive long-term real returns from the assets owned.

The most recent review of the investment strategies was undertaken in 2018/19, taking into account the results of the 2017 actuarial valuation. Investment strategies are set at the broad asset class level of Equities, Gilts, Non-Gilt Debt, Real Assets and Cash, which are the key determinants of investment risk and return. The strategic allocations for the Fund will be reviewed again following the results of the 2020 actuarial valuation.



## INVESTMENT

### Lothian Pension Fund

To provide suitable investment strategies for the differing employer requirements, the Fund currently operates four investment strategies. The strategies at 31 March 2020 are presented in the table below. The total fund strategy is simply a weighted average of the four individual strategies.

LOTHIAN PENSION FUND 31 March 2020	Main strategy	Mature Employer strategy	50/50 strategy	Buses strategy	Total fund strategy
Equities	65.0%	0.0%	32.5%	35.0%	62.0%
Real Assets	18.0%	0.0%	9.0%	18.0%	17.7%
Non-Gilt Debt	10.0%	0.0%	5.0%	20.0%	10.5%
Gilts	7.0%	100.0%	53.5%	27.0%	9.8%
Cash	0.0%	0.0%	0.0%	0.0%	0.0%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

More than 90% of employer liabilities are funded under the Main Strategy, which adopts a long-term investment strategy aiming to generate relatively high investment returns within reasonable and considered risk parameters and hence reduce the cost to the employer.

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

### COLLEAGUE PROFILE **Albert Chen, Portfolio Manager**

Albert joined LPF in January 2017 as a Portfolio Manager with responsibility for the Fund's investments in credit, private debt and private equity. He also contributes on investment strategy as a member of the Asset Allocation Committee and supports the Fund in its work with collaborative partner funds and on LGPS issues. Albert says:

**"I really enjoy being part of a team focused on generating positive investment outcomes for the Fund, its members and employers. Working with like-minded partners on shared investment challenges is an added bonus."**





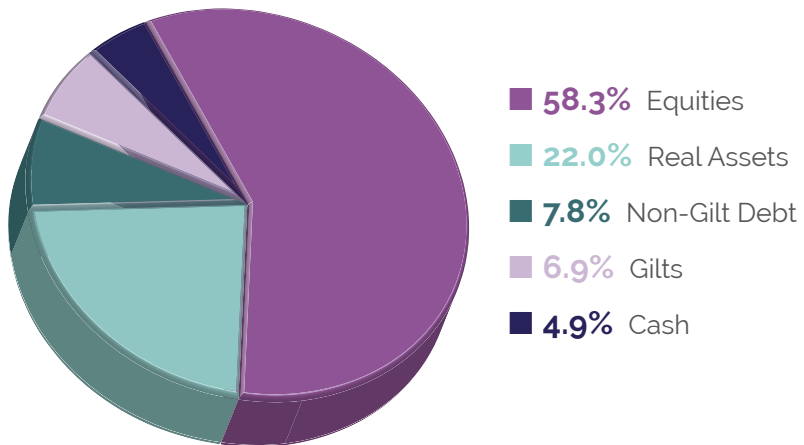
## INVESTMENT

Just over 1% of liabilities are funded by the 50/50 Strategy, which is a combination of the above two strategies. The 50/50 Strategy is for employers who are closed to new members but who don't yet qualify for the Mature Employer Strategy.

Finally, the Lothian Buses employer is funded in the Buses Strategy. The liabilities associated with the Buses Strategy represent approximately 7% of Lothian Pension Fund liabilities.

The total fund strategy in the table above is the long-term target allocation to the five policy groups (or asset classes). The actual allocation at end March 2020 is presented in the pie chart below.

**LOTHIAN  
PENSION FUND  
ACTUAL ASSET  
ALLOCATION  
(%) AT 31/03/2020**



### WHAT OUR MEMBERS SAY:

'I find the Fund staff very easy to talk to and helpful. The human element is very important, so please don't lose it.'





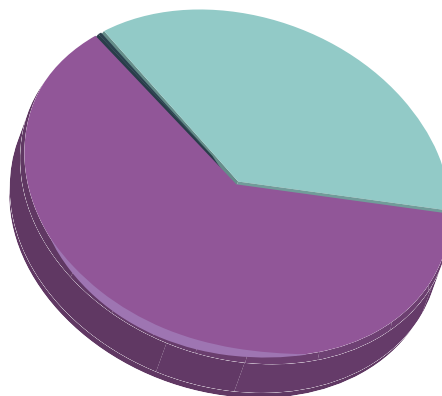
## INVESTMENT

### Scottish Homes Pension Fund

The investment strategy for the Scottish Homes Pension Fund is designed to minimise funding level risk. It's a relatively mature pension fund and is invested entirely in UK government securities (both index-linked and nominal gilts) and cash at 31 March 2020.

The implementation of the strategy reflects the nature of the liabilities, some of which are fixed and some of which are index-linked. The investments match the interest rate and inflation sensitivity of the liabilities as closely as possible. In addition, the cash flow of assets matches with future pension payments up to one year beyond the next actuarial valuation (end March 2020) to minimise transaction costs and funding level risk.

### SCOTTISH HOMES PENSION FUND ACTUAL ASSET ALLOCATION AT 31/03/2020



- 63.6% Index linked gilts
- 35.6% Nominal gilts
- 0.8% Cash

### Internal investment team

Investment strategies for the Fund are implemented and monitored by our experienced internal team of investment professionals supported by external advisers. Over recent years, our internal team has expanded with very positive effects on costs and capabilities.

During 2019/20, our internal team was expanded with the establishment of a team responsible for direct property investments to complement the existing property expert responsible for managing, monitoring and advising on indirect property for LPF and our collaborative partners. The team was also strengthened with the appointment of one senior and one trainee investment analyst. The majority of LPF's listed equity and publicly traded bond assets continue to be managed internally.

The focus on internal investment capabilities reflects the Fund's focus on cost-effective implementation of our investment strategy, but it also strives for improved governance, oversight and greater alignment of interest. One of our guiding principles is to use strong internal investment capabilities to their maximum potential and to retain external managers for specialist mandates.



## RESPONSIBLE INVESTMENT

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### Responsible Investment (RI)

Lothian Pension Fund must deliver positive real returns on its investment portfolio over the long term to pay pensions. In our investing activities, we act in our members' interests by positively contributing to a more sustainable and resilient financial system, supporting sustainable economic growth and a thriving and fairer society.

We've been a signatory of the UN-backed Principles for Responsible Investment (PRI) since 2008 and align our practices and processes to their six principles and definition of Responsible Investment.

Our approach is informed by our investment beliefs, policies and priorities, together with regulations and statutory guidance. The six principles are embedded in our investment processes and everyday activities.

#### PRINCIPLE 1:

We'll incorporate ESG issues into investment analysis and decision-making processes

#### PRINCIPLE 2:

We'll be active owners and incorporate ESG issues into our ownership policies and practices

#### PRINCIPLE 3:

We'll seek appropriate disclosure on ESG issues by the entities in which we invest

#### PRINCIPLE 4:

We'll promote acceptance and implementation of the Principles within the investment industry

#### PRINCIPLE 5:

We'll work together to enhance our effectiveness in implementing the Principles

#### PRINCIPLE 6:

We'll report on our activities and progress towards implementing the Principles



PRI

**‘RESPONSIBLE INVESTMENT IS AN APPROACH TO INVESTING THAT AIMS TO INCORPORATE ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) FACTORS INTO INVESTMENT DECISIONS, TO BETTER MANAGE RISK AND GENERATE SUSTAINABLE, LONG-TERM RETURNS.’**



## RESPONSIBLE INVESTMENT

### PRI Annual Assessment

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

### SUMMARY SCORECARD

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

### Our investment principles

Responsible Investment is a core part of our investment policy and we always operate within the policy, legal and regulatory frameworks that apply to us. We invest on behalf of our members and their dependants and have a fiduciary duty to act in a financially prudent manner and to consider factors of ESG in the context only of the financial risk that arises from the investment.

As an asset owner in the public sector, striving for high standards of transparency within the constraints of commercial sensitivities, we're understandably subject to considerable scrutiny of our investments. Lobby groups often present ethical arguments for divestment of specific investments. They create adverse publicity to further their campaigns, sometimes being selective in their use of facts to raise awareness and to create impact, often with an incomplete understanding of the investments that they oppose.

The issues raised by lobby groups often centre on complex social, legal or moral issues, and while we are unable to divest investments for these reasons, we can use the views of lobby



## RESPONSIBLE INVESTMENT

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groups, where supported by credible evidence, to support our assessment of financial risk. As a Responsible Investor, LPF engages with companies in whom we invest to influence improved ESG outcomes and our belief is that doing so as an active investor is more responsible than divestment.

### 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 full LPF [statement of compliance](#) with the UK Stewardship Code can be viewed on our website.

### Collaboration

There are limits to the influence that we achieve as a single investor and the resources we can reasonably commit. We recognise that progress can be best achieved on ESG issues through collaboration with other investors and organisations. We're an active member and supporter of several Global and Industry ESG Initiatives:

### [Principles for Responsible Investment \(PRI\)](#)

We've been a signatory to the PRI since 2008 and focus heavily on how to implement the six Principles of Responsible Investment into our everyday work to be good stewards of capital. PRI is an important partner, providing excellent guidance on responsible investment and we work closely with them on the future direction of the organisation.

### [Federated Hermes EOS \(EOS\)](#)

We've been clients of Hermes EOS since 2008 and they manage most of our voting and engagement activity. Our Internal Equities team work closely with EOS in our collective approach to engagement, reflecting the areas of stakeholder interest and concern. Through working collaboratively with EOS, and alongside EOS's international client base, we're able to have a stronger voice when engaging with our investee companies.



## RESPONSIBLE INVESTMENT

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### Climate Action 100+ (CA100+)

CA100+ is an international collaborative initiative encompassing investors representing over \$40 trillion in assets. Signatories to Climate Action 100+ are requesting the boards and senior management of companies to:

- Implement a strong governance framework which clearly articulates the board's accountability and oversight of climate change risks and opportunities
- Take action to reduce greenhouse gas emissions across the value chain, consistent with the Paris Agreement's goal of limiting global average temperature increase to well below 2°C above pre-industrial level
- Provide enhanced corporate disclosure in line with the final recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), to enable investors to assess the robustness of companies' business plans against a range of climate scenarios, including well below 2°C, and improve investment decision-making.

### The Transition Pathway Initiative (TPI)

TPI is a global initiative led by asset owners and supported by asset managers. Aimed at investors and free to use, it assesses companies' preparation for the transition to a low-carbon economy, supporting efforts to address climate change. TPI:

- Evaluates and tracks the quality of companies' management of their greenhouse gas emissions and risks and opportunities related to the low-carbon transition
- Evaluates how companies' planned or expected future carbon performance compares to international targets and national pledges made as part of the Paris Agreement
- Publishes the results of this analysis online through a publicly-available tool hosted by its academic partner, the Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science (LSE).

We're a public supporter of TPI and the extremely useful data it produces.

### The Local Authority Pension Fund Forum LAPFF

LAPFF is a collaborative shareholder engagement group, comprising over 80 UK local authority pension funds and six of the LGPS pension fund pools in England & Wales. A member of Lothian Pension Fund's Pensions Committee, John Anzani, is on the executive board of LAPFF and has represented LAPFF and its member funds in high level engagement with company management.



## RESPONSIBLE INVESTMENT

LPF also works closely with other asset owners in several semi-formal working groups including:

- The Cross-Pool RI Working Group: a group comprised of the heads of responsible investment at the English and Welsh local authority pensions pools, alongside representatives of many of the underlying schemes and the Scottish local authority pension funds
- The UK Asset Owners RI Roundtable: a group comprised of several UK asset owners including the local authority pools, many corporate schemes including Railpen, NEST and Unilever, and faith-based funds including the Church Commissioners and the Church of England Pensions Board
- The Scottish Asset Owners RI Roundtable: a new collaborative initiative between Scottish Asset owners. Members include local authority funds, Universities, and corporate defined-benefit and defined-contribution pension schemes.

All these groups aim to share best practice between asset owners with the aim of raising RI standards throughout the industry. We're very active in the initiatives of these groups.

### Engagement

We believe that the best way to alter listed company behaviour for the better is through meaningful structured engagement with the management teams and boards of the companies that we hold.

The Fund commits significant resources to engagement activity, most of which is undertaken by the our voting and engagement service provider and partner, Federated Hermes EOS (EOS).



Federated Hermes EOS brings a focus and expertise to engagement activities, as well as scale, by representing a large number of like-minded clients.

As EOS engages on behalf of a wide shareholder base, they can effectively influence management to enact positive change in investee companies.

EOS consults with its clients to develop an engagement plan so that it can prioritise engagement activity. The latest plan (available on our website [\[insert link\]](#)) highlights 12 main themes for engagement over the three-year period 2019-21.



## RESPONSIBLE INVESTMENT

In the diagram below, the themes surrounding the core subjects of engagement activity are: environmental matters; social issues; and strategy, risk and communication.

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

We stand behind EOS in achieving progress in each of these areas, and our Internal Equities team offers support and ideas to help them to carry out this vital work.

Our Internal Equities team undertakes formal and informal engagements during its many company management meetings each year. The highest profile of these is LPF's participant membership of Climate Action 100+, where the internal portfolio managers represent investors totalling \$40 trillion of assets in engagement with a major European utility company.







## FORTUM

As part of climate action 100+, our internal team at lpf has been engaging with finnish utility company fortum to improve its carbon performance. While fortum is a leader in european renewables, it does have plenty of carbon intensive generation, particularly in its russian business. The company has also recently acquired a controlling stake in uniper, one of europe's largest fossil-fuel based generators. We've had a series of meetings with the cfo, ceo and chair of fortum and have delivered a [statement](#) (p50) at their 2020 virtual agm. There's a lot of work that fortum still needs to do, particularly around its plans for the acquired generation at uniper and forthcoming coal phase-out in europe, but the company is taking many of the right steps – it has been a long-time supporter of carbon pricing in europe, and its top management has entered an open and honest dialogue with the climate action 100+ engagement group.

Recent announcements of a commitment to net zero by 2035 in the uniper european business is a huge change in strategy for the business and we hope this will be followed by significant announcements on net zero and coal phase-out from fortum.



## RESPONSIBLE INVESTMENT

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### Voting

We vote on the resolutions of 100% of the companies in which we're invested. Two of our external providers are charged with voting on the Fund's behalf based on pre-agreed policies. This is done by Baillie Gifford, who manage assets for LPF, and EOS, our voting and engagement partner.

Annual General Meetings (AGM) present asset owners with another opportunity to influence management on important issues. Shareholders can file resolutions which allow all other shareholders to vote on matters that aren't raised by management.



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

### Climate Change

As of February 2020, 196 states and the EU had ratified or acceded to the Paris Agreement of the United Nations Framework Convention on Climate Change, with the only significant emitters still not parties being Iran and Turkey. Under this agreement, each country must determine, plan and regularly report on the contribution it undertakes to mitigate global warming. The three key aims of the agreement are:

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

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



## RESPONSIBLE INVESTMENT



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

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

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

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

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

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



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



## RESPONSIBLE INVESTMENT

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### Climate Change – Governance

In accordance with training policy, the Pensions Committee and Pension Board are required to undertake a minimum of 21 hours training. Each year, the Fund's provider of voting and engagement services is invited to present to and interact with the Committee and Board. During 2019/20, they received training on climate change-related risks and opportunities, and climate-specific reporting, including a carbon footprint of the Fund's equity holdings, which is now updated annually. The Pensions Committee's approach to climate change risks are encapsulated in the recommendations agreed in June 2018:



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

The Committee and Board considers climate related issues as part of its annual review of the Fund's approach to Stewardship. In late 2018, LPF organised an event on our responsible investment approach and activities, to which major stakeholders and elected officials of local authority employers were invited. This provided the opportunity for discussion with investment managers, legal professionals, representatives from PRI and Hermes EOS and Committee and Board members. A recording of the whole event is available on our website, for those who want or need to understand the Fund's approach.

Climate-related risks and opportunities are an integral part of the overall investment process for LPF. The Pensions Committee is responsible for setting investment strategy and delegates investment decision-making to officers and investment managers with advice from the Joint Investment Strategy Panel. Climate-related risk management is reviewed as part of the regular monitoring process for all investment mandates and includes scrutiny of how ESG analysis is integrated into investment decision-making.



## RESPONSIBLE INVESTMENT

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### Climate Change – Strategy and Risk Management

We recognise the outsized impact that some specific sectors and industrial activities have on climate change by virtue of the magnitude of their greenhouse gas emissions. While many prefer to label companies in carbon-intensive industries as 'bad' and those in low-carbon and alternative energy businesses as 'good', history shows that firms need to reinvent themselves to survive. LPF strives to influence and support positive changes by corporate leaders to achieve sustainability for their firms and for society. Consequently, we have a policy of engagement rather than blanket divestment, which allows us to exert influence on companies to improve their business practices, align with the Paris goals, and disclose internal climate-related risk and opportunity management with TCFD compliant reporting.

Academic research commissioned by Lothian Pension Fund suggests that divestment at best is ineffective, and at worst provides a clear disincentive for management to change.

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



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

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

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



## RESPONSIBLE INVESTMENT

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The Fund's investments can be broadly classified as follows: fundamentally managed equity; quantitatively managed equity; passively managed government debt; directly owned commercial property and externally managed funds (covering all asset classes). As part of the stock selection process for the fundamentally managed portfolios, any fundamentally material climate-related risks and opportunities (such as carbon pricing and the low carbon transition) are individually assessed and monitored by the managers. The quantitative portfolios are monitored for material risks arising from ESG issues on a regular basis. Both the fundamental and quantitatively managed equity funds utilise engagement with managers to improve practices. The selection and monitoring process for external managers incorporates ESG assessments, which continue to be refined as the industry evolves. Our internal managers continue to monitor opportunities in the green energy and future technology space, both in the public and private markets. Much of the public spending on green energy is undertaken by the incumbent energy providers (the diversification of carbon-extractive companies and carbon burning utilities).



With a research budget specifically allocated to data services targeting ESG and climate-related risks and opportunities, we produce an annual carbon footprint for listed equities. This measures the weighted average carbon intensity of the portfolio as a whole. More importantly, it allows us to identify important factors, such as high carbon emissions, to guide our company engagements and forward-looking analysis of the risks to the Fund's invested capital from the low carbon transition. To date, no divestments due to outsized climate-related risks have been made,

but there has been meaningful engagement activity as highlighted above.

While it's widely acknowledged that Climate Change is one of the great issues facing society, it's one of several risks that the Fund must mitigate. In that sense, it's no different to any other risk. We believe in a holistic, integrated approach to analysis taking all risks, including climate-related risk, into consideration.

### Climate Change – Monitoring and Metrics

The Pensions Committee and Pension Board review ESG (including climate related) issues at least annually as part of oversight of the stewardship of Fund assets. Officers and the Joint Investment Strategy Panel of advisers monitor investment mandates and individual investments at least quarterly.

In-line with TCFD best practice, we report a measure of carbon efficiency (the weighted average carbon intensity, with units of tons CO<sub>2</sub>/\$M sales). We use a carbon efficiency



## RESPONSIBLE INVESTMENT

measure as it allows us to look on a granular basis at how well a company is managing its emissions, rather than simply what its absolute emissions are. By looking at companies with similar activities, it's possible to use this metric to separate those companies with good practices from those with bad practices. We weight these intensities according to the portfolio position sizes and add all the weighted intensities to give a figure for the portfolio and the index.

	2018 Weighted Average Carbon Intensity (tons CO2/\$M sales)	2019 Weighted Average Carbon Intensity (tons CO2/\$M sales)	Year on year change	2020 Weighted Average Carbon Intensity (tons CO2/\$M sales)	Year on year change
LPF All Equities	328.6	325.2	-1.0%	294.9	-9.3%
MSCI ACWI	218.9	200.2	-8.5%	178.1	-11.1%

Source: MSCI

These numbers are presented on the basis of Scope 1 and 2 carbon emissions.

As data from the Transition Pathway Initiative (TPI) and Carbon Action 100+ are developing and improving, it has become increasingly incorporated into the equity management process. The TPI data showing Paris Alignment is an important indicator for risk management purposes.

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

Carbon intensity numbers are currently treated as outputs of the investment process rather than targeted inputs into the investment process. This is because these numbers are fundamentally easy to "game". We firmly believe that global decarbonisation will provide benefits to society and the environment, and we therefore support efforts to reduce carbon emissions.

The carbon intensity numbers as reported could easily be brought down by selling the most carbon intensive stocks and replacing those investments with lower emission stocks. While this might be considered "good" optically, companies will continue to emit carbon in the same manner whether LPF sells or retains the shares.

Our involvement in Climate Action 100+ reinforces our belief that engaging with companies to help them pivot their businesses towards a lower carbon future is a far more responsible approach than being an irresponsible divestor. We'll continue to engage with our holdings rather than setting specific carbon intensity targets for our overall portfolio.

There is no reduction in global carbon output if LPF sells carbon intensive businesses.





## RESPONSIBLE INVESTMENT

### Infrastructure Investment

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

Over the last 15 years, LPF has developed our reputation, networking and execution capabilities to secure access to investment opportunities within this market niche. The Fund's experienced team appraises and invests in primary and secondary funds as well as co-investments, to achieve our target allocation in a cost-effective manner. An important element of the implementation strategy is to work closely with investment managers to ensure execution certainty and to diligence the commercial and legal terms. Collectively, with our collaboration partners, LPF committed over £300 million in infrastructure investment during 2019/20.

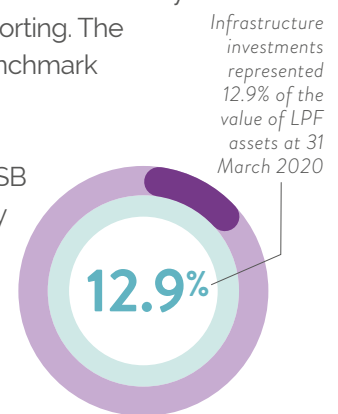
LPF has a long-standing commitment to responsible investment. In addition to becoming a signatory of the PRI (Principles of Responsible Investment) in 2008, we have subscribed to GRESB (Global Real Estate Sustainability Benchmark) to further enhance our analysis of environmental, social and governance (ESG) issues.

At 31 March 2020, 89% of the Infrastructure portfolio value was invested in assets/funds which were also signatories of the PRI and 32% of funds participated in the 2019 GRESB Infrastructure Assessment, a relatively new initiative. Most of Lothian Pension Fund's infrastructure funds also publish an internal ESG policy, outlining the consideration given to ESG issues within the decision-making and ongoing investment monitoring process, and this has become a standard requirement/consideration for manager selection.

Within the GRESB Infrastructure Assessments, participating funds and assets report annually to GRESB on their internal controls and policies. GRESB validates the submitted data and assesses the fund or asset with reference to a series of performance indicators, including the sustainability of its investment strategy, stakeholder relations and level of gender/diversity reporting. The aggregate scores determine a total fund or asset score which can be used to benchmark performance against its peer group.

Funds and assets across all infrastructure sub-sectors can participate in the GRESB Infrastructure assessments, but Transport and Renewable Power assets currently have the greatest participation rate within Lothian Pension Fund's portfolio.

Infrastructure investments represented 12.9% of the value of Lothian Pension Fund assets at 31 March 2020, comprising one of the largest and most diversified allocations among UK LGPS funds. Of the total infrastructure investment of £962 million (31 March 2019: £870 million), the majority is invested in the UK.





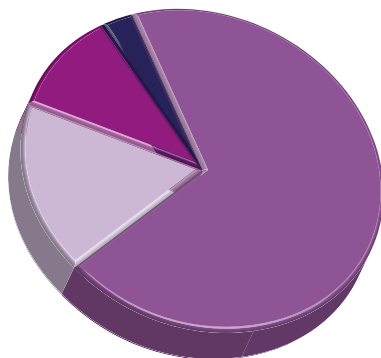


## RESPONSIBLE INVESTMENT

During 2019/20, Lothian Pension Fund completed investments in eight secondary fund interests and made three co-investments. Approximately £165 million has been invested over the year in UK, European and Global infrastructure assets. During the same period, £187 million has been distributed/returned to the Fund. Of note, there were two successful realisations generating proceeds of £80 million and recording a net internal rate of return over 20% and a total value to paid-in multiple of 2x. A sale of another of the larger assets was agreed, which crystallises proceeds of approximately £39 million in April 2020.

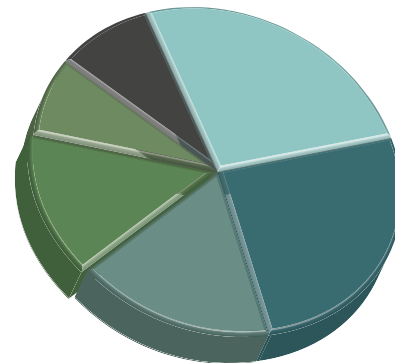
The geographic and sector diversification for Lothian Pension Fund infrastructure (as percentage of infrastructure asset value of £962m at 31 March 2020) is shown in the charts below.

### GEOGRAPHIC DIVERSIFICATION



- **69%** UK
- **17%** Europe ex UK
- **11%** North America
- **3%** Rest of the world

### SECTOR DIVERSIFICATION



- **26%** Utilities
- **26%** Social Infra.
- **17%** Renewables
- **14%** Transportation
- **9%** Telecom & Others
- **8%** Energy & Power

Infrastructure investments in the UK contributed 69% (or £661 million) of the total. The Fund's 20 largest UK investments, representing £407 million of value, are shown in the map below.

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

- Utilities (including regulated water, gas and electricity)
- Social infrastructure (including hospitals, schools and roads)
- Renewables, Energy and Power (including wind farms, biomass and natural gas pipelines)
- Transportation (including ports and rail); and
- Telecom and Others (including telecom towers and car parks).



## RESPONSIBLE INVESTMENT

We recognise the role infrastructure investment can make to address part of the current environmental challenges related to climate change. Approximately, 17% of the infrastructure portfolio is invested in renewable energy.

During the year, the Fund allocated c. £32 million to new investments in UK renewable energy projects and new opportunities continue to be appraised.

Since March 2020, the impact of COVID-19 on the Lothian Pension Fund infrastructure portfolio has been closely monitored. The portfolio sector bias towards regulated utilities, social infrastructure and renewable energy, includes essential critical assets which benefit from contracted or regulated income streams, and is expected to largely insulate the portfolio from material adverse financial impacts derived from COVID-19.



### WHAT OUR MEMBERS SAY:

'The service provided has been excellent in every way. Thank you.'



## FUNDING STRATEGY STATEMENT

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

The purpose of the Funding Strategy Statement is to:

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



These objectives are desirable individually but may be mutually conflicting.

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

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





## FUNDING STRATEGY STATEMENT

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The Funding Strategy Statement was revised at the 2017 Actuarial Valuation and reflects CIPFA guidance: "Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme 2016".

In addition, updates required as a result of changes to the Scheme Regulations and other pensions legislation included:

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

As required by Scheme Regulations, the Fund consulted with employers as part of the review process. Further amendments were made in 2019 to incorporate changes to Scheme Regulations in 2018 and an update to the Fund's bulk transfer policy. The Funding Strategy Statement will be revised again as part of the 2020 valuation, with a further consultation exercise carried out as part of this process.

The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy), or asset returns (derived from the investment strategy). A formal review of the Fund's investment strategies is undertaken at least every three years to ensure appropriate alignment with liabilities. Further information on the investment strategies can be found in the Fund's Statement of Investment Principles also available at [www.lpf.org.uk](http://www.lpf.org.uk).

The next triennial valuation for both Funds will be undertaken as at 31 March 2020. Member data will be supplied to the Actuary during Summer 2020, with results reported later in the financial year 2020/21.

### COLLEAGUE PROFILE **Katy Bush, Trainee Solicitor**

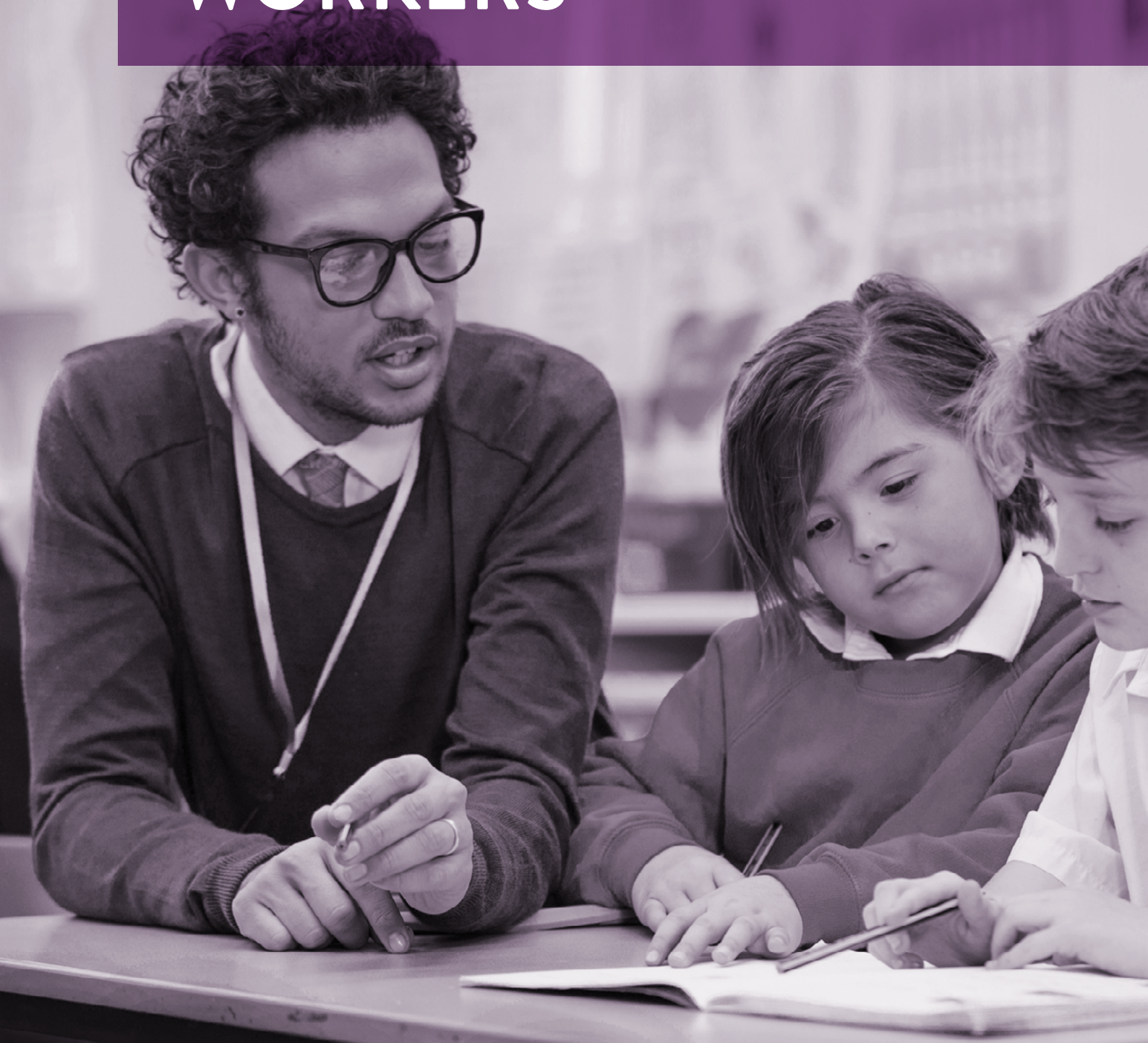
Katy initially joined LPF as a Trainee Solicitor on a six-month secondment from City of Edinburgh Council in March 2019. She returned on a permanent basis in March 2020 and starts as Legal Counsel in September 2020 when she qualifies. She says:

**"My role is extremely varied but primarily I provide legal support to the Investment and Employer teams. There are lots of reasons I enjoy working at LPF – the work is really varied and interesting, the environment is friendly and inclusive, and I've always been motivated to use my legal skills to provide a public benefit."**





WE'RE PROUD TO SERVE  
**932 PUPIL SUPPORT  
WORKERS**





## FINANCIAL PERFORMANCE

### Administration expenses

A summary of the Fund's administrative expenditure for 2019/20, against the budget approved by the Pensions Committee, is shown in the table below.

The budget focuses on controllable expenditures, so excludes all benefit payments and transfers of pensions from the Fund. Similarly, income doesn't include contributions receivable and pension transfers to the Fund. The total net cost outturn of £31,812k against the budget of £32,951k represented an underspending of £1,139k (3.5%) for the Fund.

The most significant budget variances serving to generate this underspending were:

- **Employees – £537k underspending.** Following an organisational design review earlier in the year, recruitment delays led to an underspending. Most of these vacant posts have now been filled.
- **Supplies and Services – £526k underspending.** Budgetary provision for the investment front-office trading system, specifically property management functionality and additional user licences, didn't need to be fully utilised.
- **Other third-party payments – £147k underspending.** The provision for co-investment broken deal costs did not require to be called upon.
- **Support Costs – £285k underspending.** Contingency provision had been made in respect of full procurement of enhanced ICT provision. Formal procurement was initiated later than originally anticipated and therefore outlays were deferred. Appointment of an ICT provider is expected later in the financial year 2020/21.
- **Income – £322k under-recovery.** Budgeted income included anticipated receipts from collaborative partners for asset management services, following requisite FCA approval. This has been delayed until the 2020/21 financial year.

	Approved budget	Actual outturn	Variance
	£000	£000	£000
Employees	5,354	4,817	(537)
Transport and premises	255	289	(5)
Supplies and services	2,128	1,602	(526)
Investment managers fees*	24,900	24,932	32
Other third-party payments	1,439	1,292	(147)
Capital funding - depreciation	147	154	7
<b>Direct Expenditure</b>	<b>34,223</b>	<b>33,047</b>	<b>(1,176)</b>
Support costs	643	358	(285)
Income	(1,915)	(1,593)	322
<b>Total net controllable cost to LPF</b>	<b>32,951</b>	<b>31,812</b>	<b>(1,139)</b>

\*Does not include performance element. In 2019/20, £2.9m was paid in fees in relation to the Fund's private market investments.



## FINANCIAL PERFORMANCE

Reconciliation to total costs	Actual outturn
£000	
Actual outturn on budgeted items above	31,812
Add: Securities lending revenue included in income above	577
Investment management fees deducted from capital – performance related element	2,933
IAS19 LPFE retirement benefits	(77)
LPFE deferred tax on retirement benefits	(31)
Corporation tax	(9)
<b>Total cost to LPF (inclusive of full cost investment management fees)</b>	<b>35,205</b>
Per fund accounts	
Lothian Pension Fund Group	35,126
Scottish Homes Pension Fund	79
<b>Total</b>	<b>35,205</b>

### Cash-flow

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

The tables below show the projected cash flow, as reported to Pensions Committee on 25 March 2020, against the actual movement for the year. It's important to distinguish between the basis of preparation for these, with the projected figures prepared on a cash basis, i.e. from when cash is received by the Fund, compared to the accruals basis of the Financial Statements to reflect accounting standards.



## FINANCIAL PERFORMANCE

### LOTHIAN PENSION FUND

	2019/20 Projected	2019/20 Accruals basis	2019/20 Cash Basis
<b>Income</b>	£'000	£'000	£'000
Contributions from Employers	194,000	184,818	189,125
Contributions from Employees	50,000	49,508	50,705
Transfers from Other Schemes	5,000	6,036	6,036
	<b>249,000</b>	<b>240,362</b>	<b>245,866</b>
<b>Expenditure</b>			
Pension Payments	(180,000)	(179,229)	(179,229)
Lump Sum Retirement Payments	(70,500)	(65,809)	(68,077)
Refunds to Members Leaving Service	(750)	(723)	(723)
Transfers to Other Schemes	(36,000)	(30,660)	(30,660)
Administrative expenses	(2,500)	(2,521)	(2,521)
	<b>(289,750)</b>	<b>(278,942)</b>	<b>(281,210)</b>
<b>Net Additions/(Deductions)  From Dealings with Members</b>	<b>(40,750)</b>	<b>(38,580)</b>	<b>(35,344)</b>

*\*Does not include performance element. In 2019/20, £3.1m was paid in fees in relation to the Fund's private market investments.*

LPF continued to experience a net reduction in value from our dealings with our members. This reduction increased by £24.1million in the year with outlays exceeding receipts by £38.6 million compared to £14.5million at 31 March 2019. It is worth highlighting that a majority of this increase was driven by the one off event of a bulk transfer of an employer, Barony Housing Association, to another scheme which accounted for £20.5million of the rise in outlays.





## FINANCIAL PERFORMANCE

### SCOTTISH HOMES PENSION FUND

	2019/20 Projected	2019/20 Accruals basis	2019/20 Cash Basis
	£'000	£'000	£'000
<b>Income</b>			
Administration charge	80	70	70
<b>Expenditure</b>			
Pension Payments	(6,545)	(6,653)	(6,653)
Lump Sum Retirement Payments	(655)	(625)	(666)
Transfers to Other Schemes	(100)	-	-
Administrative expenses	(80)	(45)	(45)
	<b>(7,380)</b>	<b>(7,323)</b>	<b>(7,364)</b>
<b>Net Additions/(Deductions) From Dealings with Members</b>	<b>(7,300)</b>	<b>(7,253)</b>	<b>(7,294)</b>

Scottish Homes Pension Fund is a mature fund with no active members. As a result, pension outlays are met from investment income, supplemented by asset sales. Net pension outlays were £7.3million representing a £1.7million change in position from 31 March 2019 (net withdrawals of £5.6million). 2018/19 figures do include the transfer of Homeless Action Scotland from Lothian Pension Fund to Scottish Homes which accounts for the £1.7m difference. Future cash flows are expected to be broadly consistent with 2019/20 figure going forward.

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



## FINANCIAL PERFORMANCE

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### 2017 Actuarial Valuations

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

For Lothian Pension Fund, the funding level increased from 91% at 31 March 2014 to 98% at this valuation. The deficit decreased from £417million at 31 March 2014 to £145million at 31 March 2017. Reflecting the differences in the employers in the Fund, a third investment strategy was introduced for employers which are closed to new entrants, but not close to exiting the Fund.

Lothian Pension Fund also introduced a requirement for employers to provide written confirmation that minimum contribution rates set by the Actuary are affordable as it's not in the best interests of the individual employers or the fund for employers to continue to accrue unaffordable pension liabilities. The fund continues to work with employers to put in place funding agreements to address repayment of debt when an employer leaves, to avoid employer default or insolvency.

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

The next triennial valuation for both Funds will be undertaken as at 31 March 2020. Member data will be supplied to the Actuary during Summer 2020, with results reported later in the financial year 2020/21.





## FINANCIAL PERFORMANCE

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### Investment management cost transparency

Local authorities are required to account for pension funds in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). The Code is based on approved accounting standards issued by the International Accounting Standards Board and interpretations of the International Financial Reporting Interpretations Committee, except where these are inconsistent with specific statutory requirements.



The Code also draws on approved accounting standards issued by the International Public Sector Accounting Standards Board and the UK Financial Reporting Council, where these provide additional guidance. Guidance is still awaited from CIPFA as to how these costs should be standardised and reported in the Annual Reports of LGPS Funds.

The Chartered Institute of Public Finance and Accountancy (CIPFA) published this guidance in July 2014, which promoted greater transparency of investment management fees. These principles were adopted as best practice in the presentation of the Lothian Pension Fund audited Annual Report 2015. In June 2016, CIPFA revised its guidance including the following: "Investment costs incurred by a separate legal entity, or in respect of investment decisions over which the pension fund has no control, should not be included in the Fund Account."

The revised guidance changed the disclosure of fees for fund of funds investment arrangements. A 'fund of funds' is an investment holding a portfolio of other investment funds rather than investing directly in funds. Typically, fees are payable to the 'fund of funds' manager as well as to the managers of the underlying funds. Generally, under the revised guidance from CIPFA, the second and third layer of fees would not be disclosed with just the fees from the 'fund of funds' manager stated.

In the preparation of the Fund's Annual Report for 2014/15 and 2015/16, the Fund made efforts to be completely transparent on the totality of costs incurred for managing its investment assets. The Fund's disclosures included all layers of fees. At its meeting on 28 September 2016, the Pensions Committee instructed the Committee Clerk to communicate



## FINANCIAL PERFORMANCE

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to CIPFA, Audit Scotland and the Scottish Local Government Pension Scheme Advisory Board (SLGPSAB), the Committee's and Convener's disquiet with the relaxation of the principle of full cost transparency of investment management fees, as explicit in CIPFA's revised guidance "Accounting for Local Government Pension Scheme Management Costs".

In May 2018, CIPFA published: "Proposals for LGPS Fund Reporting in a 'Pooled World.'" This sets out proposals for revised reporting for LGPS pension funds to meet several objectives, including:

- To further enhance reporting of costs reflecting the introduction of the LGPS SAB Code of Transparency for asset managers
- Initiatives underway by the Financial Conduct Authority (FCA) and Department for Work and Pensions (DWP) which aim to create more transparent and granular reporting standards for both providers and trustees

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

The Pensions and Lifetime Saving Association (PLSA) has also issued cost data templates to support its Cost Transparency Initiative. The aim of this initiative is to provide a standardised way for asset managers to report costs and charges to investors. Such further cost disclosure will be included within the notes to the financial statements.

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



## FINANCIAL PERFORMANCE

	Lothian Pension Fund		Scottish Homes Pension Fund	
	2018/19	2019/20	2018/19	2019/20
	£000	£000	£000	£000
Investment management expenses in compliance with CIPFA guidance	31,041	31,704	84	104
Investment management expenses per financial statements	36,102	32,659	84	104
Disclosure in excess of CIPFA guidance	5,061	955	0	0

Utilising its internal investment management expertise, the investment strategy of Lothian Pension Fund has evolved to move away from complicated and expensive investment vehicle structures, such as fund of funds, to increased direct investment, e.g. in infrastructure. This significantly reduces the layers of management fees incurred.

The Fund is now at the realisation stage of its fund of fund investments, with its holdings in listed private equity and infrastructure funds being reduced and those receipts serving to fund additional direct investments. This is the reason for the much lower disclosure in excess of CIPFA guidance in 2019/2020 (£955K), compared to the previous year (£5,061K). This trend is expected to continue for Lothian Pension Fund. Crucially, however, the disclosure of the full costs of investment management remains fundamental to effective comparison between LGPS funds, particularly given the common use of fund of fund investment vehicles.



## FINANCIAL PERFORMANCE

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### Investment cost benchmarking

Investment strategy focuses on risk adjusted returns, net of costs. The Fund has participated in investment cost benchmarking provided by CEM, an independent benchmarking expert for global pension funds with a database of 332 pension funds representing £7.2 trillion in assets. To provide a fair comparison, CEM calculates a benchmark based on fund size and asset mix, which are key drivers of investment costs.

The latest analysis available (for the year to 31 March 2019) showed that LPF's investment costs of 0.39% of Fund assets were significantly lower than CEM's benchmark cost of 0.49%, an equivalent annual saving of approximately £7.0m. This saving largely reflects the fact that the Fund manages a relatively high percentage of assets internally compared with other similar pension funds and that it has low exposure to fund-of-fund investment vehicles.

### WHAT OUR MEMBERS SAY:

'I feel very privileged and fortunate to be a member.'





## PERFORMANCE AND ADMINISTRATION

### Key Performance Indicators 2019/20

Our strong commitment to customer service drives continuous service development, ensuring the best possible service, whilst recognising potential demands of the future. We set challenging performance targets and measure these through both key indicators which are reported to our Pensions Committee and Pension Board, and internal indicators, which are reported to internal management. This year we've focused on improving the services we provide digitally to enable members quick and easy access to their personal information.

The table shows our performance against these targets.

2018/2019		Target	2019/2020
Retained	Maintain Customer Service Excellence Standard (CSE) (Annual assessment)	Retain	*outcome pending
Met	Audit of Annual Report and Accounts 2019/20	Unqualified opinion	Met
100%	Proportion of members receiving a benefit statement by August	100%	100%
92.7%	Overall satisfaction of employers, active members and pensioners measured by surveys	92%	96.0%
99.7%	Percentage by value of pension contributions received within 19 days of end of month to which they relate	99%	99.5%
Met	Investment performance and Risk of Lothian Pension Fund over a rolling five-year period	Meet benchmark	Not met
Met	Monthly pension payroll paid on time	Met	Met
3.9%	Level of sickness absence	4.0%	2.85%
100%	All colleagues complete at least two days training per year	Yes	100%
69%	Colleague engagement index	Greater than 70%	69%

\* Due to the Coronavirus outbreak the assessment to be held in March 2020 was postponed and will take place as soon as circumstances allow.



# STOP



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# 122 SCHOOL CROSSING GUIDES







## PERFORMANCE AND ADMINISTRATION

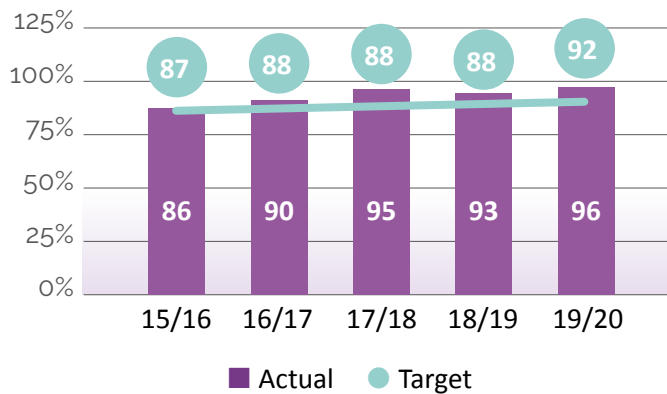
### Value for Money

Value for Money is the term used to assess whether an organisation has obtained the maximum benefit from the services it acquires or provides, within the resources available to it. It has three components to take account of: economy, efficiency and effectiveness.

For several years, LPF has participated in benchmarking provided by the Chartered Institute of Public Finance and Accountancy (CIPFA). The purpose of this is to help identify the areas where we can make improvements to deliver better value for money. The benchmarking facilitates:

- Comparison between costs and performance
- The provision of evidence to support decisions on budget relating to the sustainability and capability of the investment and administrative teams to enhance customer satisfaction
- Sharing of information and ideas with peers
- A review of performance trends over time.

### OVERALL SATISFACTION





## PERFORMANCE AND ADMINISTRATION

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The outputs and analyses have served to supplement internal performance management information. However, the Chartered Institute of Public Finance and Accountancy (CIPFA) has stated that, to protect its commercial interests, its benchmarking reports "cannot be put in the public domain. It is for internal uses only within the authority . . . and for contacting and communicating with other members of the club." We're therefore unable to include full information on the results in the Annual Report.



A summary of the benchmarking, based on 2018/19 data as reported to Pensions Committee in December 2019, is below:

- Lothian Pension Fund's cost per member of £22.09 falls within the very wide range of local authority funds of c£13 to £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 the Fund membership compared with an average of 32.7%, and pensioners represent 29.9% compared with 25.5%, which means 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
- The proportion of colleagues holding relevant pension administration qualifications is significantly higher than the average (more than double)
- In addition, the Fund's administration performance is above average for 10 of the 13 industry standard indicators in certain instances, by a considerable margin.

The Fund participated in the pension administration survey carried out by CEM for the first time in 2019 to gain further insight into pension administration cost and quality of service.

Although CIPFA is exclusive to local authority funds, the CEM peer group also included UK private sector schemes. Participating funds, from both private and public sectors, were of significantly larger size. CEM's benchmarking results categorised the Fund's pension administration service as "low cost; high service standard".



## PERFORMANCE AND ADMINISTRATION

### Customer and complaint feedback

Listening to feedback is key to our services and LPF carry out surveys to monitor individual and overall satisfaction. Our overall satisfaction continues to improve and in 2019/20 remains above the 92% target at 96.0%.

We also monitor complaints and ensure we respond to and resolve all complaints where possible, within 20 working days.

We investigate and learn from both formal and informal complaints to ensure we're continuously improving our services. Complaints are split by those about the service we provide and those about how Scheme Regulations are applied.

We carried out 17,782 processes in 2019/20 and there were very few complaints made, less than 0.01%. Complaints covered a broader range of issues including taking small pensions as a cash lump sum and the time it took to pay a Cash Equivalent Transfer Value to new pension providers.

### Internal Dispute Resolution Procedure (IDRP)

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

In 2019/20, there were four stage 1 disputes for investigation. If a member remains dissatisfied with the Stage 1 decision, they have six months to take their appeal to Stage 2. In 2019/20, there was one Stage two dispute and one remaining from 2018/19, both of which are included in the statistics below.

Reason for dispute	Stage 1 outcome	Stage 2 outcome	On-going
Transfer of Employment Protection of Undertakings (TUPE) transfer/protected Normal Retirement Date (NRD)	1 not upheld – complaint rested with SPPA	1 upheld	0
Overpayment	1	1 not upheld	0
Awards, e.g. early payment of deferred pension on health grounds	3	3 not upheld	0

Further information about the IDRP and complaints procedure is available on our website at [www.lpf.org.uk/aboutus](http://www.lpf.org.uk/aboutus).



## PERFORMANCE AND ADMINISTRATION

### Our data

We issued 100% of benefit statements by the statutory deadline of 31 August 2019. This is the second year in a row we've achieved this target set by the Pensions Regulator in 2015. Previous years saw us achieve 99%.



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

All our employers submit monthly contribution and pensionable pay data through the Fund's employer data portal. The Fund audits the submissions to ensure the continuation of data accuracy.

The Fund utilises a Data Quality Service provided by the administration software supplier to determine the scores for our common and conditional data as required by the Pensions Regulator. The scores are based on the percentage of clean member records; those considered to be without a single data failure.

The following scores were submitted to the Pension Regulator for the 2019 annual scheme return. Lothian Pension Fund and Scottish Homes Pension Fund scored 98.3% and 96.5% respectively for common data and 95.4% and 96.7% for conditional data. The quality of data continues to be considered to be of a high standard.

### COLLEAGUE PROFILE    Steph Duddy, People Business Partner

Steph joined LPF in September 2019 as our People Business Partner. Steph's responsible for providing guidance to drive the delivery of the HR and people plans, including recruiting and development for our colleagues. Steph says:

**"The favourite aspect to my role is helping to develop our colleague give them the skills to deliver great service for our members. The people and culture are what makes LPF a great place to work."**





## PERFORMANCE AND ADMINISTRATION

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### Guaranteed Minimum Pension (GMP)

Following the end of contracting-out of the Second State Pension (S2P) on 5 April 2017, HMRC committed to sending a statement to all individuals affected stating the amount of Guaranteed Minimum Pension (GMP) they'll receive and who is responsible for paying it. As implied, GMP is the underpin that guarantees benefits will be no lower than the additional state pension, a member would have accrued had their pension not contracted out. As different levels of indexation are applied to the GMP element of a member's pension compared to the balance, any incorrectly calculated GMPs can result in over or underpayment of benefits. The UK Government's deadline for pension schemes to reconcile the GMP values they hold for members with those calculated by HMRC was 31 March 2019.

As reported previously, the Fund reconciled GMP values held for its members with those calculated by HMRC, to within the accepted tolerance of £2 per week, by the statutory deadline of 31 March 2019. In total, 120 members were identified who had been underpaid GMP. This resulted in arrears of £37,597.90, which was paid in June 2019. Requisite increases to ongoing annual pensions totalled £4,028.

In respect of overpayments, the Local Government Pension Scheme (Increased Pension Entitlement) (Miscellaneous Amendments) (Scotland) Regulations 2019, provide that pensions currently in payment will remain unadjusted going forward. The Fund has calculated an annual total of such pension overpayment of £73,624.32, across 572 members' records, that is an average of £128.71 per member.



### McCloud judgement

When public service pension schemes were reformed following the Public Service Pensions Act 2013, protections for older scheme members were introduced. In December 2018, the Court of Appeal ruled that the transitional protections included in the Judges' ("McCloud") and Firefighters' ("Sargeant") pension schemes constituted unlawful age discrimination. Following this, in July 2019 a Written Ministerial Statement confirmed that the UK Government believed that the ruling applied to all the main public service pension schemes and that the discrimination would be addressed in all the relevant schemes, including Local Government Pension Scheme (LGPS) in Scotland.

The Scottish Government is considering what this means for the LGPS and a remedy is expected later this year. Protection will compare the benefits payable under the current rules with the entitlements which would have been paid if the Scheme had not changed in 2015 and pay the higher. This protection will apply automatically and members who meet the qualifying criteria won't need to take any action.



## PERFORMANCE AND ADMINISTRATION

Many members benefits won't change or will only see a small increase because of low salary growth since the new scheme was introduced. However, as the changes will be backdated to April 2015 and apply to qualifying members who left the LGPS after that date, implementing the remedy is expected to be extremely challenging from an administration perspective.

### Pension administration

Our in-house pension administration team provides a dedicated service for the pension fund members. We monitor the time taken to complete our procedures. Key procedures include: processing of retirement and dependent benefits; providing information for new members; and transfers and retirement quotes. Despite the challenging environment, 93.53% of key procedures in 2019/20 were completed in target. However, in other areas, some delays were experienced while this key work was prioritised.

The table below shows the number and type of retirements in 2019/20.

Reason for dispute	Ill health	Early-age 60 to NPA	Early-age 55 to 59	Redundancy	Efficiency	Late	TOTAL
Lothian Pension Fund	118	907	140	115	61	165	<b>1506</b>
Scottish Homes Pension Fund	0	21	0	0	0	0	<b>21</b>



## PERFORMANCE AND ADMINISTRATION

The table below shows performance against key procedures in 2019/20.

2018/19		Target	2019/20
92.2%	Proportion of critical pensions administration work completed within standards – individual performance within this indicator are shown below	Greater than 91%	93.53%
96.7%	Provide a maximum of one guaranteed Cash Equivalent Transfer Value (CETV) within 10 working days of receiving a request	90%	97.64%
97.5%	Pay lump sum retirement grant within seven working days of receiving all the information we need from the member	95%	98.84%
97.2%	Acknowledge of the notification of the death of a member to next of kin within five working days.	95%	97.62%
100%	Respond in writing within 20 working days to formal complaints that have escalated from frontline resolution, or recorded directly as an investigation	95%	100%
81.7%	Notify early leavers entitled to deferred benefits of their rights and options within 10 days of being informed of end of pensionable service.	90%	97.83%
73.6%	Proportion of non-key procedures completed within standard including Additional Regular Contributions, responding to member communications, updating nominations and maintaining the member database.	75%	75.18%
98.3%	Notification of dependant benefits within five working days of receiving all necessary paperwork	95%	92.81%
97.2%	Payment of CETV within 20 working days of receiving all completed transfer out forms	95%	94.75%
80.4%	Provide transfer-in quote within 10 working days of receiving the Cash Equivalent Transfer Value (CETV) from member's previous pension provider.	95%	64.21%
77.0%	Notify members holding more than three months, but less than two years' service, of their options at leaving. As there is a one month and a day lying period, the target is within 10 days of the end of the lying period or after the employer providing full leaving information if later.	80%	77.29%
87.7%	Pay a refund of contributions within seven working days of receiving the completed declaration and bank detail form.	90%	89.25%
82.3%	Estimate requested by employer of retirement benefits within 10 working days	90%	82.63%
92.7%	Pay any lump sum death grant within seven working days of receipt of the appropriate documentation	95%	90.76%



## PERFORMANCE AND ADMINISTRATION

We also participate in the National Fraud Initiative which is a data matching exercise led by Audit Scotland and is carried out every two years. The 2018/19 data match against current pensioners and deferred pensioners identified 31 and 13 deaths respectively, that hadn't been reported. The total overpayment for current pensioners amounted to £52,026 and recovery is in progress.

In 2019/20, the total value of pension overpayments written off under delegated authority (overpayments up to £3,000) between 1 September 2018 – 31 August 2019 was £7,888.

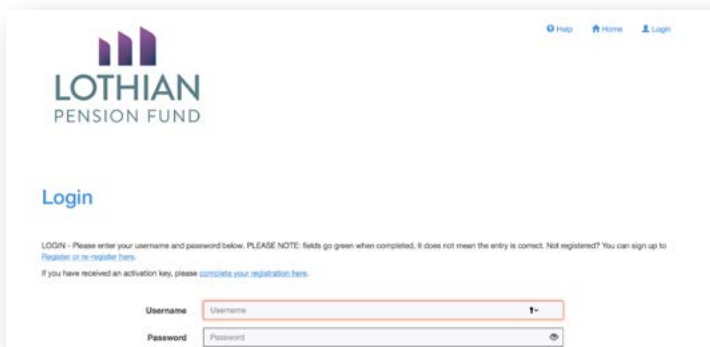
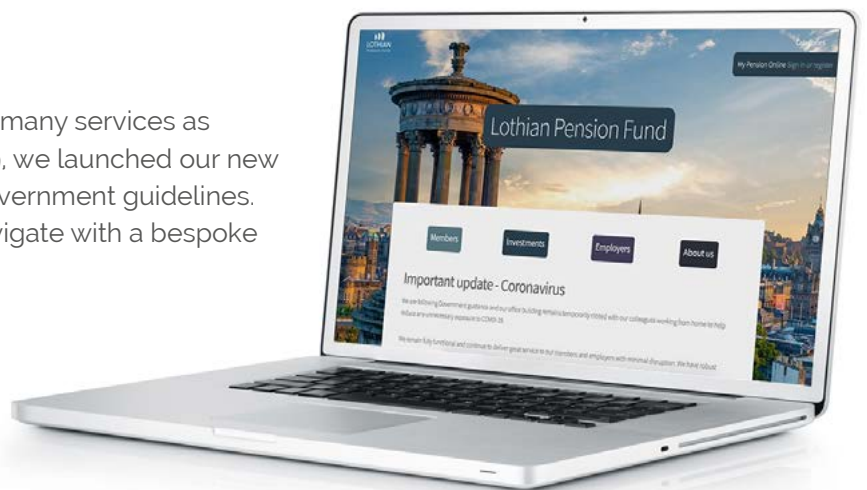
### Online services

LPF is moving towards providing as many services as possible digitally. In December 2019, we launched our new accessible website to meet new Government guidelines. The website is clear and easy to navigate with a bespoke member area.

The My Pension Online service provides members with easy access to their personal information and we continue to investigate ways to improve the customer experience and services for our members.

Enhancements to our digital service have allowed us to provide retirement estimates and member documentation online, enable secure upload of documents to the Fund and completion of forms online.

We recently changed our refund process so now members can view, complete and return the forms and documents securely, all within our digital service.



We also introduced online payslips and P60s for all our members. 8,427 members (26.3% of existing pensioners) who were signed up to the digital service at the end of February no longer receive paper copies of their payslips or P60s.

All new pensioner members are automatically designated to receive electronic payslips and P60s, but they'll be given the option to retain paper service if that's their preference. We'll issue further communications to persuade existing pensioners to sign up to the online service.





## PERFORMANCE AND ADMINISTRATION

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Information for members is also available via email, phone and in person by visiting our office. We currently have 30,000 members registered for the online service with 44% of all active members being registered and we're continuing to work to increase these numbers.

Our employers provide monthly contribution returns via a portal that allows data to be automatically uploaded to the pension software system. This has significantly improved the provision of employer data and allowed for the automation of tasks that were previously done manually.

### Unclaimed Monies Account

When a member leaves the Fund with less than two years membership they're entitled to a refund or transfer to another pension provider. Where we don't receive a response to any of our correspondence, we record these as 'Status 3: Exit – No liability' with a marker as unclaimed. At 1 April 2019 the unclaimed amount was £909,056 with 2,527 records with the unclaimed marker and on 1 April 2020 the figure was £914,306 with 2,571 unclaimed records.

Over the year we wrote to over 1,200 members reminding them of their options and we'll continue this work over the next 12 months by sending a reminder letter to those that haven't replied.

Although the unclaimed members and monies remain around the same level, new members who don't reply become unclaimed.

### Employer performance

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

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

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



## PERFORMANCE AND ADMINISTRATION

Since the strategy was introduced, provision of early leaver and retiral information from employers has been well below the expected standard. This is despite our LPF officers taking a variety of approaches to improve employer performance, including:

- Providing training to payroll/HR colleagues
- Presenting performance updates at employer seminars and user groups
- Escalating to senior officers at annual employer meetings
- More frequent meetings and monitoring with employers where performance has been particularly poor.

To improve service to members, indirect costs can now be recovered from an employer should there be any persistent and ongoing administration failure occurs, with no improvement demonstrated or unwillingness to resolve the identified issues.

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

Overall employer performance for 2019/20 is shown below, with 2018/19 shown for comparison purposes.

Case type	Target (working days)	2018/19			2019/20		
		Number received	Number within target	% within target	Number received	Number within target	% within target
New members	20	4,379	N/A	N/A	7,489	4,554	61%
Leavers	20	3,628	1,715	47%	3,632	1,450	40%
Retirements	20	1,249	488	39%	1,374	512	37%
Deaths in Service	10	11	7	64%	16	10	63%



## PERFORMANCE AND ADMINISTRATION

Reconciliation of data in Q1 affected the performance indicator for new starters significantly. The performance of our largest employers improved from Q2 onwards.

Whilst the provision of leaver information within target has decreased and the majority were received out of target, a huge amount of effort this year has gone into targeting historical cases. We continue to provide missing leaver queries to employers monthly and are confident that employers can focus on 'business as usual' cases in 2020/21.

Most retirement information continued to be provided out of target. Just over a quarter of retirements out of target are received between 10 and 19 days before the member's retirement date but just over 50% are received after the member's retirement date.

Employer	Number of late payments	Employer	Number of late payments
Scotland's Learning Partnership	5	Bellrock	1
Freespace Housing	3	Citadel Youth Centre	1
Visit Scotland	3	Hanover Housing Association	1
Granton Info Centre	3	Heriot Watt University	1
Edinburgh Cyrenians Trust	2	Pilton Equalities Project	1
Enjoy East Lothian	2	West Lothian College	1
Four Square	1	Edinburgh Festival Society	1
Edinburgh Development Group	1		
<b>TOTAL</b>			<b>27</b>

99.74% of contributions by value were paid on time. Of the 976 payments made, 27 were paid later than the 19th and these are shown in the table. The option to levy interest on overdue contributions was not exercised in 2019/20 as late contributions weren't received significantly later than the 19th.



## PERFORMANCE AND ADMINISTRATION

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### Scotland's Learning Partnership

On 26 April 2019, the Scottish Public Pensions Agency (SPPA) advised that "Ministers have agreed that Scottish Government will provide a guarantee in respect of the liabilities for the staff from the former Community Learning Scotland who transferred to the Local Government Pension Scheme". This guarantee was signed on 3 June 2019.

Following the guarantee, Scotland's Learning Partnership received an updated valuation result with amended contribution rates and has agreed to settle an outstanding secondary rate payment by March 2022 via instalments. Whilst this means that the Fund hasn't yet received the minimum contributions in full, as certified by the Fund Actuary, the level of outstanding secondary rate contributions is not deemed significant and the Fund isn't exposed to default risk, given the guarantee by the Scottish Government. We have advised the Scottish Public Pensions Agency of the position.

### WHAT OUR MEMBERS SAY:



'I can absolutely say that the Lothian Pension Fund has changed our lives for the better. We're now in a brand new home and we're very comfortably off. It was without doubt the best decision I made when I joined this fund in 1982'



## OUR COLLEAGUES

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### Our Colleagues

Engaging our colleagues is critical to delivering our strategy and ambition. We firmly believe that having happy and motivated colleagues helps us deliver for our members, employers and stakeholders.

This year we were delighted to reach number 68 in the Sunday Times Top 100 Not for Profit Companies 2020 and number 38 in the Best Companies to work for in Scotland.



### Our core values

We're passionate about pensions and our values are enduring principles that inform, inspire and instruct our day to day behaviour. We're proud to be:

- Agile and dependable
- We approach work with an open and flexible attitude and take responsibility to manage our work effectively and efficiently. We also embrace new processes in a consistent and reliable way.
- Self-motivated and team players
- We actively participate as individuals, taking pride and responsibility in what we do. At the same time, we show awareness for the team and ensure our objectives support the team's objectives.
- Challenging and respectful
- We appreciate the need to challenge status quo and ask questions in a constructive and respectful way.
- Innovative and prudent
- We always look to improve processes and practices and ensure we do this in a way that's safe and protects LPF from unnecessary risk.

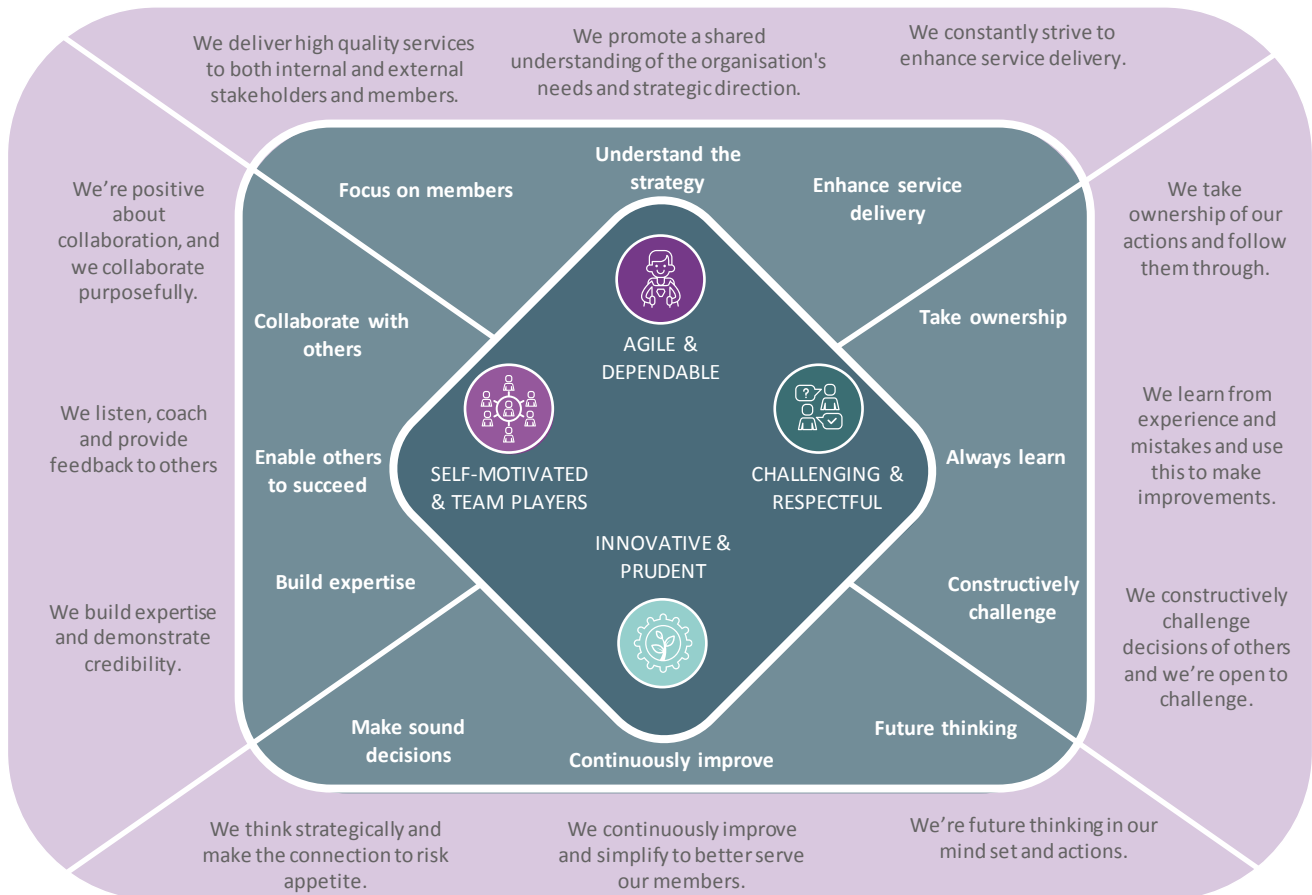
### Inclusivity

We're one team, but we represent many ideas, experiences and backgrounds. We value everyone's contributions and believe that everyone should be their whole self at work. We want a diverse, inclusive and respectful workplace and this will be achieved by driving a positive environment. As at 31 December 2019 our permanent headcount was 68; 53% female 47% male.

We recognise the many strengths and talents our diverse colleagues bring to the workplace so we're taking steps to make sure that LPF is as inclusive as possible for both our colleagues and members:



## OUR COLLEAGUES



- In 2019, we signed up to Disability Confident and more importantly, committed to review and improve everything we do with respect to recruitment and employment. Through Disability Confident, we'll work to ensure that disabled people and those with long term health conditions can fulfil their potential and realise their aspirations with us as an employer
- We're proud to be one of the firms in Scotland to partner with Future Asset and offer work experience placements for senior school girls. Future Asset aims to raise aspirations and confidence in girls in S4-S6, encouraging them to choose ambitious career paths, and informing them about rewarding opportunities in investment
- We've joined several organisations supporting the Scottish launch of a nationwide initiative focused on increasing diversity and inclusion in the asset management, professional services and financial services industries
- We helped launch the Scotland chapter of the Diversity Project, which aims to accelerate progress toward a more inclusive culture in the investment and savings sectors across all demographics, including gender, ethnicity, sexual orientation, age and disability



WE'RE PROUD TO SERVE  
**558 SOCIAL  
WORKERS**





## OUR COLLEAGUES

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### Gender Balanced

We continue to work towards our goal of being fully gender balanced across the organisation by 2030.

- As at 31 December 2019 we have, on aggregate, 35% women in our top three leadership layers. Over the year, we've increased our female management roles by three which equates to 33% women in our top three leadership layers
- Our mean gender pay gap is 36.15% (median: 4.33%) and the mean bonus pay gap is 43% (median 21%)
- Our positive action approach for gender, which is benchmarked externally, is helping to ensure that our people policies and processes are inclusive and accessible, from how we attract and recruit, to how we reward and engage our colleagues. We're confident this approach is the right one and through time, it will help us achieve a better balance of diversity throughout the organisation. Between August and December 2019, we recruited seven colleagues, 57% of these were women, and all of these colleagues were recruited above median pay.



### Performance and Reward

Our approach to performance management provides clarity for our employees about how their contribution links to our ambition and all our employees have goals set across a balanced scorecard of measures. We continue to ensure colleagues are paid fairly for the work they do and are supported by simple and transparent pay structures in line with industry best practices. We keep our HR policies and processes under review to ensure we do so.

This clarity and certainty on how we pay is also helping to improve our employees' financial wellbeing. Our rates of pay continue to exceed the Living Wage and we ensure employees performing the same roles are paid fairly. We make sure that colleagues have a common awareness of the financial and economic factors affecting LPF's performance through quarterly 'your FORUM' events led by our Group Chief Executive Officer and Senior Leadership Team. More information on our remuneration policies and employee share plans can be found later in this document.





## OUR COLLEAGUES

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### Developing Skills and Capabilities Culturally

Becoming a learning organisation is one of our priorities. We ensure that colleagues have the required skills and qualifications to perform their roles and prepare them for the future. We're committed to developing colleagues in key areas we've identified that will help build the right knowledge, skills and behaviours to help them stay relevant and employable and support our ambition and purpose. In addition, we're encouraging agility and shifting mindsets so that a focus on the future, continuous learning, knowledge-sharing and reflective practice becomes the norm.

Professional standards are important to us and we offer a wide range of learning to support professional development. We work closely with a wide range of professional bodies, government agencies and our peers to maintain and grow professional standards across the industry.



### Investing in Colleagues

We've also transformed our colleagues' experience by deploying new digital tools. Bamboo HR was implemented as a new digital HR platform in August 2019, and includes a mobile app, giving colleagues an experience on par with the digital experience our customers enjoy.

### Health and Wellbeing

We firmly believe that colleague wellbeing is linked to a successful and happy workforce. We partner with a community enterprise initiative to source fruit baskets and make these available to colleagues to encourage healthy eating. All colleagues have access to our free Employee Assistance Programme which offers help and advice on topics like health, legal, finance and lifestyle.

We take our colleagues' mental health very seriously and support mental health and wellbeing initiatives including Time to Talk Day, Purple Tuesday and we work with Enable to ensure that colleagues have the support, confidence and trust they need to talk about any concerns they may have.

### Management commentary approved by:

**Andrew Kerr**

Chief Executive Officer  
The City of Edinburgh Council  
24 June 2020

**Doug Heron**

Chief Executive Officer  
Lothian Pension Fund  
24 June 2020

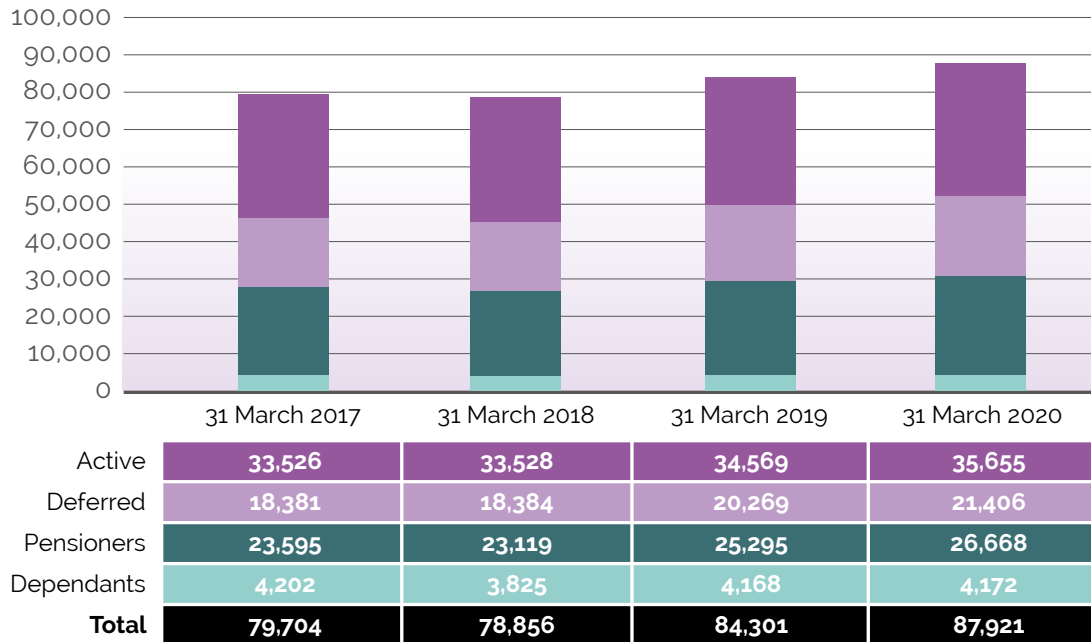
**John Burns**

Chief Finance Officer  
Lothian Pension Fund  
24 June 2020



## LOTHIAN PENSION FUND ACCOUNTS

### LOTHIAN PENSION FUND MEMBERSHIP



Homeless Action Scotland (HAS) ceased its membership of LPF with effect from 12 July 2018 and, following Ministerial Direction, its members transferred into the Scottish Homes Pension Fund. At the point of transfer, HAS had eleven deferred members, four pensioner members and one dependant member. The figures for 2019 have been adjusted to show this reduction. Further information on the transfer is shown in the Scottish Homes account section.

### Investment Strategy

In order to provide suitable investment strategies for the differing requirements of employers, the Fund currently operates four investment strategies. Most employer liabilities are funded under the Main Strategy, which adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and minimise the cost to the employer. The investment strategy is set at broad asset class or policy group levels, which are the key determinants of risk and return. These policy groups consist of Equities, Other Real Assets, Non-Gilt Debt, Gilts and Cash.

The Fund's (Main) investment strategy was approved by the Pensions Committee in December 2018. This adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer. The strategy retains significant exposure to real investments, such



## LOTHIAN PENSION FUND ACCOUNTS

as Equities and Infrastructure, which have a history of protecting or enhancing purchasing power over the long term.

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

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

The Buses Strategy was introduced on 31 January 2019 when the assets and liabilities of Lothian Buses Pension Fund were consolidated into the Lothian Pension Fund. In June 2019, the Committee agreed that the Buses Strategy should be adjusted in line with the investment strategy that it had previously approved for the Lothian Buses Pension Fund. With a maturing liability profile, the strategy reduced the risk / return profile of the assets over a five-year period. As the estimated funding level improved more quickly than expected, risk reduction was achieved during 2019/20 by reducing the equity allocation from 51.5% to 35% and increasing the allocation to gilts and non-gilt debt.

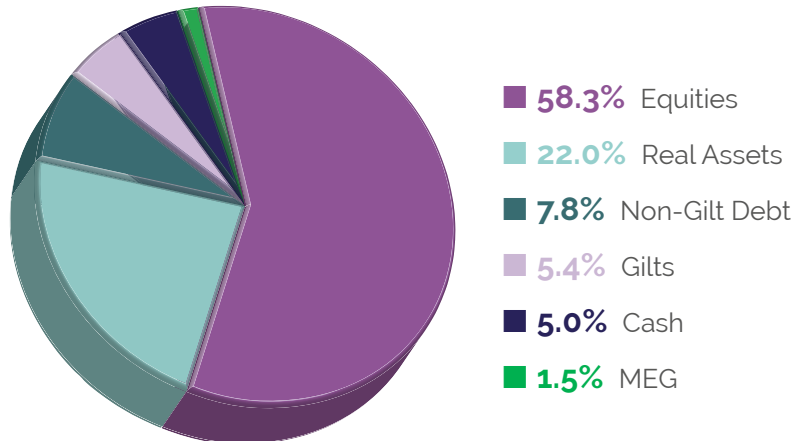
The table below presents total fund strategy, which is the weighted average of the four employer strategies also shown.

LOTHIAN PENSION FUND 31 March 2020	Main strategy	Mature Employer strategy	50/50 strategy	Buses strategy	Total fund strategy
Equities	65.0%	0.0%	32.5%	35.0%	62.0%
Real Assets	18.0%	0.0%	9.0%	18.0%	17.7%
Non-Gilt Debt	10.0%	0.0%	5.0%	20.0%	10.5%
Gilts	7.0%	100.0%	53.5%	27.0%	9.8%
Cash	0.0%	0.0%	0.0%	0.0%	0.0%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>



## LOTHIAN PENSION FUND ACCOUNTS

### ACTUAL ASSET ALLOCATION TOTAL FUND STRATEGY 31 MARCH 2020



A key objective of the Fund's investment strategy is to avoid unrewarded risk, and significant steps were taken more than six years ago to achieve this. The current equity strategy evolved by shifting from a regional to a global manager structure with a significant proportion of assets managed internally. The intention was to create relative stability appropriate to a long-term pension fund. The current equity investment strategy has remained broadly unchanged for several years now. With the structure of the equity exposure in more of a 'steady-state', there were no major changes over 2019/20.

Almost 85% of the Fund's listed equities are managed internally, with the majority of this in low cost, low turnover strategies which are expected to enhance the Fund's risk-adjusted returns over the long-term. The Fund also hedges exposure to the currencies of overseas listed equities with the explicit aim of reducing volatility rather than seeking to generate improved returns. The Fund therefore maintains exposure to currencies that are expected to reduce volatility, such as the US Dollar and Japanese Yen which tend to fall as equities rise, and hedge exposure to currencies that are expected to increase volatility, such as the Australian Dollar, which tends to rise as equities rise.

Over recent years, the Fund's strategy has been to increase the actual allocation to the Real Asset policy group, which includes investments in property, infrastructure and timber funds and assets. The long term and defensive nature of most of these assets provides an element of diversification to the overall investment strategy and the objective is to provide attractive risk-adjusted returns that are expected to be somewhat lower than listed equities over the long term. Most of these investments are unlisted and increasing exposure is dependent on sourcing attractive opportunities. The Fund's longstanding commitment to infrastructure investing has resulted in a large and diverse portfolio of real assets. The Fund's actual allocation has increased slightly this year from 20% to 22%. Almost 60% of this exposure is invested in infrastructure and approximately one third is investment in property. A small team of property professionals was recruited over 2019/20 to manage the commercial real estate portfolio, including both direct UK properties and indirect property investments.



## LOTHIAN PENSION FUND ACCOUNTS

The Non-Gilt Debt allocation has been increasing in recent years as the Fund strives to improve diversification and secure returns in excess of gilt yields. The actual allocation was increased gradually over 2019/20 from 5.2% to 7.8% with additional commitments to private debt as well as the drawdown of existing commitments and new investments in investment grade corporate bonds. Given very low sovereign bond yields and historically low spreads in credit markets, the Fund remains below the long-term strategic allocation.

The Fund's allocation to Gilts declined over the year, from 9% to 7%, which is below the long-term strategy target of 10%. The risk associated with index-linked gilts was raised by the UK government plans to align RPI with CPI between 2025 and 2030 – this would have a meaningful detrimental impact on future returns, which are already negative in real terms and expensive in an international context – yields are relatively low and inflation expectations relatively high. The Fund retains exposure as index-linked gilts do provide diversification, some insurance against an unexpected rise in inflation and a return broadly in line with the Fund's liabilities.

### Investment performance

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

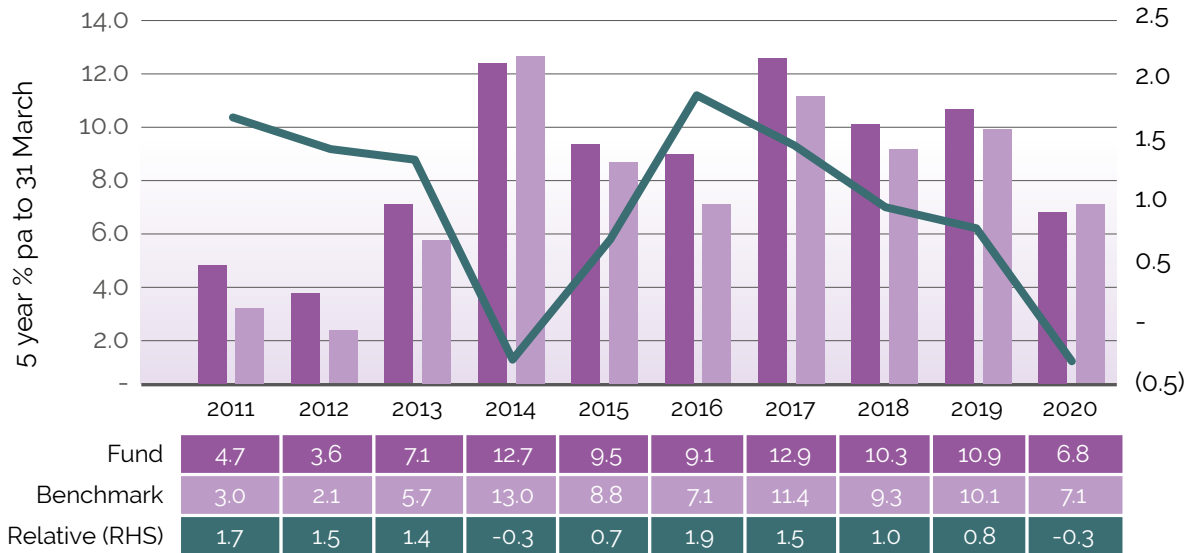
Annualised returns to 31 March 2020 (% per year)	1 year	5 years	10 years
Lothian Pension Fund	-3.6	6.8	8.1
Benchmark*	-0.2	7.1	7.9
Average Weekly Earnings (AWE)	1.5	2.4	2.0
Consumer Price Index (CPI)	1.5	1.7	2.0

\*Comprises equity, 'gilts plus', gilts and cash indices



## LOTHIAN PENSION FUND ACCOUNTS

### ANNUALISED 5 YEARLY RETURNS ENDING 31 MARCH (% PER YEAR)



The investment objectives of the Fund 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. In effect, the Fund aims to generate adequate 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. The Fund aims to achieve a return in line with its strategic benchmark allocation, over the long term, with a lower-than-benchmark level of risk.

The Fund return was relatively weak over the past year but remains broadly in line with its objective of meeting the strategic benchmark return over five and ten-year periods with lower risk. It should be noted that the Fund is not expected to behave like the benchmark in the short term for two main reasons: portfolios are not constructed to track the market capitalisation benchmarks and private market market benchmarks are not readily available nor assets well suited to short term measurement. UK CPI and Average Weekly Earnings have grown at low and relatively stable rates for many years, although liability values have grown faster than asset values as interest rates have almost reached zero.



## LOTHIAN PENSION FUND ACCOUNTS

The Fund's focus on risk-adjusted returns and lower volatility has been broadly in place since 2013 involving a change in structure that included a greater focus on lower volatility equities. One way of assessing the success of the strategy is by measuring the direction of the Fund's performance when markets are increasing and decreasing. Over the period since the change in structure, the Fund's returns have been delivered with lower volatility than the benchmark.



From March 2015 to March 2020, the Fund performed:

- better than the strategic allocation when markets fell (19 out of 60 months) with average performance of 0.3% better than the strategic benchmark and,
- worse than the strategic allocation when markets were rising (41 out of 60 months) with average performance 0.2% behind the strategic benchmark demonstrating that the Fund is positioned relatively defensively, in line with strategy.

The Fund's independent performance measurement provider, Portfolio Evaluation, also reports that the Fund's annualised ex-post active risk has been lower than the strategic benchmark over the most recent five-year (7.3% vs. 8.0%) and ten-year (7.3% vs. 7.7%) periods.

### COLLEAGUE PROFILE **Ruth Hunter, Investment Administrator**

Our investment Administrator Ruth has been with LPF for eight years. Ruth provides administrative support for the Investment team which is a varied role and includes co-ordinating the Fund's investment reporting cycle, preparing reporting data and co-ordinating data between our collaborating partners. Ruth says:

**"The LPF team are all great to work with and I really enjoy the challenges of my role and the direction the Fund is moving in."**





WE'RE PROUD TO SERVE  
**166 WASTE  
OPERATIVES**







## LOTHIAN PENSION FUND ACCOUNTS

### Fund Account for year ended 31 March 2020

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

Lothian Pension Fund			Lothian Pension Fund		
Parent	Group		Parent	Group	
Restated 2018/19	Restated 2018/19		2019/20	2019/20	
£000	£000	Note	£000	£000	
<b>Income</b>					
175,672	175,672	Contributions from employers	5 /	184,818	184,818
47,416	47,416	Contributions from members	6	49,508	49,508
3,852	3,852	Transfers from other schemes	7	6,036	6,036
<b>226,940</b>	<b>226,940</b>			<b>240,362</b>	<b>240,362</b>
<b>Less: expenditure</b>					
167,962	167,962	Pension payments including increases	8	179,229	179,229
50,270	50,270	Lump sum retirement payments	9	58,809	58,809
5,542	5,542	Lump sum death benefits	10	7,081	7,081
720	720	Refunds to members leaving service		722	722
(82)	(82)	Premiums to State Scheme		1	1
14,754	14,754	Transfers to other schemes	11	30,660	30,660
2,281	2,530	Administrative expenses	12a	2,496	2,467
<b>241,447</b>	<b>241,696</b>			<b>278,998</b>	<b>278,969</b>
<b>(14,507)</b>	<b>(14,756)</b>	Net (withdrawals)/additions from dealing with members		<b>(38,636)</b>	<b>(38,607)</b>
<b>Returns on investments</b>					
190,975	190,975	Investment income	13	232,842	232,842
503,624	503,624	Change in market value of investments	15, 20b	(500,295)	(500,295)
(35,938)	(36,102)	Investment management expenses	12b	(32,827)	(32,659)
<b>658,661</b>	<b>658,497</b>	Net returns on investments		<b>(300,280)</b>	<b>(300,112)</b>
<b>644,154</b>	<b>643,741</b>	Net increase in the Fund during the year		<b>(338,916)</b>	<b>(338,719)</b>
<b>7,175,080</b>	<b>7,173,722</b>	Net assets of the Fund at 1 April 2019		<b>7,819,234</b>	<b>7,817,463</b>
<b>7,819,234</b>	<b>7,817,463</b>	Net assets of the Fund at 31 March 2020		<b>7,480,318</b>	<b>7,478,744</b>



## LOTHIAN PENSION FUND ACCOUNTS

### Net Assets Statement as at 31 March 2020

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

Lothian Pension Fund			Note	Lothian Pension Fund	
Parent	Group			Parent	Group
31 March 2019	31 March 2019			31 March 2020	31 March 2020
£000	£000		£000	£000	
<b>Investments</b>					
7,788,872	7,788,872	Assets		7,444,652	7,444,652
(1,912)	(1,912)	Liabilities		(1,965)	(1,965)
<b>7,786,960</b>	<b>7,786,960</b>	<b>Net investment assets</b>	<b>14</b>	<b>7,442,687</b>	<b>7,442,687</b>
<b>Non current assets</b>					
3,457	3,457	Debtors	24	5,256	5,256
430	430	Computer systems		658	658
60	-	Share Capital		590	-
-	393	Deferred tax	29a	-	424
<b>3,947</b>	<b>4,280</b>			<b>6,504</b>	<b>6,338</b>
<b>Current assets</b>					
884	884	The City of Edinburgh Council	28	4,924	4,924
35,897	36,238	Cash balances	21, 28	38,168	39,038
22,345	22,568	Debtors	25	18,118	18,447
<b>59,126</b>	<b>59,690</b>			<b>61,210</b>	<b>62,409</b>
<b>Non current liabilities</b>					
-	(2,309)	Retirement benefit obligation	30	-	(2,232)
-	(13)	Creditors		-	(15)
-	<b>(2,322)</b>			-	<b>(2,247)</b>
<b>Current liabilities</b>					
(30,799)	(31,145)	Creditors	26	(30,083)	(30,443)
<b>(30,799)</b>	<b>(31,145)</b>			<b>(30,083)</b>	<b>(30,443)</b>
<b>7,819,234</b>	<b>7,817,463</b>	<b>Net assets for the Fund</b>		<b>7,480,318</b>	<b>7,478,744</b>

The unaudited accounts were issued on 24 June 2020 and the audited accounts were authorised for issue on XX September 2020.



## LOTHIAN PENSION FUND ACCOUNTS

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### **John Burns FCMA CGMA, PgC**

Chief Finance Officer,  
Lothian Pension Fund

### **Notes to the net asset statement**

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





## NOTES TO THE FINANCIAL STATEMENTS

### 1 Statement of Accounting Policies

The statement of accounting policies for both Funds can be found on page 157.

### 2 Prior Year Adjustment

#### Ministerial Direction – Homeless Action Scotland

The admission to Local Government Pension (LGPS) membership of Homeless Action Scotland (HAS) was terminated by Lothian Pension Fund (LPF) with effect from 12 July 2018. The Actuary to LPF calculated the liabilities that remained on cessation at £641,000. Following specific request by LPF, on 31 March 2020, the Scottish Ministers issued a direction to the effect that:

(a) Scottish Homes Pension Fund (SHPF) be substituted for Lothian Pension Fund as the appropriate fund for the Scheme employer as at 11 July 2018 and that all assets and liabilities of Lothian Pension Fund relating to the Scheme employer are transferred to SHPF as at that date;

(b) with effect from 11 July 2018, City of Edinburgh Council, as the administering authority of SHPF, shall admit the Scheme employer as an admission body of SHPF; and

(c) the administering authority must by 30 June 2020 execute all documents and do all things necessary to complete the substitution of SHPF for Lothian Pension Fund as the appropriate fund for the Scheme employer as at 11 July 2018 and the transfer of all assets and liabilities of Lothian Pension Fund relating to the Scheme employer to SHPF as at that date.

	2018/19 Audited	Adjustment	2018/19 Restated
	£000	£000	£000
Transfers to other schemes	13,028	1,726	14,754
Pension Payments	167,997	(35)	167,962
Administrative Expenses	2,532	(2)	2,530
Change in Market Value of Investments	503,734	(110)	503,624
Investment Assets	7,790,671	(1,799)	7,788,872



## NOTES TO THE FINANCIAL STATEMENTS

### 3 Lothian Pension Fund Group

#### Basis of consolidation, presentation of financial statements and notes

Replace text with: The consolidation of the group accounts was prepared prior to the LPFE and LPFI boards approval of their respective audited financial statements for 2019/20. The figures used in the consolidation are therefore the unaudited financial statements.

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

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

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

The consolidation of the group accounts was prepared prior to the LPFE and LPFI boards approval of their respective audited financial statements for 2019/20. The figures used in the consolidation are therefore the unaudited financial statements.



## NOTES TO THE FINANCIAL STATEMENTS

### 4 Events after the Reporting Date

There have been no events since 31 March 2020, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

### 5 Contributions from employers

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

	2018/19	2019/20
By category	£000	£000
Primary Contribution (future service)	160,778	170,896
Secondary Contribution (past service deficit)	8,057	7,821
Strain costs	4,082	2,931
Cessation contributions	2,755	3,170
	<b>175,672</b>	<b>184,818</b>

	2018/19	2019/20
By employer type	£000	£000
Administering Authority	59,830	64,051
Other Scheduled Bodies	92,644	96,189
Community Admission Bodies	22,414	23,402
Transferee Admission Bodies	784	1,176
	<b>175,672</b>	<b>184,818</b>

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

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



## NOTES TO THE FINANCIAL STATEMENTS

2018/19 contributions included a £107k accrual covering revised sums in respect of assumed pensionable pay due by City of Edinburgh Council in relation to the financial period 2015/16 to 2017/18. These payments were transferred to the Fund in the first quarter of 2019/20, however there may still be revisions to these figures that are yet to be monetised due to back dated pay awards.

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

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

### 6 Contributions from members

	2018/19	2019/20
By employer type	£000	£000
Administering Authority	16,437	17,508
Other Scheduled Bodies	24,507	25,295
Community Admission Bodies	6,217	6,375
Transferee Admission Bodies	255	330
	<b>47,416</b>	<b>49,508</b>

### 7 Transfers in from other pension schemes

	2018/19	2019/20
	£000	£000
Group transfers	-	-
Individual transfers	3,852	6,036
	<b>3,852</b>	<b>6,036</b>



## NOTES TO THE FINANCIAL STATEMENTS

### 8 Pensions payable

	2018/19 restated	2019/20
By employer type	£000	£000
Administering Authority	76,932	80,152
Other Scheduled Bodies	75,860	82,455
Community Admission Bodies	14,958	16,383
Transferee Admission Bodies	212	239
	<b>167,962</b>	<b>179,229</b>

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

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

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

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

### 9 Lump sum retirement benefits payable

	2018/19	2019/20
By employer type	£000	£000
Administering Authority	17,374	19,335
Other Scheduled Bodies	27,818	31,809
Community Admission Bodies	5,053	7,420
Transferee Admission Bodies	25	245
	<b>50,270</b>	<b>58,809</b>





## NOTES TO THE FINANCIAL STATEMENTS

### 10 Lump sum death benefits payable

	2018/19	2019/20
By employer type	£000	£000
Administering Authority	2,943	2,874
Other Scheduled Bodies	2,049	2,497
Community Admission Bodies	550	1,635
Transferee Admission Bodies	-	75
	<b>5,542</b>	<b>7,081</b>

### 11 Transfers out to other pension schemes

	2018/19 restated	2019/20
	£000	£000
Group transfers	1,726	20,504
Individual transfers	13,028	10,156
	<b>14,754</b>	<b>30,660</b>

Following a Direction from the Scottish Ministers, Barony Housing Association transferred to Strathclyde Pension Fund on 31 January 2020.

The data transfer was successfully carried out to allow payment of pensions from February 2020 onwards. The Actuary calculated the Bulk transfer amount to be £20,504,175 based on asset values at the transfer date and this sum was paid to Strathclyde Pension Fund on 24 March 2020. In summer 2020, once the actual investment returns for the period to the payment date are known, a post payment date adjustment will be calculated by the Actuary. If the resulting Bulk Transfer Value is higher than the amount paid on the Payment Date, Lothian Pension Fund will make a top up payment to the Strathclyde Pension Fund equal to the difference, or if the reverse should be the case, then Strathclyde Pension Fund will be required to make a corrective payment to the Lothian Pension Fund equal to the difference.



## NOTES TO THE FINANCIAL STATEMENTS

### 12a Administrative expenses

	LPF Parent 2018/19	LPF Group 2018/19	LPF Parent 2019/20	LPF Group 2019/20
	£000	£000	£000	£000
Employee Costs	1,494	1,540	1,501	1,484
System costs	304	305	417	419
Actuarial fees	72	72	103	103
External/Internal audit fees	49	52	69	71
Legal fees	20	20	12	12
Printing and postage	111	111	152	152
Depreciation	45	45	34	34
Office costs	100	100	116	116
Sundry costs less sundry income	86	71	92	115
IAS19 retirement benefit adjustments - see note 30	-	249	-	(25)
Deferred tax on retirement benefit obligation - see note 29a	-	(42)	-	(10)
Corporation tax	-	6	-	(4)
	<b>2,281</b>	<b>2,529</b>	<b>2,496</b>	<b>2,467</b>

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



## NOTES TO THE FINANCIAL STATEMENTS

### 12b Investment management expenses

	LPF Parent 2018/19	LPF Group 2018/19	LPF Parent 2019/20	LPF Group 2019/20
	£000	£000	£000	£000
External management fees - invoiced	4,977	4,977	4,423	4,423
deducted from capital (direct investment)	17,657	17,657	16,772	16,772
deducted from capital (indirect investment)	5,062	5,062	955	955
Securities lending fees	189	189	115	115
Transaction costs - Equities	1,498	1,498	2,479	2,479
Property operational costs	2,615	2,615	3,121	3,121
Employee costs	2,075	2,165	2,560	3,251
Custody fees	356	356	390	390
Engagement and voting fees	114	114	119	119
Performance measurement fees	92	92	94	94
Consultancy fees	125	125	71	71
Research fees	329	329	462	462
System costs	441	442	555	559
Legal fees	134	137	201	267
Depreciation	16	16	118	118
Office costs	76	76	127	127
Sundry costs less sundry income	182	(57)	265	(586)
IAS19 retirement benefit adjustments - see note 30	-	345	-	(52)
Deferred tax on retirement benefit obligation - see note 29	-	(59)	-	(21)
Corporation tax	-	23	-	(5)
Corporation tax losses utilised by CEC group	-	-	-	-
	<b>35,938</b>	<b>36,102</b>	<b>32,827</b>	<b>32,659</b>

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

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales (see note 14 - Reconciliation of movements in investments and derivatives).



## NOTES TO THE FINANCIAL STATEMENTS

The external investment management fees (deducted from capital) above include £2.9m (£2.8m direct, £0.1m indirect) in respect of performance-related fees compared to £8.5m in 2018/19 (£6.1m direct, £2.4m indirect).

It should be noted that Lothian Pension Fund's disclosure on investment management fees exceeds CIPFA's Accounting for Local Government Pension Scheme Management Costs revised guidance on cost transparency which came into effect from 1st April 2016. Consistent with previous years, the Fund recognises fees deducted from investments not within its direct control (such as fund of fund fees) to give a full picture of its investment management costs. Further details can be found in the "Investment management cost transparency" section of the Management Commentary. This further disclosure highlights an extra £1m in costs (2019 £5.1m).

### 12c Total management expenses

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

	LPF Parent 2018/19	LPF Group 2018/19	LPF Parent 2019/20	LPF Group 2019/20
	£000	£000	£000	£000
Administrative costs	1,988	2,176	2,255	2,251
Investment management expenses	34,422	34,629	30,403	30,128
Oversight and governance costs	1,811	1,829	2,665	2,747
	<b>38,221</b>	<b>38,634</b>	<b>35,323</b>	<b>35,126</b>



## NOTES TO THE FINANCIAL STATEMENTS

### 13 Investment income

	2018/19	2019/20
	£000	£000
Income from bonds	4,483	3,526
Dividends from equities	159,953	163,388
Unquoted private equity and infrastructure	5,005	40,419
Income from pooled investment vehicles	2,432	3,134
Gross rents from properties	23,501	23,914
Interest on cash deposits	2,156	2,213
Stock lending and sundries	943	577
	<b>198,473</b>	<b>237,171</b>
Irrecoverable withholding tax	(7,498)	(4,329)
	<b>190,975</b>	<b>232,842</b>

Included within the dividend from equities income for the year is cross border withholding tax yet to be received. The Fund's custodian Northern Trust manages this process and due to the high certainty of success it is assumed that the Fund will make full recovery of these reclaims. For the period of 2019/20 £7,673k of the stated income relates to tax yet to be received. At the 31st March 2020 £14,900k (including prior periods) of investment income receivable related to cross border withholding tax. The Fund monitors these claims to ensure its optimum tax efficiency and provides an annual progress report to the Pensions Audit Sub-Committee.



14 Net investment assets	Region	Restated 31 March 2019	31 March 2020
Investment assets		£000	£000
<b>Bonds</b>			
Public sector fixed interest	UK	158,219	-
Public sector index linked gilts quoted	UK	695,412	457,536
		<b>853,631</b>	<b>457,536</b>
<b>Equities</b>			
Quoted	UK	641,038	569,679
Quoted	Overseas	3,918,803	3,627,410
		<b>4,559,841</b>	<b>4,197,089</b>
<b>Pooled investment vehicles</b>			
Private equity, infrastructure, private debt & timber	UK	616,556	705,173
Private equity, infrastructure, private debt & timber	Overseas	633,487	690,020
Property	UK	90,358	86,954
Other	UK	31,978	174,366
		<b>1,372,379</b>	<b>1,656,513</b>
<b>Properties</b>			
Direct property	UK	411,978	367,494
		<b>411,978</b>	<b>367,494</b>
<b>Derivatives</b>			
Derivatives - forward foreign exchange		3,025	15,228
		<b>3,025</b>	<b>15,228</b>
<b>Cash deposits</b>			
Deposits		569,190	681,472
		<b>569,190</b>	<b>681,472</b>
<b>Other investment assets</b>			
Due from broker		1,037	44,128
Dividends and other income due		17,791	25,176
		<b>18,828</b>	<b>69,304</b>
<b>Total investment assets</b>		<b>7,788,872</b>	<b>7,444,636</b>
<b>Investment liabilities</b>			
<b>Derivatives</b>			
Derivatives - forward foreign exchange		(854)	(22)
		<b>(854)</b>	<b>(22)</b>
<b>Other financial liabilities</b>			
Due to broker		(1,058)	(1,927)
		<b>(1,058)</b>	<b>(1,927)</b>
<b>Total investment liabilities</b>		<b>(1,912)</b>	<b>(1,949)</b>
<b>Net investment assets</b>		<b>7,786,960</b>	<b>7,442,687</b>



## NOTES TO THE FINANCIAL STATEMENTS

### 15a Reconciliation of movement in investments and derivatives

	Market value at 31 March 2019*	Purchase at cost & derivative payments	Sale & derivative receipts	Change in market value	Market value at 31 March 2020*
	£000	£000	£000	£000	£000
Bonds	853,631	338,698	(777,727)	42,934	457,536
Equities	4,559,841	1,638,264	(1,372,045)	(628,971)	4,197,089
Pool investment vehicles	1,372,379	448,073	(253,708)	(89,769)	1,656,513
Property	411,978	2,571	(22,304)	(24,751)	367,494
Derivatives - futures	-	-	-	-	-
Derivatives - forward foreign exchange	2,171	12,606	(4,382)	4,811	15,206
	<b>7,200,000</b>	<b>2,440,212</b>	<b>(2,430,166)</b>	<b>(516,208)</b>	<b>6,693,838</b>

#### Other financial assets / liabilities

Cash deposits*	569,190			15,921	681,472
Broker balances*	(21)			(8)	42,202
Investment income due*	17,791			-	25,175
	<b>586,960</b>			<b>15,913</b>	<b>748,849</b>
<b>Net financial assets</b>	<b>7,786,960</b>			<b>(500,295)</b>	<b>7,442,687</b>

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

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



## NOTES TO THE FINANCIAL STATEMENTS

	Market value at 31 March 2018*	Purchase at cost & derivative payments	Sale & derivative receipts	Change in market value	Market value at 31 March 2019*
	£000	£000	£000	£000	£000
Bonds	736,478	227,909	(152,586)	41,830	853,631
Equities	4,287,464	1,090,848	(1,122,578)	304,107	4,559,841
Pool investment vehicles	1,264,553	219,829	(261,125)	149,122	1,372,379
Property	392,743	21,290	-	(2,055)	411,978
Derivatives - futures	-	30	(30)	-	-
Derivatives - forward foreign exchange	11,917	8,223	(12,199)	(5,770)	2,171
	<b>6,693,155</b>	<b>1,568,129</b>	<b>(1,548,518)</b>	<b>487,234</b>	<b>7,200,000</b>

### Other financial assets / liabilities

Cash deposits*	426,380	16,376	569,190
Broker balances*	(2,211)	14	(21)
Investment income due*	17,163	-	17,791
	<b>441,332</b>	<b>16,390</b>	<b>586,960</b>
<b>Net financial assets</b>	<b>7,134,487</b>	<b>503,624</b>	<b>7,786,960</b>

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

### 15b Reconciliation of fair value measurements within level 3

	Market value at 31 March 2019	Level 3 transfers		Purchases at cost & derivative payments	Sale & derivative receipts	Unrealised gains / (losses)	Realised gains / (losses)	Market value at 31 March 2020
	£000	in	out	£000	£000	£000	£000	£000
<b>Pooled investments</b>								
Infrastructure	844,860			176,081	(170,304)	(13,750)	98,683	935,570
Property	48,983	-	-	33	(826)	(2,105)	442	46,527
Private Equity	76,159			1,642	(22,790)	(10,154)	18,017	62,874
Timber	124,028			-	(563)	6,043	199	129,707
Private debt	204,996	-	-	89,399	(30,706)	3,841	(491)	267,039
Freehold property	411,978	-	-	2,571	(22,303)	(34,917)	10,165	367,494
	<b>1,711,004</b>	<b>-</b>	<b>-</b>	<b>269,726</b>	<b>(247,492)</b>	<b>(51,042)</b>	<b>127,015</b>	<b>1,809,211</b>

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





## NOTES TO THE FINANCIAL STATEMENTS

### 16 Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2020

Contract settlement within	Currency bought	Currency sold	Local currency bought	Local currency sold	Asset value	Liability value
			000	000	£000	£000
Up to one month	GBP	AUD	63,581	116,121	6,274	-
Up to one month	CAD	GBP	138,338	228,396	8,948	-
One to six months	CHF	USD	812	835	-	(22)
One to six months	USD	CHF	3,238	3,148	6	-
Open forward currency contracts at 31 March 2020					<b>15,228</b>	<b>(22)</b>
Net forward currency contracts at 31 March 2020						<b>15,206</b>

#### Prior year comparative

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

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

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



## 17 Investment managers and mandates

Manager	Mandate	Market value	% of total	Market value	% of total
		at 31 March 2019 Restated	31 March 2019 Restated	at 31 March 2020	31 March 2020
		£000	%	£000	%
In-house	UK all cap equities	144,692	1.9	212,547	2.9
In-house	UK mid cap equities	121,698	1.6	91,095	1.2
<b>Total UK equities</b>		<b>266,390</b>	<b>3.5</b>	<b>303,642</b>	<b>4.1</b>
In-house	European ex UK equities	125,418	1.6	197,939	2.7
In-house	US equities	160,148	2.1	202,460	2.7
<b>Total regional overseas equities</b>		<b>285,566</b>	<b>3.7</b>	<b>400,399</b>	<b>5.4</b>
In-house	Global high dividend	1,006,587	12.9	1,016,988	13.7
In-house	Global low volatility	1,249,276	16.1	980,951	13.2
In-house	Global multi factor value	993,535	12.8	899,426	12.1
Harris	Global equities	278,794	3.6	177,602	2.4
Nordea	Global equities	306,617	3.9	290,006	3.9
Baillie Gifford	Global equities	123,103	1.6	121,808	1.6
<b>Total global equities</b>		<b>3,957,912</b>	<b>50.9</b>	<b>3,486,781</b>	<b>46.9</b>
In-house	Currency hedge	1,925	-	15,222	0.2
<b>Total currency overlay</b>		<b>1,925</b>	<b>-</b>	<b>15,222</b>	<b>0.2</b>
<b>Total listed equities</b>		<b>4,511,793</b>	<b>58.1</b>	<b>4,206,044</b>	<b>56.6</b>
In-house	Private equity unquoted	76,159	1.0	62,875	0.8
In-house	Private equity quoted	78,382	1.0	65,591	0.9
<b>Total private equity</b>		<b>154,541</b>	<b>2.0</b>	<b>128,466</b>	<b>1.7</b>
<b>Total equity</b>		<b>4,666,334</b>	<b>60.1</b>	<b>4,334,510</b>	<b>58.3</b>
In-house	Index linked gilts	595,360	7.6	400,458	5.4
In-house	Mature employer gilts	114,296	1.5	113,039	1.5
<b>Total inflation linked assets</b>		<b>709,656</b>	<b>9.1</b>	<b>513,497</b>	<b>6.9</b>
In-house	Property	35,421	0.5	86,954	1.2
Standard Life	Property	516,767	6.6	464,317	6.2
In-house	Infrastructure unquoted	844,860	10.8	935,570	12.6
In-house	Infrastructure quoted	24,819	0.3	26,087	0.4
In-house	Timber	124,029	1.6	129,707	1.7
<b>Total real assets</b>		<b>1,545,896</b>	<b>19.8</b>	<b>1,642,635</b>	<b>22.1</b>
Baillie Gifford	Corporate bonds	31,835	0.4	32,211	0.4
In-house	Private debt	204,996	2.6	267,039	3.6
In-house	Sovereign bonds	165,183	2.1	168,108	2.3
In-house	Investment Grade Credit	-	0.0	116,394	1.6
<b>Total debt assets</b>		<b>402,014</b>	<b>5.1</b>	<b>583,752</b>	<b>7.9</b>

**17 Investment managers and mandates (cont)**

Manager	Mandate	Market value at 31 March 2019 Restated	% of total 31 March 2019 Restated	Market value at 31 March 2020	% of total 31 March 2020
		£000	%	£000	%
In-house	Cash	462,976	5.9	367,144	4.9
In-house	Transitions	84	0.0	1,149	0.0
<b>Total cash and sundries</b>		<b>463,060</b>	<b>5.9</b>	<b>368,293</b>	<b>4.9</b>
<b>Net financial assets</b>		<b>7,786,960</b>	<b>100.0</b>	<b>7,442,687</b>	<b>100.0</b>

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

**18 Securities lending**

During the year Lothian Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2020, £132.6m (2019 £407.2m) of securities were released to third parties. Collateral valued at 107.0% (2019 107.3%) of the market value of the securities on loan was held at that date.

**19 Property holdings**

	2018/19	2019/20
	£000	£000
Opening balance	392,743	411,978
Additions	21,290	2,096
Disposals	-	(22,303)
Net change in market value	(2,055)	(24,277)
<b>Closing balance</b>	<b>411,978</b>	<b>367,494</b>

As at 31 March 2020, there were no restrictions on the realisability of the property or the remittance of income or sale proceeds. As at 31 March 2020 the Fund is contractually obliged to further construction costs of £140k.

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

	2018/19	2019/20
	£000	£000
Within one year	23,257	17,886
Between one and five years	58,867	52,629
Later than five years	92,633	69,701
	<b>174,757</b>	<b>140,216</b>



## NOTES TO THE FINANCIAL STATEMENTS

### 20 Financial Instruments

#### 20a Classification of financial instruments

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

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

Classification of financial instruments - parent	Restated 31 March 2019			Restated 31 March 2020		
	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost
Investment assets	£000	£000	£000	£000	£000	£000
Bonds	855,430	-	-	457,536	-	-
Equities	4,559,841	-	-	4,197,089	-	-
Pooled investments	1,372,379	-	-	1,656,513	-	-
Property Leases	2,284	-	-	-	-	-
Derivative contracts	3,025	-	-	15,228	-	-
Margin balances	-	-	-	-	-	-
Cash	-	569,189	-	-	681,472	-
Other balances	-	18,828	-	-	69,304	-
	<b>6,792,959</b>	<b>588,017</b>	-	<b>6,326,366</b>	<b>750,776</b>	-
Other assets						
City of Edinburgh Council	-	884	-	-	4,924	-
Cash	-	35,897	-	-	38,168	-
Share Capital	-	60	-	-	590	-
Debtors - current	-	22,345	-	-	18,119	-
Debtors - non-current	-	3,457	-	-	5,256	-
	-	<b>62,643</b>	-	-	<b>67,057</b>	-
<b>Assets total</b>	<b>6,792,959</b>	<b>650,660</b>	-	<b>6,326,366</b>	<b>817,833</b>	-



## NOTES TO THE FINANCIAL STATEMENTS

Classification of financial instruments - parent (cont)	Restated 31 March 2019			Restated 31 March 2020		
	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost
Financial liabilities	£000	£000	£000	£000	£000	£000
<b>Investment liabilities</b>						
Derivative contracts	(854)	-	-	(22)	-	-
Other investment balances	-	-	(1,058)	-	-	(1,927)
	(854)	-	(1,058)	(22)	-	(1,927)
<b>Other liabilities</b>						
Creditors	-	-	(30,799)	-	-	(30,084)
<b>Liabilities total</b>	<b>(854)</b>	<b>-</b>	<b>(31,857)</b>	<b>(22)</b>	<b>-</b>	<b>(32,011)</b>
<b>Total net assets</b>	<b>6,792,105</b>	<b>650,660</b>	<b>(31,857)</b>	<b>6,326,344</b>	<b>817,833</b>	<b>(32,011)</b>
<b>Total net financial instruments</b>			<b>7,410,908</b>			<b>7,112,166</b>
Amounts not classified as financial instruments			410,125			368,152
<b>Total net assets - parent</b>			<b>7,821,033</b>			<b>7,480,318</b>



## NOTES TO THE FINANCIAL STATEMENTS

### 20a Classification of financial instruments (cont)

Classification of financial instruments - adjustments to parent to arrive at group	Restated 31 March 2019			Restated 31 March 2020		
	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost
	£000	£000	£000	£000	£000	£000
<b>Other assets</b>						
Cash	-	341	-	-	870	-
Share Capital	-	(60)	-	-	(590)	-
Debtors - current	-	223	-	-	328	-
Debtors - non-current	-	393	-	-	424	-
	-	897	-	-	1,032	-
<b>Assets total</b>	-	897	-	-	1,032	-
<b>Other liabilities</b>						
Retire. benefit obligation	-	-	(2,309)	-	-	(2,232)
Creditors	-	-	(346)	-	-	(359)
Creditors - non current	-	-	(13)	-	-	(15)
<b>Liabilities total</b>	-	-	(2,668)	-	-	(2,606)
<b>Total net assets</b>	-	897	(2,668)	-	1,032	(2,606)
<b>Total net financial instruments</b>			(1,771)			(1,574)
<b>Total net assets - parent</b>			7,819,262			7,478,744

### 20b Net gains and losses on financial instruments

	2018/19	2019/20
	£000	£000
Designated as fair value through fund account	489,399	(491,457)
Loans and receivables	16,390	15,913
Financial liabilities at amortised cost	-	-
<b>Total</b>	<b>505,789</b>	<b>(475,544)</b>
Gains and losses on directly held freehold property	(2,055)	(24,751)
<b>Change in market value of investments per fund account</b>	<b>503,734</b>	<b>(500,295)</b>



## NOTES TO THE FINANCIAL STATEMENTS

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### 20c Fair Value Hierarchy

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

#### Level 1

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

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

#### Level 2

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

#### Level 3

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

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

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



## NOTES TO THE FINANCIAL STATEMENTS

### 20c Fair Value Hierarchy (cont)

	31 March 2020			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
<b>Investment assets</b>				
Designated as fair value through fund account	4,238,265	646,379	1,441,718	6,326,362
Non-financial assets at fair value through profit and loss	-	-	367,494	367,494
<b>Total investment assets</b>	<b>4,238,265</b>	<b>646,379</b>	<b>1,809,212</b>	<b>6,693,856</b>
<b>Investment liabilities</b>				
Designated as fair value through fund account	-	(22)	-	(22)
<b>Total investment liabilities</b>	<b>-</b>	<b>(22)</b>	<b>-</b>	<b>(22)</b>
<b>Net investment assets</b>	<b>4,238,265</b>	<b>646,357</b>	<b>1,809,212</b>	<b>6,693,834</b>

	Restated 31 March 2019			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
<b>Investment assets</b>				
Designated as fair value through fund account	4,563,196	926,654	1,299,026	6,788,876
Non-financial assets at fair value through profit and loss	-	-	411,978	411,978
<b>Total investment assets</b>	<b>4,563,196</b>	<b>926,654</b>	<b>1,711,004</b>	<b>7,200,854</b>
<b>Investment liabilities</b>				
Designated as fair value through fund account	-	(854)	-	(854)
<b>Total investment liabilities</b>	<b>-</b>	<b>(854)</b>	<b>-</b>	<b>(854)</b>
<b>Net investment assets</b>	<b>4,563,196</b>	<b>925,800</b>	<b>1,711,004</b>	<b>7,200,000</b>





## NOTES TO THE FINANCIAL STATEMENTS

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### 21 Nature and extent of risk arising from financial instruments

#### Risk and risk management

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

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

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

#### Types of investment risk

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

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

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



## NOTES TO THE FINANCIAL STATEMENTS

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

The Fund manages these risks in a number of ways:

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

#### Sensitivity analysis

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

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

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

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

Asset type	Potential price movement (+ or -)
Equities - Developed Markets	20.5%
Equities - Emerging Markets	30.0%
Private Equity	30.0%
Timber and Gold	18.0%
Secured Loans	10.0%
Fixed Interest Gilts	5.9%
Index-Linked Gilts	10.9%
Infrastructure	12.0%
Property	13.0%
Cash	0.8%



## NOTES TO THE FINANCIAL STATEMENTS

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

	Value at 31 March 2020	% of fund	Potential Change +/-	Value on increase	Value on decrease
	£m	%	%	£m	£m
Equities - Developed Markets	3,898	52.4	20.5%	4,697.1	3,098.9
Equities - Emerging Markets	293	3.9	30.0%	380.9	205.1
Private Equity	128	1.7	30.0%	166.4	89.6
Timber and Gold	130	1.7	18.0%	153.4	106.6
Secured Loan	416	5.6	10.0%	457.6	374.4
Fixed Interest Gilts	168	2.3	5.9%	177.9	158.1
Index-Linked Gilts	515	6.9	10.9%	571.1	458.9
Infrastructure	962	12.9	12.0%	1,077.4	846.6
Property	549	7.4	13.0%	620.4	477.6
Cash and forward foreign exchange	384	5.2	0.8%	387.1	380.9
<b>Total [1]</b>	<b>7,443</b>	<b>100.0</b>	<b>16.7%</b>	<b>8,689.3</b>	<b>6,196.7</b>
<b>Total [2]</b>			<b>13.0%</b>	<b>8,412.1</b>	<b>6,473.9</b>
<b>Total [3]</b>			<b>13.7%</b>	<b>8,464.2</b>	<b>n/a</b>

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

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

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

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

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

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



## NOTES TO THE FINANCIAL STATEMENTS

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

#### Credit risk

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

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

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

#### Cash deposits

At 31 March 2020, cash deposits represented £719.6m, 9.5% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2020	Balances at 31 March 2019	Balances at 31 March 2020
		£000	£000
<b>Held for investment purposes</b>			
Northern Trust Global Investment Limited - liquidity funds	Aaa-mf	13,517	88,569
Northern Trust Company - cash deposits	Aa2	443,357	238,706
UK Short-Term Bills and Notes	Aa2	-	218,968
The City of Edinburgh Council - treasury management	See below	112,315	135,229
<b>Total investment cash</b>		<b>569,189</b>	<b>681,472</b>
<b>Held for other purposes</b>			
The City of Edinburgh Council - treasury management	See below	35,897	38,168
<b>Total cash - parent</b>		<b>605,086</b>	<b>719,640</b>
<b>Cash held by LPFE/LPFI Limited</b>			
Royal Bank of Scotland	A1	341	870
<b>Total cash - group</b>		<b>605,427</b>	<b>720,510</b>

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



## NOTES TO THE FINANCIAL STATEMENTS

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

	Moody's Credit Rating at 31 March 2020	Balances at 31 March 2019	Balances at 31 March 2020
		£000	£000
<b>Money market funds</b>			
Deutsche Bank AG, London	Aaa-mf	3,979	20,825
Goldman Sachs	Aaa-mf	58	12,444
Aberdeen Standard Sterling Liquidity Fund	Aaa-mf	21,746	23,005
<b>Bank call accounts</b>			
Bank of Scotland	Aa3	14,578	4,795
Royal Bank of Scotland	A1	573	9,634
Santander UK	Aa3	1	-
Barclays Bank	A1	13	12
Svenska Handelsbanken	Aa2	6	6
HSBC Bank PLC	Aa3	14	4
<b>Notice accounts</b>			
HSBC Bank PLC	Aa3	17,527	9,044
<b>UK Pseudo-Sovereign risk instruments</b>			
Other Local Authorities [1]	Aa2	89,717	93,628
		<b>148,212</b>	<b>173,397</b>

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2020 was 'Aa2').

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

- (a) UK Government and other UK local Authorities with no limit, other public bodies up to £20 million per organisation.
- (b) Money market funds (MMFs) no more than £30 million or 15% with any one Fund.
- (c) Financial Institutions: Banks and Building Societies with multiple criteria based on a range of short and long term credit ratings, as well as any security, provided from maximum of £60 million / 20% of assets under management (AUM) for institutions with the highest criteria to £10 million / 5% of AUM for institutions with the lowest acceptable criteria.

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



## NOTES TO THE FINANCIAL STATEMENTS

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

#### Securities lending

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

#### Derivatives

The Fund transacts foreign currency derivatives over-the-counter and hence is exposed to credit risk in the event of a counterparty defaulting on the net payment or receipt that remains outstanding. This risk is minimised by the use of counterparties that are recognised financial intermediaries with acceptable credit ratings and by netting agreements. At 31 March 2020, the Fund was owed £15.2m on over-the-counter foreign currency derivatives.

#### Refinancing risk

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

#### Liquidity risk

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

The majority (estimated to be approximately 76% (2019 78%)) of the Fund's investments could be converted to cash within three months in a normal trading environment.

### 22 Actuarial statement

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



## NOTES TO THE FINANCIAL STATEMENTS

### 23 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £8,774m (2019 £9,435m). The figure is only prepared for the purposes of IAS26 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

	31 March 19	31 March 20
	% p.a.	% p.a.
Inflation / pensions increase rate	2.5	1.9
Salary increase rate	4.2	3.5
Discount rate	2.4	2.3

### Longevity assumptions

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

	31 March 2019		31 March 2020	
	Male	Female	Male	Female
Current pensioners	21.7 years	24.3 years	21.7 years	24.3 years
Future pensioners (assumed to be currently 45)	24.7 years	27.5 years	24.7 years	27.5 years

### Commutation assumption

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



## NOTES TO THE FINANCIAL STATEMENTS

### 24 Non-current Debtors

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £8,774m (2019 £9,435m). This figure is used for statutory accounting purposes by Lothian Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS102/IAS19 reports at each year end.

	LPF Parent 31 March 2019	LPF Group 31 March 2019	LPF Parent 31 March 2020	LPF Group 31 March 2020
	£000	£000	£000	£000
Contributions due - employers' cessation	3,457	3,457	5,256	5,256
	<b>3,457</b>	<b>3,457</b>	<b>5,256</b>	<b>5,256</b>

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

The above debtors all relate to community admission bodies.

### 25 Debtors

	LPF Parent 31 March 2019	LPF Group 31 March 2019	LPF Parent 31 March 2020	LPF Group 31 March 2020
	£000	£000	£000	£000
Contributions due - employers	16,831	16,831	13,680	13,680
Contributions due - members	4,691	4,691	3,808	3,807
Benefits paid in advance or recoverable	6	6	49	49
Sundry debtors	503	717	195	525
Prepayments	314	323	386	386
LPFE & LPFI Limited Loan facility - see note 28	-	-	-	-
	<b>22,345</b>	<b>22,568</b>	<b>18,118</b>	<b>18,447</b>





## NOTES TO THE FINANCIAL STATEMENTS

### 26 Creditors

	LPF Parent 31 March 2019	LPF Group 31 March 2019	LPF Parent 31 March 2020	LPF Group 31 March 2020
	£000	£000	£000	£000
Benefits payable	8,886	8,886	6,622	6,622
VAT, PAYE and State Scheme premiums	1,354	1,738	4,402	4,863
Contributions in advance	17,785	17,785	16,742	16,742
Miscellaneous creditors and accrued expenses	2,332	2,488	1,791	2,004
Office - operating lease	220	220	197	197
Corporation tax	-	28	-	15
Intra group creditor - see note 28	222	-	329	-
	<b>30,799</b>	<b>31,145</b>	<b>30,083</b>	<b>30,443</b>

### 27 Additional Voluntary Contributions

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

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

	2018/19	2019/20
Total contributions during year for Lothian Pension fund	£000	£000
Standard Life	312	323
Prudential	2,225	2,037
	<b>2,537</b>	<b>2,360</b>

	31 March 2019	31 March 2020
Total value at year end for Lothian Pension Fund	£000	£000
Standard Life	4,685	4,102
Prudential	7,676	7,515
	<b>12,361</b>	<b>11,617</b>



## NOTES TO THE FINANCIAL STATEMENTS

### 28 Related parties

#### The City of Edinburgh Council

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

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

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

	31 March 2019	31 March 2020
	£000	£000
Year end balance of holding account	884	4,924
	<b>884</b>	<b>4,924</b>

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2020, the fund had an average investment balance of £144.7m (2018/19 £139.1m). Interest earned was £1135k (2018/19 £977.1k)

#### Year end balance on treasury management account

	31 March 2019	31 March 2020
	£000	£000
Held for investment purposes	112,315	135,229
Held for other purposes	35,897	38,168
	<b>148,212</b>	<b>173,397</b>



## NOTES TO THE FINANCIAL STATEMENTS

### 28 Related parties (cont)

#### Scheme employers

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

	31 March 2019	31 March 2020
	£000	£000
City of Edinburgh Council	59,694	64,051
West Lothian Council	25,841	26,458
Scottish Water	15,975	16,504
East Lothian Council	14,746	15,799
Midlothian Council	14,041	14,927
Lothian Buses	7,002	6,565
Edinburgh Napier University	5,199	5,521
Heriot-Watt University	3,026	3,205
Scottish Police Authority	3,016	2,802
Edinburgh College	2,676	2,777

#### Governance

As at 31 March 2020, all members of the Pensions Committee, with the exception of Richard Lamont, and all members of the Pension Board, with the exception of Sharon Cowle, were members of the Lothian Pension Fund. One member of both the Pensions Committee and the Pension Board are in receipt of pension benefits from Lothian Pension Fund.

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

During the period from 1 April 2019 to the date of issuing of these accounts, a number of employees of the City of Edinburgh Council and its wholly owned subsidiary, LPFE Limited, held key positions in the financial management of the Lothian Pension Fund. Total compensation paid in relation to key management personnel employed by LPFE Limited during the period was as follows:

	31 March 2019	31 March 2020
	£000	£000
Short-term employee benefits	647	757
Post-employment benefits - employer pension contributions	111	140



## NOTES TO THE FINANCIAL STATEMENTS

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### 28 Related parties (cont)

Key management personnel employed by LPFE had accrued pensions totalling £106,596 (1 April 2019: £120,245) and lump sums totalling £121,925 (1 April 2019: £132,375 ) at the end of the period. Further details on senior management remuneration can be found within the remuneration report on page 115.

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

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

### LPFE Limited & LPFI Limited- loan facility

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

Interest payable by LPFE Limited during the period was £2,132 of which £1,037 was due at the year end and for LPFI Limited there was minimal interest payable for the year. At 31 March 2020, there was zero balance on the loan facilities for both LPFE Limited and LPFI Limited. "

### LPFE Limited - staffing services

Staffing services are provided to Lothian Pension Fund for the purposes of administering the Funds under a intra-group resourcing agreement. The agreement also provides for the running costs of the company to be covered as part of a service charge and allows for the provision of staffing services to LPFI Limited. During the year to 31 March 2020, the Fund was invoiced £4,239k (2019 £3,614k) for the services of LPFE Limited staff.



## NOTES TO THE FINANCIAL STATEMENTS

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

#### Movement in deferred tax asset (Non-current asset)

	LPF Group 2018/19	LPF Group 2019/20
	£000	£000
At 1 April 2018	292	393
Credit for year to Fund Account	101	31
<b>At 31 March 2019</b>	<b>393</b>	<b>424</b>

#### Elements of closing deferred tax asset

	LPF Group 31 March 2019	LPF Group 31 March 2020
	£000	£000
Pension liability	393	424
	<b>393</b>	<b>424</b>

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

	31 March 2019	31 March 2020
	£	£
Allotted, called up and fully paid Ordinary shares of £1 each - LPFE Limited*	1	1
Allotted, called up and fully paid Ordinary shares of £1 each - LPFI Limited	60,000	590,378
	<b>60,001</b>	<b>590,379</b>

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

As part of the LPFI's FCA permissions extension, the Fund is required to meet new ICAAP capital requirements based on the value of assets under management. The Fund financed an additional £530k of share capital for LPFI in March 2020 to meet this requirement.



## NOTES TO THE FINANCIAL STATEMENTS

### 30 Retirement benefits obligation - group

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

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

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

### Fund assets

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

Asset		Fair value at 31 March 2019	% of total 31 March 2019	Fair value at 31 March 2020	% of total 31 March 2020
		£000	%	£000	%
Equity securities:	Consumer	1,094	14.0	1,036	10.0
	Manufacturing	1,265	15.0	1,568	14.0
	Energy & Utilities	777	6.0	693	7.0
	Financial institutions	865	9.0	707	7.0
	Health & care	559	5.0	752	7.0
	Information Technology	335	6.0	470	4.0
	Other	1,003	6.0	794	7.0
Debt securities:	Corporate Bonds	-	2.0	582	5.0
	UK Government	1,045	10.0	669	6.0
Private equity:	All	139	2.0	95	1.0
Real property:	UK property	697	6.0	712	7.0
	Overseas property	-	0.0	10	0.0
Investment funds and unit trusts:	Equities	102	1.0	133	1.0
	Bonds	261	0.0	46	0.0
	Infrastructure	1,277	12.0	1,529	14.0
Derivatives:	Foreign Exchange	3	0.0	22	0.0
Cash and cash equivalents	All	863	6.0	1,053	10.0
		<b>10,285</b>	<b>100.0</b>	<b>10,871</b>	<b>100.0</b>



## NOTES TO THE FINANCIAL STATEMENTS

### 30 Retirement benefits obligation - group (cont)

#### Amounts recognised in the Net Assets Statement

	LPF Group 31 March 2019	LPF Group 31 March 2020
	£000	£000
Fair value of Fund assets	10,285	10,871
Present value of Fund liabilities	(12,594)	(13,103)
	<b>(2,309)</b>	<b>(2,232)</b>

#### Movement in the defined benefit obligation during the period

	LPF Group 31 March 2018/19	LPF Group 31 March 2019/20
	£000	£000
Brought forward	10,367	12,594
Current service cost	843	1,144
Past service cost	-	307
Interest cost on obligation	294	332
Fund participants contributions	186	233
Benefits paid	-	(11)
Actuarial losses arising from changes in financial assumptions	904	(1,496)
Actuarial losses arising from changes in demographic assumptions	-	-
Other actuarial losses	-	-
<b>Balance at year end</b>	<b>12,594</b>	<b>13,103</b>



## NOTES TO THE FINANCIAL STATEMENTS

### 30 Retirement benefits obligation - group (cont)

#### Movement in the fair value of Fund assets during the period

	LPF Group 31 March 2018/19	LPF Group 31 March 2019/20
	£000	£000
Brought forward	8,652	10,285
Benefits paid		
Interest income on Fund assets	244	270
Contributions by employer	567	792
Contributions by member	194	233
Contributions in respect of unfunded benefits	-	(11)
Unfunded benefits paid	(8)	
Effect of business combinations and disposals	-	
Return on assets excluding amounts included in net interest	636	(698)
<b>Balance at year end</b>	<b>10,285</b>	<b>10,871</b>

#### Amounts recognised in the Fund Account

	LPF Group 31 March 2018/19	LPF Group 31 March 2019/20
	£000	£000
Interest received on Fund assets	(244)	(270)
Interest cost on Fund liabilities	294	332
Current service costs	843	1,144
Past service costs	-	307
Employer contributions	(567)	(792)
Actuarial gain/(loss) due to re-measurement of defined benefit obligation	904	(1,496)
Return on Fund assets (excluding interest above)	(636)	698
<b>Net cost recognised in Fund account</b>	<b>594</b>	<b>(77)</b>





## NOTES TO THE FINANCIAL STATEMENTS

### 30 Retirement benefits obligation - group (cont)

#### Principal actuarial assumptions used in this valuation

	31 March 2019	31 March 2020
	% p.a.	% p.a.
Inflation / pensions increase rate	2.4	1.8
Salary increase rate	4.1	3.4
<b>Discount rate</b>	<b>2.5</b>	<b>2.3</b>

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

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

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

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

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

	31 March 2019		31 March 2020	
	Male	Female	Male	Female
Current pensioners	21.7 years	24.3 years	21.7 years	24.3 years
Future pensioners	24.7 years	27.5 years	24.7 years	27.5 years

Expected employer contributions to the defined benefit plan for the year ended 31 March 2021 are £881k, based on a pensionable payroll cost of £2.895k



## NOTES TO THE FINANCIAL STATEMENTS

### 31 Contractual commitments

#### Investment commitments

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

	31 March 2019	31 March 2020
	£000	£000
Outstanding investment commitment	325,361	301,002
	<b>325,361</b>	<b>301,002</b>

#### Office accommodation - 144 Morrison Street, Edinburgh

The Fund is committed to making the following future payments.

	31 March 2019	31 March 2020
	£000	£000
Within one year	115	124
Between one and five years	345	373
After five years	647	566
	<b>1,107</b>	<b>1,063</b>
<b>Recognised as an expense during the year</b>	<b>92</b>	<b>105</b>

The Fund is overdue a review on its rent agreement, the above expense including a provision for a backdated rental increase. This expense has been allocated across the two Funds, with Lothian Pension Fund's share being £103k.



## NOTES TO THE FINANCIAL STATEMENTS

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### 32 Contingent assets and liabilities

#### Contribution refunds

At 31st March 2020, Lothian Pension Fund had £914k (2019: £909k) in unclaimed refunds due to members.

#### Employer Cessations

As stated in note 24, "In accordance with the Funding Strategy Statement and in recognition of severe affordability constraints facing the charitable sector, "Funding Agreements" have been put in place with certain former employers to repay cessation valuation debt".... In exceptional circumstances, this includes "repayment of less than the cessation debt in order to avoid employer insolvency, with an appropriate agreement which allows the Fund to revisit the repayment of the remaining debt at a future date (i.e. the debt would be a contingent liability and hence not recognised on an employer's balance sheet); and seeking, where appropriate, suitable "anti-embarrassment" provisions in legal agreement covering future increase in employer asset values". At 31 March 2020, such contingent assets of the Fund totalled £1,635k and the fund has secured second ranking security over two employer property assets.

Waverley Care, Freespace and Four Square also left the Fund during the 2019/20 year. The Fund is currently working with the Actuary to finalise exit valuations. Waverley Care and Freespace have indicated they are unlikely to be able to meet their exit deficits in full and funding agreements will be put in place as required. At 31 March 2020, it is estimated that these cessation debts would be valued at circa. £3,500k.

#### EU Tax claims & income recovery

The Fund participates in various claims to recover withheld investment income. EU tax claims relate to the recovery of tax deducted from dividend payments prior to receipt or payable tax credits thereon. The claims can be divided into three main types – "Manninen" / Foreign Income Dividends (Fids), "Fokus Bank" and Manufactured Dividends. Given the high level of uncertainty as to the eventual success of such claims from EU tax authorities, no accrual of income is made in the financial statements. The value of these outstanding claims is approximately £11.6m. To date, the amount of tax recovered exceeds the cost of pursuing claims. Legal costs are shared across a pool of claimants and the Fund has the right to cease participation without incurring further costs. An annual progress report is provided to Pensions Audit Sub-Committee.



## NOTES TO THE FINANCIAL STATEMENTS

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### 32 Contingent assets and liabilities (cont)

#### Variable pay arrangements

In 2018/19 the company introduced three variable pay schemes, two of which have vesting periods. The Portfolio Manager and Senior Management schemes entitle staff to receive an assessed percentage of their salary as an additional variable pay award if they meet certain objectives during the year. The assessment year runs from 1 February to 31 January with the award then vesting over three years. The first part is payable at the end of the first year if the objectives are met and the remaining two parts are payable in the following two years if the requirement that the employee is still employed by the company at such time is met. Payment one for the 2019/20 and payment two for the 2018/19 was made in January 2020. A liability has been raised at 31 March 2020 for the two months of service for the second and third instalment of 2019/20 and third instalment of 2018/19 which the employees have delivered with regards to the second and third payments in the scheme.

In the event that all the staff involved in the arrangements at 31 January 2020 remain in the company's employment there is a contingent liability of £468,395 in excess of the current and non-current liabilities, as recognised in these financial statements in accordance with IAS19. This amount would be payable over two years.

#### Age Discrimination in Public Service Pension

On 13 May 2020, the Scottish Public Pensions Agency (SPPA) advised that:

"In December 2018, the Court of Appeal found that the transitional protections introduced to the judicial and firefighters' schemes during the reform of public service pensions in 2015 discriminated on grounds of age. The UK Government sought permission to appeal this decision but this was not granted, and on 15 July 2019 the UK Government issued a written ministerial statement to confirm that as transitional protection was provided in all public service schemes, the ruling had implications for all those schemes, including the Scottish Local Government Pension Scheme (SLGPS).

"Details of the Court of Appeal ruling, hereafter referred to as McCloud, are available ...

"Whilst initial proposals to address the specific discrimination in the SLGPS have been shared with the scheme advisory board, there remains uncertainty around the timing and changes needed in light of McCloud."

The Fund's IAS26 reporting from its actuary, as disclosed in Note 23, takes into account the appeal decision. There remains significant uncertainty over the remedy to be applied and associated costs to Scottish LGPS funds.



## NOTES TO THE FINANCIAL STATEMENTS

### 32 Contingent assets and liabilities (cont)

#### Employer Cost Cap considerations

In the same communication of 13 May 2020, SPPA stated:

"The reforms introduced to public service pensions from 1 April 2015 (or a year earlier in the case of the local government scheme in England and Wales) also included a new cost control mechanism, known as the employer cost cap.

"The purpose of the mechanism was to introduce a way of sharing pension cost increases and sav-ings between the employer (ultimately often the taxpayer) and scheme members...

"The first cost cap valuation for LGPS Scotland was due to take place at 31 March 2017. As you are aware, GAD commenced this process however it has not yet been completed, as the cost cap element of scheme valuations was suspended by the UK Government in early 2019 pending the resolution of McCloud. In a written ministerial statement on 25 March 2020, the Economic Secretary to the Treasury outlined the UK Government's intention to provide an update on the cost cap mechanism alongside proposals to address McCloud.

"We realise the challenges that actuaries face in considering the uncertainties in McCloud and the cost cap, particularly given the tight timescales for completing valuations. We regret that we are currently unable to suggest how provision might be made for any running of the cost cap process but hope to have more clarity in the next two months. We will write to administering authorities to provide an update at the earliest opportunity."

### 33 Impairment losses

	2018/19	2019/20
	£000	£000
Bad Debt provision	43	166

During the year the Fund recognised an increase in impairment losses in respect of specific benefit over payments for which reimbursement has been requested of £123k. This increased the impairment to £166k at the year end.



## ACTUARIAL STATEMENT FOR 2019/20

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

### Description of Funding Policy

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

- to ensure the long-term solvency of the overall Fund;
- to ensure the solvency of each individual employers' share of the Fund based on their expected term of participation in the Fund;
- to minimise the degree of short-term change in employer
- maximise the returns from investments within reasonable and considered risk parameters, and hence minimise the cost to the employer;
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment;
- to help employers manage their pension liabilities; and
- where practical and cost effective, to make allowance for the different characteristics of different employers and groups of employers.

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

### Funding Position as at the last formal funding valuation

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

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

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

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

### Principal Actuarial Assumptions and Method used to value the liabilities

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



## ACTUARIAL STATEMENT FOR 2019/20

### Method

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

### Assumptions

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

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

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

The key demographic assumption was the allowance made for longevity. The life expectancy assumption was based on the Fund's Vita Curves alongside future improvements based on the CMI 2016 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Male	Female
Current Pensioners	21.7 years	24.3 years
Future Pensioners *	24.7 years	27.5 years

\*Aged 45 as at 31 March 2017

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

### Experience over the period since 31 March 2017

Markets were disrupted by COVID 19 which resulted in difficult market conditions towards the end of the 2019/20 financial year. As a result, the funding level of the Fund as at 31 March 2020 is expected to have reduced versus that reported at the previous formal valuation.

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

### Laura McInroy FFA

For and on behalf of Hymans Robertson LLP  
20 Waterloo Street, Glasgow, G2 6DB  
Friday, 15 May 20



## ACCOUNTS

### LIST OF ACTIVE EMPLOYERS AT 31 MARCH 2020

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

Admitted Bodies	
Amey Services	Improvement Service (The)
Audit Scotland	ISS UK Ltd
Baxter Storey	LPFE Ltd
Bellrock Property and Facilities Management	Melville Housing Association
Canongate Youth Project	Mitie (Edinburgh College)
Capital City Partnership	Mitie PFI
CGI UK Ltd	Morrison Facilities Services Ltd
Children's Hearing Scotland	Museums Galleries Scotland
Children's Hospice Association Scotland	Newbattle Abbey College
Citadel Youth Centre	North Edinburgh Dementia Care
Compass Chartwell	NSL Services Ltd
Convention of Scottish Local Authorities	Penumbra





## ACCOUNTS

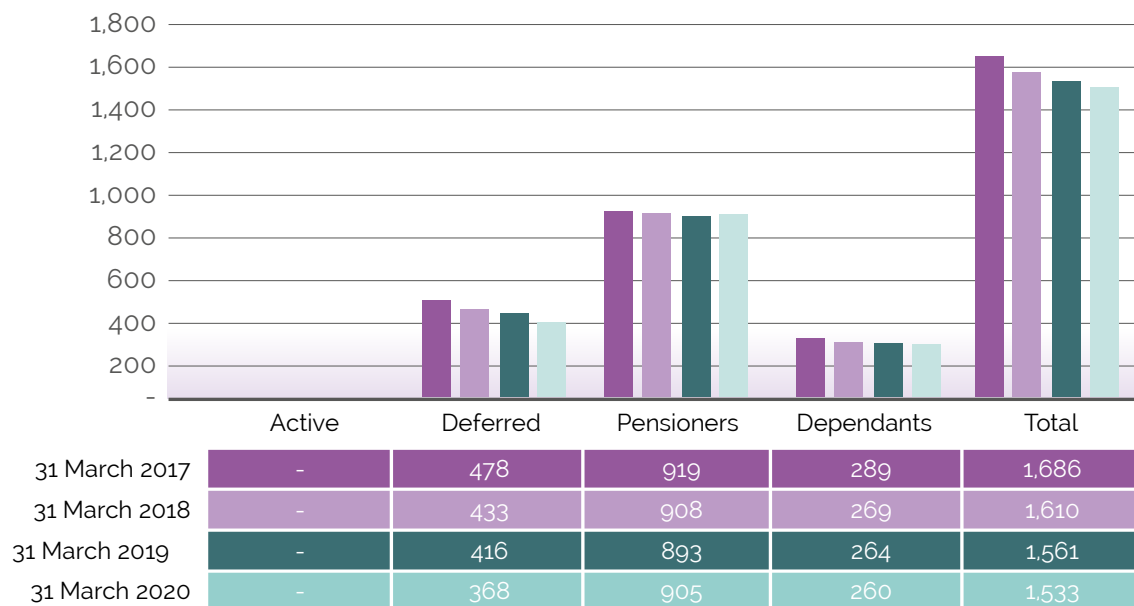
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Cyrenians	Pilton Equalities Project
Dacoll Limited	Queen Margaret University
Edinburgh Development Group	Royal Edinburgh Military Tattoo
Edinburgh International Festival Society	Royal Society of Edinburgh
Edinburgh Leisure	Scotland's Learning Partnership
Edinburgh Napier University	Scottish Adoption Agency
ELCAP	Scottish Futures Trust
Enjoy East Lothian	Scottish Schools Education Research Centre (SSERC)
Family Advice and Information Resource	Skanska UK
First Step	Sodexo Ltd
Forth and Oban Ltd	St Andrew's Children's Society Limited
Granton Information Centre	Stepping Out Project
Handicabs (Lothian) Ltd	University of Edinburgh (Edinburgh College of Art)
Hanover (Scotland) Housing Association	Weslo Housing Management
Health in Mind	West Granton Community Trust
Homes for Life Housing Partnership	West Lothian Leisure
HWU Students Association	Young Scot Enterprise



## SCOTTISH HOMES PENSION FUND ACCOUNTS

### SCOTTISH HOMES PENSION FUND ACCOUNTS



\* 2019 and 2020 include HAS members

### Homeless Action Scotland

The admission to Local Government Pension membership of Homeless Action Scotland (HAS) was terminated by LPF with effect from 12 July 2018. At the point of transfer, HAS had eleven deferred members, four pensioner members and one dependant member. The Actuary calculated the liabilities that remained on cessation at £641,000. Following specific request by LPF, on 31 March 2020, the Scottish Ministers issued a direction to the effect that:

- SHPF be substituted for Lothian Pension Fund as the appropriate fund for the Scheme employer as at 11 July 2018 and that all assets and liabilities of LPF relating to the Scheme employer are transferred to SHPF as at that date
- with effect from 11 July 2018, City of Edinburgh Council, as the administering authority of SHPF, shall admit the Scheme employer as an admission body of SHPF
- the administering authority must by 30 June 2020 execute all documents and do all things necessary to complete the substitution of SHPF for Lothian Pension Fund as the appropriate fund for the Scheme employer as at 11 July 2018 and the transfer of all assets and liabilities of Lothian Pension Fund relating to the Scheme employer to SHPF as at that date.



## SCOTTISH HOMES PENSION FUND ACCOUNTS

### Investment strategy

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

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

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

The strategic and actual asset allocations for the Fund at the end of the 2019 and 2020 financial years are shown in the table below.

Asset Class	Strategic Allocation	Actual Allocation	Strategic Allocation	Actual Allocation
	31 March 2019	31 March 2019	31 March 2020	31 March 2020
	%	%	%	%
Equities	-	-	-	-
Bonds	100	98	100	99
Property	-	-	-	-
Cash	-	2	-	1
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Given that the Fund had achieved full funding, the Pensions Committee approved a new investment objective in June 2018: "To match the cash flow from gilt income and redemption payments as closely as possible with the expected liability payments of the fund."



## SCOTTISH HOMES PENSION FUND ACCOUNTS

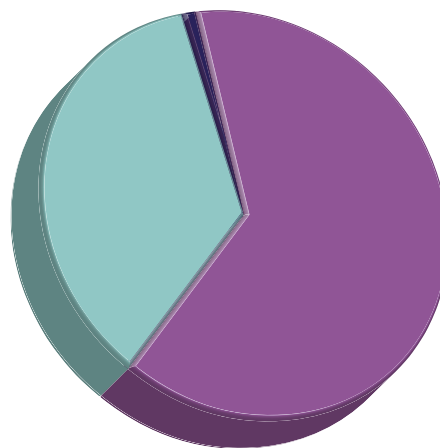
Detailed analysis of the Scottish Homes liabilities was undertaken during 2018/19 to ensure that the invested assets are as closely matched with the liability profile as possible, taking into consideration the expected duration of liabilities and whether they're fixed or index-linked in nature.

This resulted in a portion of index-linked gilts being sold and reinvested in nominal gilts to achieve a closer asset-liability match. There have been no further changes over 2019/20.

At 31 March 2020, the Fund is 'cash flow matched' up to one year beyond the next actuarial valuation expected in early 2021, and 'duration matched' liabilities beyond that. This is because there is greater certainty in the earlier period – funding levels will continue to be subject to the actuary's financial or demographic assumptions of future experience, which will be reassessed during 2020/21.

The actual asset allocation of the Fund is shown in the pie chart below.

### ACTUAL ASSET ALLOCATION 31 MARCH 2020



- **63.6%** Index Linked Gilts
- **35.6%** Nominal Gilts
- **0.8%** Cash

### Investment movements

As the Scottish Homes Pension Fund is mature, it uses the proceeds of gilt coupons and redemptions to pay pensions. Cash or cash equivalents are held to enable pensions to be paid between the dates when gilts redeem.

The Fund's assets have increased in value by 3.9% over the year, adjusted for cash flow movements to pay pensions.



## SCOTTISH HOMES PENSION FUND

### Fund Account for year ended 31 March 2020

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

Restated 2018/19		Note	2019/20
£000			£000
<b>Income</b>			
-	Contributions from the Scottish Government	4	-
1,726	Transfers from other schemes		-
<b>1,726</b>			<b>-</b>
<b>Less: expenditure</b>			
6,607	Pension payments including increases		6,653
591	Lump sum retirement payments		621
5	Lump sum death benefits		4
129	Transfers to other schemes	6	-
(17)	Administrative expenses	7b	(25)
<b>7,315</b>			<b>7,253</b>
<b>(5,589)</b>	<b>Net withdrawals from dealing with members</b>		<b>(7,253)</b>
<b>Returns on investments</b>			
1,824	Investment income	8	2,466
5,877	Change in market value of investments	9, 12b	4,473
(84)	Investment management expenses	7c	(104)
<b>7,617</b>	<b>Net returns on investments</b>		<b>6,835</b>
<b>2,028</b>	<b>Net increase/(decrease) in the Fund during the year</b>		<b>(418)</b>
<b>164,460</b>	<b>Net assets of the Fund at 1 April 2019</b>		<b>166,488</b>
<b>166,488</b>	<b>Net assets of the Fund at 31 March 2020</b>	<b>7c</b>	<b>166,070</b>



## SCOTTISH HOMES PENSION FUND

### Net Assets Statement as at 31 March 2020

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

Restated 31 March 2019		Note	31 March 2020
£000			£000
<b>Investment Assets</b>			
160,542	Bonds - UK		159,933
3,650	Cash Deposits		3,824
618	Other investment assets		615
<b>164,810</b>			<b>164,372</b>
<b>Investment Liabilities</b>			
-	Other investment liabilities		-
-			-
<b>164,810</b>	<b>Net investment assets</b>	<b>10</b>	<b>164,372</b>
<b>Current assets</b>			
10	The City of Edinburgh Council	18	130
1,741	Cash balances	13, 18	1,599
1	Debtors	16	2
<b>1,752</b>			<b>1,731</b>
<b>Current liabilities</b>			
(74)	Creditors	17	(33)
<b>(74)</b>			<b>(33)</b>
<b>1,678</b>	<b>Net current assets</b>		<b>1,698</b>
<b>166,488</b>	<b>Net assets of the Fund</b>	<b>12</b>	<b>166,070</b>

The unaudited accounts were issued on 24 June 2020 and the audited accounts were authorised for issue on XX September 2020.

#### John Burns FCMA CGMA, PgC

Chief Finance Officer, Lothian Pension Fund  
XX/09/2020

#### Note to the net asset statement

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



## NOTES TO THE FINANCIAL STATEMENTS

### Net Assets Statement as at 31 March 2020

#### 1 Statement of Accounting Policies

The statement of accounting policies for both Funds can be found on page 157.

#### 2 Prior Year Adjustment

##### Ministerial Direction – Homeless Action Scotland

The admission to Local Government Pension (LGPS) membership of Homeless Action Scotland (HAS) was terminated by Lothian Pension Fund (LPF) with effect from 12 July 2018. The Actuary to LPF calculated the liabilities that remained on cessation at £641,000. Following specific request by LPF, on 31 March 2020, the Scottish Ministers issued a direction to the effect that:

(a) Scottish Homes Pension Fund (SHPF) be substituted for Lothian Pension Fund as the appropriate fund for the Scheme employer as at 11 July 2018 and that all assets and liabilities of Lothian Pension Fund relating to the Scheme employer are transferred to SHPF as at that date;

(b) with effect from 11 July 2018, City of Edinburgh Council, as the administering authority of SHPF, shall admit the Scheme employer as an admission body of SHPF; and

(c) the administering authority must by 30 June 2020 execute all documents and do all things necessary to complete the substitution of SHPF for Lothian Pension Fund as the appropriate fund for the Scheme employer as at 11 July 2018 and the transfer of all assets and liabilities of Lothian Pension Fund relating to the Scheme employer to SHPF as at that date.

	2018/19 Audited	Adjustment	2018/19 Restated
	£000	£000	£000
Transfers from other schemes	-	1,726	1,726
Pension Payments	6,572	35	6,607
Administrative Expenses	(19)	2	(17)
Change in Market Value of Investments	5,767	110	5,877
Bonds - UK	158,743	1,799	160,542



## NOTES TO THE FINANCIAL STATEMENTS

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### 3 Events after the Reporting Date

There have been no events since 31 March 2020, and up to the date when these Financial Statements were authorised, that require any adjustments to these Financial Statements.

### 4 Contributions from the Scottish Government

The Scottish Homes Pension Fund (SHPF) is a dual employer pension fund for former employees of Scottish Homes (subsequently Communities Scotland) (and persons who were employed by the Scottish Special Housing Association, but who did not become employees of Scottish Homes) and former employees of Homeless Action Scotland (HAS) (formerly The Scottish Council for Single Homeless). The City of Edinburgh Council was selected by the Scottish Executive to be the administering authority of a fund created prior to the wind up of the Scottish Homes Residuary Body and therefore became the administering authority of SHPF on 1 July 2005, pursuant to section 2(a)(1A) of The Local Government Pension Scheme (Scotland) Amendment (No. 2) Regulations 2005 (SSI 315/2005) (the 2005 Regs). Former employees of HAS were transferred to SHPF on 12 July 2018 following receipt of Scottish Ministers approval on 31 March 2020.

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

Section 2 (1C) of the 2005 Regs stipulates that:

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

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

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

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

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





## NOTES TO THE FINANCIAL STATEMENTS

### 5 Transfers from other pension schemes

	Restated 2018/19	2019/20
	£000	£000
Group transfers	1,726	-
Individual transfers	-	-
	<b>1,726</b>	<b>-</b>

### 6 Transfers out to other pension schemes

	2018/19	2019/20
	£000	£000
Group transfers	-	-
Individual transfers	129	-
	<b>129</b>	<b>-</b>

### 7a Total Management expenses

	Restated 2018/19	2019/20
	£000	£000
Administrative costs	(17)	(25)
Investment management expenses	50	62
Oversight and governance costs	34	42
	<b>67</b>	<b>79</b>

This analysis of costs for the Scottish Homes Pension Fund has been prepared in accordance with CIPFA guidance. The analysis looks at the combined administration and investment management expenses in note 7b and c and splits out the costs to include a third heading covering oversight and governance expenditure.



## NOTES TO THE FINANCIAL STATEMENTS

7b Administrative expenses	Restated 2018/19	2019/20
	£000	£000
Employee costs	28	26
System costs	8	9
Actuarial fees	8	2
External audit fees	1	1
Printing and postage	2	3
Depreciation	1	1
Office costs	2	2
Sundry costs less sundry income	3	1
	<b>53</b>	<b>45</b>
Administration fee received	(70)	(70)
	<b>(17)</b>	<b>(25)</b>

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

7c Investment management expenses	2018/19	2019/20
	£000	£000
External management fees - deducted from capital (direct)	-	-
Transaction costs	2	-
Employee costs	44	56
Custody fees	6	8
Engagement and voting fees	2	3
Performance measurement fees	3	-
Consultancy fees	3	1
System costs	9	12
Legal fees	2	3
Office costs	2	3
Sundry costs less sundry income	11	18
	<b>84</b>	<b>104</b>

The Fund has not incurred any performance-related investment management fees in 2019/20 or 2018/19.



## NOTES TO THE FINANCIAL STATEMENTS

### 8 Investment income

	2018/19	2019/20
	£000	£000
Income from fixed interest securities	1,749	2,437
Interest on cash deposits and sundries	75	29
	<b>1,824</b>	<b>2,466</b>
Irrecoverable withholding tax	-	-
	<b>1,824</b>	<b>2,466</b>

### 9 Reconciliation of movement in investments

	Market value at 31 March 2019	Purchases at cost	Sales & proceeds	Change in market value	Market value at 31 March 2020
	£000	£000	£000	£000	£000
Bonds	160,542	-	(5,015)	4,406	159,933
Equities	-	-	-	-	-
Pooled investment vehicles	-	-	-	-	-
	<b>160,542</b>	<b>-</b>	<b>(5,015)</b>	<b>4,406</b>	<b>159,933</b>
<b>Other financial assets / (liabilities)</b>					
Cash deposits*	3,650			12	3,824
Investment income due/ amounts payable*	618			-	615
	<b>4,268</b>			<b>12</b>	<b>4,439</b>
<b>Net financial assets</b>	<b>164,810</b>			<b>4,418</b>	<b>164,372</b>

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



## NOTES TO THE FINANCIAL STATEMENTS

### 9 Reconciliation of movement in investments (cont)

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

	Market value at 31 March 2018	Purchases at cost	Sales & proceeds	Change in market value	Market value at 31 March 2019
	£000	£000	£000	£000	£000
Bonds	148,064	54,948	(50,036)	7,566	160,542
Equities	-	-	-	-	-
Pooled investment vehicles	-	-	-	-	-
	<b>148,064</b>	<b>54,948</b>	<b>(50,036)</b>	<b>7,566</b>	<b>160,542</b>
<b>Other financial assets / (liabilities)</b>					
Cash deposits*	9,094			-	3,650
Investment income due/ amounts payable*	4,904			-	618
	<b>13,998</b>			<b>-</b>	<b>4,268</b>
<b>Net financial assets</b>	<b>162,062</b>			<b>7,566</b>	<b>164,810</b>

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



## NOTES TO THE FINANCIAL STATEMENTS

### 10 Investment managers and mandates

		Restated Market value at 31 March 2019	Restated % of total 31 March 2019	Market value at 31 March 2020	% of total 31 March 2020
Manager	Mandate	£000	%	£000	%
In-house	Ex-Equity	31	0.0	27	0.0
<b>Total UK equities</b>		<b>31</b>	<b>0.0</b>	<b>27</b>	<b>0.0</b>
In-house	UK Index linked gilts	161,129	97.8	163,021	99.2
<b>Total fixed interest and inflation linked bonds</b>		<b>161,129</b>	<b>97.8</b>	<b>163,021</b>	<b>99.2</b>
In-house	Cash	3,650	2.2	1,324	0.8
<b>Total cash</b>		<b>3,650</b>	<b>2.2</b>	<b>1,324</b>	<b>0.8</b>
<b>Net financial assets</b>		<b>164,810</b>	<b>100.0</b>	<b>164,372</b>	<b>100.0</b>

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

	Restated Market value at 31 March 2019	Restated % of total 31 March 2019	Market value at 31 March 2020	% of total 31 March 2020
	£000	%	£000	%
UK Gov 2.5% Index Linked 16/04/20	11,619	7.0	11,411	6.9
UK Gov 4.25% 07/06/32	9,366	5.6	9,880	6.0
UK Gov 4.125% Index Linked 22/07/30	9,124	5.5	9,258	5.6
UK Gov 1.25% Index Linked 22/11/27	8,914	5.4	9,033	5.4
UK Gov 2.5% Index Linked 17/07/24	9,053	5.4	8,913	5.4
UK Gov 1.875% Index Linked 22/11/22	8,240	5.0	8,049	4.8



## NOTES TO THE FINANCIAL STATEMENTS

### 12 Financial Instruments

#### 12a Classification of financial instruments

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

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

	Restated 31 March 2019			31 March 2020		
	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost	Designated as fair value through fund account	Loans and receivables	Financial liabilities at amortised cost
<b>Financial assets</b>						
<b>Investment assets</b>	£000	£000	£000	£000	£000	£000
Bonds	160,542	-	-	159,933	-	-
Cash	-	3,650	-	-	3,824	-
Other balances	-	618	-	-	615	-
	<b>160,542</b>	<b>4,268</b>	<b>-</b>	<b>159,933</b>	<b>4,439</b>	<b>-</b>
<b>Other assets</b>						
City of Edinburgh Council	-	10	-	-	130	-
Cash	-	1,741	-	-	1,599	-
Debtors	-	1	-	-	2	-
	<b>-</b>	<b>1,752</b>	<b>-</b>	<b>-</b>	<b>1,731</b>	<b>-</b>
<b>Assets total</b>	<b>160,542</b>	<b>6,020</b>	<b>-</b>	<b>159,933</b>	<b>6,170</b>	<b>-</b>
<b>Financial liabilities</b>						
<b>Other liabilities</b>						
Creditors	-	-	(74)	-	-	(33)
<b>Liabilities total</b>	<b>-</b>	<b>-</b>	<b>(74)</b>	<b>-</b>	<b>-</b>	<b>(33)</b>
<b>Total net assets</b>	<b>160,542</b>	<b>6,020</b>	<b>(74)</b>	<b>159,933</b>	<b>6,170</b>	<b>(33)</b>
<b>Total net financial instruments</b>			<b>166,488</b>			<b>166,070</b>



## NOTES TO THE FINANCIAL STATEMENTS

### 12b Net gains and losses on financial instruments

	Restated 2018/19	2019/20
	£000	£000
Designated as fair value through fund account	7,566	4,406
Loans and receivables	-	12
Financial liabilities at amortised cost	-	-
<b>Total</b>	<b>7,566</b>	<b>4,418</b>

### 12c Valuation of financial instruments carried at fair value

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

#### Level 1

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

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

#### Level 2

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



## NOTES TO THE FINANCIAL STATEMENTS

### 12c Valuation of financial instruments carried at fair value (cont)

#### Level 3

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

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

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

	31 March 2020			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
<b>Investment assets</b>				
Designated as fair value through fund account	-	159,933	-	159,933
<b>Total investment assets</b>	-	<b>159,933</b>	-	<b>159,933</b>
<b>Investment liabilities</b>				
Designated as fair value through fund account	-	-	-	-
<b>Total investment liabilities</b>	-	-	-	-
<b>Net investment assets</b>	-	<b>159,933</b>	-	<b>159,933</b>

	Restated 31 March 2019			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
<b>Investment assets</b>				
Designated as fair value through fund account	-	160,542	-	160,542
<b>Total financial assets</b>	-	<b>160,542</b>	-	<b>160,542</b>
<b>Investment liabilities</b>				
Designated as fair value through fund account	-	-	-	-
<b>Total financial liabilities</b>	-	-	-	-
<b>Net investment assets</b>	-	<b>160,542</b>	-	<b>160,542</b>





## NOTES TO THE FINANCIAL STATEMENTS

### 13 Nature and extent of risk arising from financial instruments

#### Risk and risk management

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

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

#### Types of investment risk

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

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

#### Sensitivity analysis

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

Asset type	Potential price movement (+ or -)
Index-Linked Gilts	17.8%
Cash	0.0%



## NOTES TO THE FINANCIAL STATEMENTS

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

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

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

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

	Value at 31 March 2020	% of fund	Potential Change +/-	Value on increase	Value on decrease
	£000	%	%	£000	£000
Index-Linked Gilts	163,021	99.2	17.8	192,093	133,949
Cash	1,351	0.8	0.0	1,351	1,351
<b>Total [1]</b>	<b>164,372</b>	<b>100.0</b>	<b>17.8</b>	<b>193,444</b>	<b>135,300</b>
<b>Total [2]</b>			<b>17.8</b>	<b>193,696</b>	<b>135,048</b>
<b>Total [3]</b>			<b>7.8</b>	<b>177,259</b>	<b>n/a</b>

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

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

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

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

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

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



## NOTES TO THE FINANCIAL STATEMENTS

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

#### Credit risk

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

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

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

#### Cash deposits

At 31 March 2020, cash deposits represented £3m, 1.8% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2020	Balances at 31 March 2019	Balances at 31 March 2020
<b>Held for investment purposes</b>			
Northern Trust Company - cash deposits	A2	580	1,324
The City of Edinburgh Council - treasury management	See below	3,070	-
		<b>3,650</b>	<b>1,324</b>
<b>Held for other purposes</b>			
The City of Edinburgh Council - treasury management	See below	1,741	1,599
<b>Total cash</b>		<b>5,391</b>	<b>2,923</b>



## NOTES TO THE FINANCIAL STATEMENTS

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

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

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

- (a) UK Government and other UK local Authorities with no limit, other public bodies up to £20 million per organisation.
- (b) Money market funds (MMFs) no more than £30 million or 15% with any one Fund.
- (c) Financial Institutions: Banks and Building Societies with multiple criteria based on a range of short and long term credit ratings, as well as any security provided, from maximum of £60 million / 20% of assets under management (AUM) for institutions with the highest criteria to £10 million / 5% of AUM for institutions with the lowest acceptable criteria.

	Moody's Credit Rating at 31 March 2020	Balances at 31 March 2019	Balances at 31 March 2020
<b>Money market funds</b>			
Deutsche Bank AG, London	Aaa-mf	129	192
Goldman Sachs	Aaa-mf	2	115
Aberdeen Standard Sterling Liquidity Fund	Aaa-mf	706	212
<b>Bank call accounts</b>			
Bank of Scotland	Aa3	473	44
Royal Bank of Scotland	A1	19	89
<b>Notice accounts</b>			
HSBC Bank PLC	Aa3	569	83
<b>UK Pseudo-Sovereign risk instruments</b>			
Other Local Authorities [1]	Aa2	2,913	864
		<b>4,811</b>	<b>1,599</b>

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2020 was 'Aa2').



## NOTES TO THE FINANCIAL STATEMENTS

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

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

#### Refinancing risk

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

#### Liquidity risk

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

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

### 14 Actuarial statement

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



## NOTES TO THE FINANCIAL STATEMENTS

### 15 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £122m (2019 £135m). This figure is used for statutory accounting purposes by Scottish Homes Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's IAS19 reports at each year end.

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

	31 March 2019	31 March 2020
	% p.a.	% p.a.
Inflation/pensions increase rate	2.5%	1.9%
Discount rate	2.4%	2.3%

### Longevity assumptions

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

	31 March 2019		31 March 2020	
	Male	Female	Male	Female
Current pensioners	22.4 years	24.8 years	22.4 years	24.8 years
Future pensioners (assumed to be currently 45)	24.8 years	27.8 years	24.8 years	27.8 years

### Commutation assumption

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



## NOTES TO THE FINANCIAL STATEMENTS

### 16 Debtors

	31 March 2019	31 March 2020
	£000	£000
Sundry debtors	2	2
	<b>2</b>	<b>2</b>

### 17 Creditors

	31 March 2019	31 March 2020
	£000	£000
Benefits payable	73	31
Miscellaneous creditors and accrued expenses	1	2
	<b>74</b>	<b>33</b>

### 18 Related party transactions

#### The City of Edinburgh Council

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

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

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

	31 March 2019	31 March 2020
	£000	£000
Year end balance of holding account	10	130
	<b>10</b>	<b>130</b>

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2020, the fund had an average investment balance of £2.5m (2019 £10.6m). Interest earned was £20k (2019 £74k).



## NOTES TO THE FINANCIAL STATEMENTS

### 18 Related party transactions (cont)

#### Year end balance on treasury management account

	31 March 2019	31 March 2020
	£000	£000
Held for investment purposes	3,070	-
Held for other purposes	1,741	1,599
	<b>4,811</b>	<b>1,599</b>

#### Fund Guarantor

The Fund guarantor (by definition) is a related party to the scheme. The Scottish Government's contributions to the Fund can be found in note 4 (page 130) of the notes to the Financial Statements.

#### LPFE Limited - staffing services

Staffing services are provided to Lothian Pension Fund and Scottish Homes Pension Fund for the purposes of administering the Funds under an intra-group resourcing agreement. The agreement also provides for the running costs of the company to be covered as part of a service charge and allows for the provision of staffing services to LPFI Limited. Lothian Pension Fund is invoiced for these services and Scottish Homes Pension Fund is then allocated a percentage recharge on a defined basis. During the year to 31 March 2020, the Fund was recharged £81k (2019 £70k) for the services of LPFE Limited staff.





## NOTES TO THE FINANCIAL STATEMENTS

### 18 Related party transactions (cont)

#### Governance

As at 31 March 2020, all members of the Pensions Committee, with the exception of Richard Lamont, and all members of the Pension Board, with the exception of Sharon Cowle, were members of the Lothian Pension Fund. One member of both the Pensions Committee and the Pension Board are in receipt of pension benefits from Lothian Pension Fund.

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

During the period from 1 April 2019 to the date of issuing of these accounts, Lothian Pension Fund was charged by City Of Edinburgh Councils via its service level agreement for time spent by its Executive Management team on pension fund issues, Scottish Homes Pension Fund is then recharged for these services on a defined basis. All other staff that held key positions in the financial management of Lothian Pension Fund and Scottish Homes Pension Fund were employed by LPFE Limited. Total compensation paid in relation to key management personnel employed by LPFE Limited during the period was as follows:

	31 March 2019	31 March 2020
	£000	£000
Short-term employee benefits	647	757
Post-employment benefits - employer pension contributions	111	140

Key management personnel employed by LPFE, had accrued pensions totalling £106,596 (1 April 2019: £120,245) and lump sums totalling £121,925 (1 April 2019: £132,375 ) at the end of the period.

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



## NOTES TO THE FINANCIAL STATEMENTS

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### 19 Contingent assets/liabilities

#### Age Discrimination in Public Service Pension

On 13 May 2020, the Scottish Public Pensions Agency (SPPA) advised that:

"In December 2018, the Court of Appeal found that the transitional protections introduced to the judicial and firefighters' schemes during the reform of public service pensions in 2015 discriminated on grounds of age. The UK Government sought permission to appeal this decision but this was not granted, and on 15 July 2019 the UK Government issued a written ministerial statement to confirm that as transitional protection was provided in all public service schemes, the ruling had implications for all those schemes, including the Scottish Local Government Pension Scheme (SLGPS).

"Details of the Court of Appeal ruling, hereafter referred to as McCloud, are available...

"Whilst initial proposals to address the specific discrimination in the SLGPS have been shared with the scheme advisory board, there remains uncertainty around the timing and changes needed in light of McCloud."

The Fund's IAS26 reporting from its actuary, as disclosed in Note 23, takes into account the appeal decision. There remains significant uncertainty over the remedy to be applied and associated costs to Scottish LGPS funds.

#### Employer Cost Cap considerations

In the same communication of 13 May 2020, SPPA stated:

"The reforms introduced to public service pensions from 1 April 2015 (or a year earlier in the case of the local government scheme in England and Wales) also included a new cost control mechanism, known as the employer cost cap.

"The purpose of the mechanism was to introduce a way of sharing pension cost increases and savings between the employer (ultimately often the taxpayer) and scheme members ...

"The first cost cap valuation for LGPS Scotland was due to take place at 31 March 2017. As you are aware, GAD commenced this process however it has not yet been completed, as the cost cap element of scheme valuations was suspended by the UK Government in early 2019 pending the resolution of McCloud. In a written ministerial statement on 25 March 2020, the Economic Secretary to the Treasury outlined the UK Government's intention to provide an update on the cost cap mechanism alongside proposals to address McCloud.

"We realise the challenges that actuaries face in considering the uncertainties in McCloud and the cost cap, particularly given the tight timescales for completing valuations. We regret that we are currently unable to suggest how provision might be made for any running of the cost cap process but hope to have more clarity in the next two months. We will write to administering authorities to provide an update at the earliest opportunity."

### 20 Contractual commitments

The Fund had no contractual commitments at the year end.

### 21 Impairment losses

Impairment losses have been identified during the year



## SCOTTISH HOMES PENSION FUND ACCOUNTS

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### Actuarial Statement for 2019/20

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

#### Description of Funding Policy

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

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

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

#### Funding Position as at the last formal funding valuation

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

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



## SCOTTISH HOMES PENSION FUND ACCOUNTS

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### Actuarial Statement for 2019/20 (cont)

#### Principal Actuarial Assumptions and Method used to value the liabilities

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

#### Method

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

#### Assumptions

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

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

Financial assumptions	Friday, 31 March 17
Discount Rate	Bank of England nominal yield curve
Benefit increase assumption (CPI)	Bank of England implied (RPI) curve less 1.0% p.a.



## SCOTTISH HOMES PENSION FUND ACCOUNTS

### Actuarial Statement for 2019/20 (cont)

The key demographic assumption was the allowance made for longevity. The life expectancy assumption was based on the Fund's Vita Curves alongside future improvements based on the CMI 2016 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.75% p.a.

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

	Male	Female
Current Pensioners	22.4	24.8
Future Pensioners *	24.8	27.8

\*Aged 45 as at 31 March 2017

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

### Experience over the period since 31 March 2017

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

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

### Laura McInroy FFA

Fellow of the Institute and Faculty of Actuaries  
For and on behalf of Hymans Robertson LLP  
20 Waterloo Street  
Glasgow  
G2 6DB  
Friday, 15 May 20



## ACCOUNTING POLICES AND GENERAL NOTES

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### 1. Basis of preparation

The Financial Statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The Financial Statements summarises the transactions of the funds for the 2019/20 financial year and report on the net assets available to pay pension benefits as at 31 March 2020. The Financial Statements don't take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present values of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, are disclosed in the Notes to the Financial Statements.

### 2. Summary of significant accounting policies

#### General

##### a) Basis of consolidation – Group accounts

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

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

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

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

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





## ACCOUNTING POLICES AND GENERAL NOTES

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### Fund account – revenue recognition

#### b) Contribution income

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

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

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

#### c) Transfers to and from other schemes

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



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

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

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

#### d) Investment income

##### i) Interest income

Interest income is recognised in the Fund accounts as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination.

Income includes the amortisation of any discount or premium, transaction costs or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.



## ACCOUNTING POLICES AND GENERAL NOTES

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### ii) Dividend income

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

### iii) Distributions from pooled funds

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

### iv) Income from unquoted private equity and infrastructure investments

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

### v) Property related income

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

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

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

### vi) Movement in the net market value of investments

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

## Fund Account – expense items

### e) Benefits payable

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





## ACCOUNTING POLICES AND GENERAL NOTES

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### f) Taxation

#### i) Pension Funds

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

#### ii) Controlled entities – LPFE and LPFI

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

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

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

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

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





## ACCOUNTING POLICES AND GENERAL NOTES

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### **g) Administrative expenses**

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

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

### **h) Investment management expenses**

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

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change.

For some investment managers, an element of their fee is performance related. The amount of any performance related fees paid is disclosed in the note to the accounts on investment management expenses provided for each Fund.

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

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



## ACCOUNTING POLICES AND GENERAL NOTES

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cost of 'fund of fund' investments, this should be included as part of the Investments section in the Annual Report."

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

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

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

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

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

### **i) Operating lease**

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



## **Net Assets Statement**

### **j) Financial assets**

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



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**156 YOUTH  
WORKERS**





## SCOTTISH HOMES PENSION FUND ACCOUNTS

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

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





## SCOTTISH HOMES PENSION FUND ACCOUNTS

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



## SCOTTISH HOMES PENSION FUND ACCOUNTS

### Sensitivity of assets valued at level 3

Having analysed historical data and current market trends, and consulted with independent investment advisers, the Fund has determined that the valuation methods described above are likely to be accurate to within the following ranges, and has set out below the consequent potential impact on the closing value of investments held at 31 March 2020.

Lothian Pension Fund	Assessed Valuation range (+ or -)	Value at 31 March 2020	Value on increase	Value on decrease
Unquoted		£m	£m	£m
Private Equity	30%	76.1	98.9	53.3
Infrastructure	12%	844.9	946.3	743.5
Timber	18%	124.0	146.3	101.7
Private Secured Loans	75%	205.0	220.4	189.6
Property	13%	461.0	520.9	401.1
		<b>1,711.0</b>	<b>1,932.8</b>	<b>1,489.2</b>

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

#### k) Foreign currency transactions and balances

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

#### l) Cash and cash equivalents

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

#### m) Financial liabilities

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

#### n) Actuarial present value of promised retirement benefits



## SCOTTISH HOMES PENSION FUND ACCOUNTS

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

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

### **o) Additional voluntary contributions**

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

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

### **p) Contingent assets and contingent liabilities**

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

A contingent asset arises where an event has taken place giving rise to a possible asset whose existence will only be confirmed or otherwise by the occurrence of future events. Contingent assets and liabilities are not recognised in the Net Assets Statement but are disclosed by way of narrative in the notes.

### **q) Employee benefits**

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

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

The liability recognised in the Net Asset Statement in respect of the defined benefit





## SCOTTISH HOMES PENSION FUND ACCOUNTS

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pension plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognised past-service costs.

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

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

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

### 3. Accounting Standards that have been issued but not yet adopted

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This applies to the adoption of the following new or amended standards within the 2020/21 Code:

The Code requires implementation from 1 April 2020 and there's therefore no impact on the 2019/20 financial statements.

- Amendments to IAS 28 Investments in Associates and Joint Ventures: Long-term Interests in Associates and Joint Ventures
- Annual Improvements to IFRS Standards 2015-2017 Cycle
- Amendments to IAS 19 Employee Benefits: Plan amendment, curtailment or settlement.

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



## SCOTTISH HOMES PENSION FUND ACCOUNTS

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### 4. Critical judgements in applying accounting policies

#### Unquoted private equity and infrastructure investments

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

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

For the Lothian Pension Fund, the value of unquoted private equity, infrastructure, timber and secured loan investments at 31 March 2019 was £1,395.1m (2018 £1,250.0m).

#### Actuarial present value of promised retirement benefits

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

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

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

The Financial Statements contain estimated figures that are based on assumptions made by the Council; private equity and infrastructure managers; other providers of valuation information; and the Scheme Actuary about the future or that are otherwise uncertain.

Estimates are made taking into account historical experience, current trends and other relevant factors. However, because amounts cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the Net Assets Statement at 31 March 2020 for which there's a significant risk of material adjustment in the forthcoming financial year are as follows:



## SCOTTISH HOMES PENSION FUND ACCOUNTS

### a) Actuarial present value of promised retirement benefits

#### Uncertainties

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

#### Effect if actual results differ from assumptions – Lothian Pension Fund

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

Change in assumptions - year ended 31 March 2020	Approx Increase in liabilities %	Approx monetary amount £m
0.5% decrease in the real discount rate	11	958
1 year increase in member life expectancy	4	382
0.5% increase in salary increase rate	2	191
0.5% increase in pensions increase rate	9	751

#### Effect if actual results differ from assumptions – Scottish Homes Pension Fund

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

Change in assumptions - year ended 31 March 2020	Approx Increase in liabilities %	Approx monetary amount £m
0.5% decrease in the real discount rate	5	7
1 year increase in member life expectancy	4	6
0.5% increase in pensions increase rate	5	7



## SCOTTISH HOMES PENSION FUND ACCOUNTS

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### b) Valuation of unquoted private equity and infrastructure investments

#### Uncertainties

These investments aren't publicly listed and therefore there's a degree of estimation involved in their valuation, see 2j above for more details on the valuation methodology.

#### Effect if actual results differ from assumptions

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

### c) Quantifying the cost of investment fees deducted from capital

#### Uncertainties

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

#### Effect if actual results differ from assumptions

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

### COLLEAGUE PROFILE Susan Macfarlane, Communications Business Partner

Susan joined LPF in September 2019 as our Communications Business Partner. As well as being our brand ambassador, Susan's responsible for shaping and delivering our internal and external communications strategy to ensure that our colleagues and stakeholders are kept up to date with what's going on at LPF. Susan says:

**"I'm really proud to work for LPF as everyone is so positive and driven to deliver for our members. I enjoy being able to help shape our culture and share the great work we're doing at LPF with our members and stakeholders."**





## SCOTTISH HOMES PENSION FUND ACCOUNTS

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### d) Property Valuations - Novel Coronavirus (COVID-19) Outbreak

#### Uncertainties

The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organisation as a "Global Pandemic" on the 11 March 2020, has impacted global financial markets. Travel restrictions have been implemented by many countries. Market activity is being impacted in many sectors. As at the valuation date, CBRE (the Fund property valuer) consider that the Fund can attach less weight to previous market evidence for comparison purposes, to inform opinions of value. The current response to COVID-19 means that CBRE are faced with an unprecedented set of circumstances on which to base a judgement.

CBRE's valuation is therefore reported on the basis of 'material valuation uncertainty' as per VPS 3 and VPGA 10 of the RICS Red Book Global. Consequently, less certainty – and a higher degree of caution – are attached to the valuation of the Funds' investment property assets than would normally be the case. Given the unknown future impact that COVID-19 might have on the real estate market, CBRE have recommend that the valuation of the Funds' properties should be kept under frequent review.

For the avoidance of doubt, the inclusion of the 'material valuation uncertainty' declaration above doesn't mean that the valuation cannot be relied on. Rather, the phrase is used to be clear and transparent with all parties, in a professional manner that – in the current extraordinary circumstances – less certainty can be attached to the valuation than would otherwise be the case. The material uncertainty clause is a disclosure, not a disclaimer.

#### Effect if actual results differ from assumptions

There's a risk that these investments may be under or overstated in the accounts at any point in time. The actual financial return of this type of investment is only known with certainty at the time the asset is sold.



## STATEMENT OF RESPONSIBILITIES FOR THE ANNUAL ACCOUNTS

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### The responsibilities of the Administering Authority

The Administering Authority's responsibilities are to:

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

### Hugh Dunn

Head of Finance

The City of Edinburgh Council

24 June 2020



## STATEMENT OF RESPONSIBILITIES FOR THE ANNUAL ACCOUNTS

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### **The responsibilities of the Chief Finance Officer, Lothian Pension Fund**

The Chief Finance Officer, Lothian Pension Fund, is responsible for the preparation of the Fund's Financial Statements which, in terms of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 (the Code of Practice), is required to present a true and fair view of the financial position of the Fund at the accounting date and their income and expenditure for the year (ended 31 March 2020).

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

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

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

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

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

### **John Burns, Fcma CGMA PgC**

Chief Finance Officer  
Lothian Pension Fund  
24 June 2020



## ANNUAL GOVERNANCE STATEMENT

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### Roles and responsibilities

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

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

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



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

### Scope of responsibility

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

In discharging these overall responsibilities, elected members, senior officers and external representatives are responsible for implementing effective arrangements for governing the affairs of the LPF Group, and facilitating the effective exercise of its functions, including arrangements for the management of risk. The Pensions Committee oversees the operational administration of the Fund by the LPF Group.





## ANNUAL GOVERNANCE STATEMENT

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The LPF Group has adopted a Local Code of Corporate Governance that's consistent with the principles of the Chartered Institute of Public Finance and Accountancy (CIPFA) and Society of Local Authority Chief Executives (SOLACE) framework 'Delivering Good Governance in Local Government'.

This statement explains how the LPF Group has complied with the Local Code of Corporate Governance and how it meets the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom.

### **The governance framework**

The LPF Group operates within the wider governance framework of the Council but within specific ringfenced governance structures focused on the Fund themselves. The governance framework comprises the systems, controls, processes, cultures and values by which the LPF Group directs and controls the Fund. It also describes the way the LPF Group engages with and accounts to its stakeholders in relation to the management of the administration of the Fund. It enables the LPF Group to monitor the achievement of its objectives and consider whether those objectives have led to the delivery of appropriate, cost-effective services.

The framework also applies to any subsidiary companies which are members of the LPF Group, namely LPFI and LPFE. The LPF Group is also directly regulated by The Pensions Regulator, the Financial Conduct Authority (regarding its regulated investment activity), the Scottish Information Commissioner and is subject to other corporate and public sector rules and regulations.

The LPF Group's ongoing compliance with its governance framework and regulatory obligations is monitored on an ongoing basis by the Pensions Committee, the Audit Sub-Committee and the Pension Board and the respective boards of LPFI and LPFE.

The Administering Authority has certain oversight functions and procedures which apply to the oversight of the LPF Group. These include the Council's Democracy, Governance and Resilience, Procurement, Information Governance and Internal Audit functions, all of which form part of the LPF Group's assurance stack.

The LPF Group also places reliance upon certain of the internal financial controls within the Administering Authority's financial systems and the monitoring in place to ensure the effectiveness of these controls.



## ANNUAL GOVERNANCE STATEMENT

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The relevant key elements of the LPF Group and the Fund governance framework within the Administering Authority, include:

- Identifying the objectives of the Fund in the Funding Strategy Statement, Statement of Investment Principles, Pension Administration Strategy and Service Plan
- Since April 2015, The Pensions Regulator has been responsible for setting standards of governance and administration for the Local Government Pension Scheme. The LPF Group has taken steps to fully integrate compliance with these standards within the overall governance framework
- A systematic approach to monitoring service performance by the Pensions Committee, Pensions Audit Sub-Committee, Pension Board (each including external stakeholder representation), Independent Professional Observer and senior officers
- A structured programme to ensure that Pensions Committee and Pension Board members have the required standard of knowledge and understanding of Local Government Pension Scheme matters
- Operating within clearly established investment guidelines defined by the Local Government Pension Scheme Investment Regulations and the Fund's Statement of Investment Principles
- Compliance with the CIPFA Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme
- With the exception of managed funds, unlisted investments and property, all investments are held under custody by a global custodian. The Fund benefits from the custodian's extensive internal control framework
- Benchmarking of services in terms of standards and cost against other pension funds
- LPFE and LPFI operating within their respective constitutional documentation and the relevant companies' regulations
- LPFI operating within the relevant governance policies and procedures to ensure compliance with the Financial Conduct Authority's rules, regulations and guidance
- For LPF Group and Fund matters, the Pensions Committee, Pensions Audit Sub-Committee and Pension Board are responsible for scrutiny and challenge and a quarterly risk reporting process is in place to ensure full consideration of such matters
- Officers of the LPF Group are managed separately through the processes and procedures of LPFE, overseen by its board of directors, with terms and conditions and a human resources performance review and management strategy tailored to the express needs of the Fund and their stakeholders
- The directors of LPFE and LPFI have obligations to report to the Pensions Committee as the governing body for the Fund and the Administering Authority as the sole shareholder. In addition, the board and colleagues of LPFI are each individually regulated by the Financial Conduct Authority and so bound by the associated Principles and Standards of governance best practice.



## ANNUAL GOVERNANCE STATEMENT

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Elements of the governance framework of the Council that are relevant to the LPF Group and Fund include:

- The Council is embedding a culture of commercial excellence to ensure that its services always deliver Best Value. That is ongoing and seeks to improve standards in buying practices and processes across the Council including, to the extent applicable, the LPF Group and the Fund which bear the cost of its operation and administration
- The submission of reports, findings and recommendations from the external auditor, other inspectorates and internal audit, to the Pensions Committee, Pensions Audit Sub-Committee for all matters affecting the LPF Group and Fund and, in certain circumstances strictly for Council wide oversight purposes, the Corporate Leadership Team, Governance, Risk and Best Value Committee and wider Council
- The roles and responsibilities of Elected Members and Officers are defined in LPF Procedural Standing Orders, Council Committee Terms of Reference and Delegated Functions, Contract Standing Orders, Scheme of Delegation to Officers, the Member/officer protocol and Financial Regulations. These are subject to annual review
- The Chief Executive Officer has overall accountability to Council, for all aspects of operational management and overall responsibility for ensuring the continued development and improvement of systems and processes concerned with ensuring appropriate direction, accountability and control
- The Section 95 Officer has overall responsibility for ensuring appropriate advice is given to the Council and the LPF Group on all financial matters, keeping proper financial records of accounts and maintaining an effective system of internal financial control. For the Fund, the Section 95 officer responsibility has been sub-delegated to the Chief Finance Officer of the LPF Group
- The Chief Internal Auditor has overall responsibility to review, appraise and report to management and the Governance, Risk and Best Value Committee, and for matters relating to the LPF Group and Fund to the Pensions Committee and Pensions Audit Sub-Committee, on the adequacy of relevant internal control and corporate governance arrangements and on risks relating to approved policies, programmes and projects
- The Council's Democracy, Governance and Resilience Manager, reporting to the Head of Strategy and Communications, has responsibility for advising the Council on corporate governance arrangements and supports the LPF Group on certain aspects of its governance arrangements
- The risk management policy and framework set out the responsibilities of elected members, Governance, Risk and Best Value Committee, and for LPF Group and Fund matters the Pensions Committee and Pensions Audit Sub-Committee, management and colleagues for the identification and management of risks to corporate and service-related priorities:
  - The Resources and Chief Executive's Risk Register and Council Risk Register all identify risks and proposed treatment and actions. These registers are regularly



## ANNUAL GOVERNANCE STATEMENT

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reviewed, updated and reported to the Corporate Leadership Team, which reviews Council-wide risk and reports to the Governance, Risk and Best Value Committee for scrutiny and challenge

- o Resilience and business continuity plans are in place for all essential Council services. These set out arrangements for continuing to deliver essential services in the event of an emergency or other disruption
- o An Elected Members remuneration and expenses scheme is in place and is consistent with the Scottish Government's 'Councillors Remuneration: allowances and expenses – Guidance'. Information on the amounts and composition of elected members salaries, allowances and expenses is published on the Council's website
- o The Council's Democracy, Governance and Resilience Senior Manager ensures that induction training on roles and responsibilities, and ongoing development opportunities, are provided for Elected Members. A separate policy on Pensions Committee and Pension Board member training has been adopted and is overseen by the LPF Group's officers
- o Mandatory training for Councillors newly appointed to the Pensions Committee is programmed within the Induction and training programme for Elected Members. This focuses on governance, investment management and strategy and how the LPF Group and Fund work. Committee members are reminded of the requirement to undertake a minimum of 21 hours of training per financial year to fulfil their role on the Pensions Committee
- o The LPF Code of Conduct and CEC Code of Conduct set out the standards of behaviour expected from Elected Members and officers, are in place
- o The Employee Code of Conduct, Anti Bribery Policy and Policy on Fraud Prevention set out the responsibilities of officers and Elected Members in relation to fraud and corruption and are reinforced by the LPF Code of Conduct and Councillors' Code of Conduct, the Code of Ethical Standards and the Financial Regulations. The LPF Group has adapted policies to take into account the specific nature of its business and regulation
- o The Whistleblowing policy provides a process for disclosure in the public interest about the Council and its activities by officers, Elected Members and others. The LPF Group has a separate and adapted policy to take into account the specific nature of its business and regulation



## ANNUAL GOVERNANCE STATEMENT

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A significant element of the governance framework is the system of internal controls, which is based on an ongoing process to identify and prioritise risks to the achievement of the Council's objectives, including those relevant to the LPG Group and Fund. Following the establishment of the wholly-owned subsidiary companies, LPFE and LPFI, the Council continues to have appropriate assurance processes and procedures in relation to the responsible officers involved in the administration of those companies and so the wider LPF Group administering the Fund.

### Review of Effectiveness

The Local Code of Governance details the Council's arrangements for monitoring each element of the framework and providing evidence of compliance. The Council's Governance and Democratic Services Manager has reviewed the effectiveness of the Code.

The Chief Internal Auditor has also provided an assurance statement on the effectiveness of the system of internal control. The opinion in the assurance statement states: [I "Internal Audit considers that the LPF control environment and governance and risk management frameworks are generally adequate but with enhancements required and is therefore reporting a 'amber' rated opinion, with our assessment towards the middle of this category."

In compliance with standard accounting practice, the Head of Finance, of the City of Edinburgh Council has provided the Chief Executive Officer with a statement of the effectiveness of the Group's internal financial control system for the year ended 31st March 2019. It's the Head of Finance's opinion that: "... although a degree of assurance can be placed upon the adequacy and effectiveness of the Group's systems of internal financial control, further improvements, including embedding of actions taken in response to previous recommendations, are still required.

"In this context, I would particularly highlight improvements in train to address a number of systemic weaknesses in respect of payroll-related controls, including those to address historic, and prevent recurring, overpayments."

The Chief Finance Officer of the LPF Group has provided a statement of the effectiveness of the internal financial control system for the year ended 31st March 2019 for the Fund. It is the Chief Finance Officer's opinion "that reasonable assurance can be placed upon the adequacy and effectiveness of the system of internal financial control for the LPF Group in administering the Lothian Pension Fund and Scottish Homes Pension Fund."



## ANNUAL GOVERNANCE STATEMENT

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### Certification

It's our opinion, in light of the foregoing, that reasonable assurance can be placed upon the adequacy and effectiveness of the systems of governance that operate within the LPF Group in its administration of the Fund. We consider the governance and internal control environment operating during the financial year from 1 April 2017 to 31 March 2019 to provide reasonable and objective assurance that any significant risks impacting on the LPF Group and its ability to achieve its objectives in properly administering the Fund have and will continue to be identified and suitably proportionate actions have and will be taken to avoid or mitigate the impact of any such risks.

The LPF Group has identified certain key areas for improvement, summarised as follows:

- Human resources: To continue to implement the new human resources strategy specific to LPF Group's requirements and also implement a new learning management system and prioritise an intranet to reinforce communications on policies, procedures and group 'culture'
- Pension Board: To ensure that vacancies in the Pension Board are filled timeously and by suitable candidates and that this body of external stakeholder representatives receives the training and support it requires on an ongoing basis
- Business continuity: To continue to assess and refresh the business continuity plan on an ongoing basis ensuring sufficient engagement with colleagues and in particular in light of the prevailing circumstances of the COVID-19 pandemic and the Fund's Digital Strategy and office arrangements
- Digital strategy: To progress the Fund's Digital Strategy and most immediately complete the appointment of a new managed service ICT provider for the Fund
- Financial services regulatory compliance: To continue to instruct external compliance audits on the operations and governance of LPFI in order to ensure best practice compliance and assurance around its existing operations (and in preparation for its extended collaborative business model) and take action to address the recommendations from those audits on an ongoing basis
- Wider governance: To continue to maintain and reinforce separate governance and controls specific to the needs of the LPF Group, the pensions funds it administers and its distinct duties to employer and member stakeholders; consistently throughout the LPF Group's governance structures. To ensure that oversight by the City of Edinburgh Council is supported in a manner consistent with these duties.



## ANNUAL GOVERNANCE STATEMENT

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The LPF Group will continue to ensure that these are treated as a priority and that progress towards implementation will be reviewed through the governance structures and processes established for the LPF Group and summarised herein.

**Andrew Kerr**

Chief Executive Officer  
The City of Edinburgh Council  
24 June 2020

**Dr Stephen S Moir**

Executive Director of  
Resources  
The City of Edinburgh  
Council  
24 June 2020

**Doug Heron**

Chief Executive Officer  
Lothian Pension Fund  
24 June 2020



## GOVERNANCE COMPLIANCE STATEMENT

The Regulations that govern the management of Local Government Pension Scheme in Scotland require that a Governance Compliance Statement is published. This statement sets out the extent to which governance arrangements comply with best practice.

The statement below describes arrangements at 31 March 2020 and over the financial year.

Principle		Full Compliance	Comments
Structure	The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing Council.	✓	<p>The City of Edinburgh Council acts as administering authority and delegates all pension scheme matters to a committee of seven members (Pensions Committee) made up as follows:</p> <p>Five City of Edinburgh Council elected members</p> <p>Two external members, one drawn from the membership of the Fund and one drawn from the employers that participate in the Fund.</p>
	That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	✓	<p>The Pensions Committee includes two external places for pension fund stakeholders i.e. one each from the employer and member representatives.</p> <p>Fund members and employers are also represented within the Fund's Pension Board. Membership includes five employer representatives and five member representatives, although this is currently under review.</p> <p>All members of the Pension Board are invited to attend the meeting of the Pensions Committee and receive the relevant papers prior to those meetings.</p> <p>Two members of the Pension Board are invited to attend the Pensions Audit Sub-Committee.</p>





## GOVERNANCE COMPLIANCE STATEMENT

Principle		Full Compliance	Comments
Structure	That where a secondary committee or board has been established, the structure ensures effective communication across both levels.	✓	<p>The Pensions Audit Sub-Committee, consisting of three members of the Pensions Committee, report to the Pensions Committee on their findings and recommendations. Two members of the Pension Board attend the Pensions Audit Sub-Committee in a non-voting capacity. The Pension Board attends the Pensions Committee meetings and takes part in training events.</p> <p>Implementation of investment strategy is delegated to the Executive Director of Resources who then delegates to the Head of Finance, who takes advice from the Joint Investment Strategy Panel. The Panel meets quarterly and reports to the Pensions Committee annually.</p> <p>The advisers on the Joint Investment Strategy Panel consists of the Chief Investment Officer and on other portfolio manager of LPFI plus two experienced independent external industry advisers.</p> <p>The Pensions Committee receives annual updates from LPFE and LPFI.</p>
Representation	That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include employing authorities (including non-scheme employers, e.g. admitted bodies) and scheme members (including deferred and pensioner scheme members).	✓	<p>The Pension Board consists of a mix of representatives:</p> <ul style="list-style-type: none"> <li>• Five employer representatives from non-administering authority employers</li> <li>• Five member representatives appointed by the Trade Unions in accordance with the approach required under Scottish statute.</li> </ul>
	Where appropriate, independent professional observers, and expert advisers (on an ad-hoc basis).	✓	<p>An Independent Professional Observer was appointed in March 2013 to help Committee scrutinise advice. This contract expired in February 2018 and a new Observer was appointed in August 2018.</p>



## GOVERNANCE COMPLIANCE STATEMENT

Principle		Full Compliance	Comments
Representation	Where appropriate, independent professional observers, and expert advisers (on an ad-hoc basis).	✓	<p>As mentioned previously, external investment advisers sit on the Joint Investment Strategy Panel.</p> <p>A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the funds.</p> <p>A non-executive director was appointed to the board of LPFI on 7 February 2017 and LPFE on 19 March 2018. A further non-executive director is expected to be appointed to both boards in Q3 2020.</p> <p>An external compliance consultant supports the LPF Group on its ongoing compliance with the Financial Conduct Authority rules, regulations and guidance.</p>
	That where lay members sit on a main or secondary committee, they're treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision- making process, with or without voting rights.	✓	<p>The Pension Board attends the Pensions Committee meetings to help ensure that the operation of the pension funds is in accordance with the applicable law and regulation. The Pension Board takes part in all Committee training events.</p> <p>The Pensions Committee takes account of the views of the Pension Board when making decisions.</p>
Selection and Role of Lay Members	That committee or board members are made fully aware of the status, role and function that they're required to perform on either a main or secondary committee.	✓	<p>A comprehensive training programme including induction is in place. Members of the Pensions Committee and Pension Board are expected to attend no less than three days of training (21 hours) per year.</p> <p>The elected members are required to read, sign and abide by the Councillors' Code of Conduct.</p> <p>The LPF Code of Conduct, approved in December 2019, (which has been specifically updated and tailored for the Pension Committee and Pension Board) will be required to be read and signed by elected and non-elected members prior to their appointment and signed by existing members by June 2020.</p>



## GOVERNANCE COMPLIANCE STATEMENT

Principle		Full Compliance	Comments
Selection and Role of Lay Members	That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	✓	<p>The declaration of members' interests is a standard item on the agenda for meetings of the Pensions Committee, Pensions Audit Sub-Committee and Pension Board.</p> <p>A Code of Conduct also applies to all members of the Pensions Committee and the Pension Board. The declaration of board members interest is a standard item on the agenda for the meetings for the LPFE and LPFI board meetings.</p>
Voting	The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	✓	<p>Five of the seven places of the Pensions Committee are held by elected members of the City of Edinburgh Council, which is required to retain a 2/3 majority in line with the Local Government (Scotland) Act 1973.</p> <p>The LPF Group's Nomination and Appointments Policy clearly documents how employer and member representatives will be elected to the Pensions Committee and Pension Board.</p> <p>LPFI and LPFE board members conduct meetings and other matters in accordance with their respective articles of association and shareholders' agreements.</p>
Training/Facility Time/Expenses	a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	✓	<p>A Training and Attendance Policy is in place covering training requirements and reimbursement of expenses. The policy is available on the LPF Group's website <a href="http://www.lpf.org.uk">www.lpf.org.uk</a>.</p> <p>Board members and staff working for LPFI and LPFE also attend separate training for the purposes of their knowledge, understanding and (where appropriate) compliance with Financial Conduct Authority regulations.</p>
	b) That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	✓	<p>The Training and Attendance Policy applies to both the Pensions Committee and the Pension Board. Advisers have their own professional development obligations.</p>



## GOVERNANCE COMPLIANCE STATEMENT

Principle		Full Compliance	Comments
Training/Facility Time/Expenses	c) That the administering authority considers the adoption of annual training plans for committee and board members and maintains a log of all such training.	✓	Each Pensions Committee and Pension Board member is expected to attend no less than three days training per year (21 hours) per year. Attendance at meetings and training is monitored and reported.
Meetings frequency	a) That an administering authority's main committee or committees meet at least quarterly.	✗	The Pensions Committee meets at least four times a year. Due to the COVID-19 pandemic the Pension Committee met three times during the year as the March Committee was cancelled.
	b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committees sits.	✓	<p>The Pensions Audit Sub-Committee is held before the Pensions Committee at least three times a year with further meetings held if necessary.</p> <p>The Joint Investment Strategy Panel meets quarterly or more frequently as required.</p> <p>The Pension Board attends all the Pensions Committee meetings and separately meets in advance of such meetings. Further meetings are held if necessary.</p> <p>The LPFE board now meet five time a year (in February, May, August, October and December) and the LPFI board at least quarterly.</p>
	c) That an administering authority who doesn't include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Not applicable	
Access	That subject to any rules in the council's constitution, all members of main and secondary committees or boards have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	✓	Pensions Committee papers and minutes are publicly available on the Council's website and all Pensions Committee and Pension Board members have equal access. Members of the Pensions Committee and Pension Board have equal access to the Independent Professional Observer who holds surgeries ahead of Committee meetings.



## GOVERNANCE COMPLIANCE STATEMENT

Principle		Full Compliance	Comments
Scope	That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	✓	<p>The Pensions Committee deals with all matters relating to both the administration and investment of the Fund and the LPF Group.</p> <p>A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the Fund.</p>
Publicity	That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	✓	<p>Governance documents, policies and details of Pension Board membership are on the LPF Group's website. The LPF Group also communicates regularly with employers and scheme members.</p>

**Andrew Kerr**

Chief Executive Officer  
The City of Edinburgh Council  
24 June 2020

**Dr Stephen S Moir**

Executive Director of  
Resources  
The City of Edinburgh  
Council  
24 June 2020

**Doug Heron**

Chief Executive Officer  
Lothian Pension Fund  
24 June 2020



## REMUNERATION REPORT

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### Remuneration policy for employees

Our Officers and employees of Lothian Pension Fund are employed by LPFE, an arms-length organisation owned by the City of Edinburgh Council, the administering authority for the Lothian Pension Fund. In recent years LPFE has been incorporated as a standalone entity to allow us to compete with private sector investment management firms for recruitment and retention of skilled and experienced investment managers and analysts.

Operating this model allows us to achieve significantly lower costs, and therefore improved net returns or lower investment risk, than would be possible by appointing private sector asset managers to invest the Fund's assets. The LPFE Board acts as a Remuneration Committee for officers and employees determining pay arrangements based on comparison to well-researched market benchmarks and performance against pre-agreed performance targets, and always linked to the principle of delivering value-for-money for the members of the Fund and their sponsoring employers.

Each year LPF participates in a range of benchmarking exercises to measure operating costs and net investment returns against peers and indices relevant to the Fund. Pay arrangements in LPFE are underpinned by comprehensive market benchmarking with an external provider and reflect the market for investment expertise where this is a requirement for the role. By using benchmarks on costs and net investment returns we're able to provide assurance to our oversight bodies that such pay arrangements represent value-for-money for employee members and their sponsoring employers who bear the costs of operating the pension fund and securing retirement benefits.

We have three variable pay schemes at LPF; two of which have vesting periods. The Portfolio Manager and Senior Management schemes entitle colleagues to receive an assessed percentage of their salary as an additional variable pay award if they meet certain objectives during the year. The assessment year runs from 1 February to 31 January each year. The award then vests over three years.

The first part is payable at the end of the first year if the objectives are met and the remaining two parts are payable in the following two years if the requirement that the employee is still employed by the company at such time is met. Payment one for assessment year 1 February 2019 to 31 January 2020 and payment two for assessment year 1 February 2018 to 31 January 2019 were made in January 2020.

The accounting treatment for variable pay as outlined in "International Accounting Standard (IAS) 19, Employee Benefits" states that employee service before the vesting date gives rise to an obligation to make payment, because, at the end of each successive reporting period, the amount of future service that an employee will have to deliver before becoming entitled to the benefit is reduced.



## REMUNERATION REPORT

In accordance with IAS 19, therefore, a liability has been raised as at 31 March 2020 for the two months of service which the employees have delivered with regards to the remaining vested payments in the scheme.

This obligation of LPF to make payments as a result of colleague service delivered up to 31 March 2020 is reflected in the figures presented below.

### NUMBER OF EMPLOYEES BY PAY BAND

The numbers of employees whose remuneration during the year exceeded £50,000 were as follows:

Remuneration Bands	2018/19	2019/20	Remuneration Bands	2018/19	2019/20
£50,000 - £54,999	1	1	£105,000 - £109,999	2	2
£55,000 - £59,999	3	1	£110,000 - £114,999	-	1
£60,000 - £64,999	1	1	£115,000 - £119,999	-	4
£65,000 - £69,999	-	1	£120,000 - £124,999	-	-
£70,000 - £74,999	-	1	£125,000 - £129,999	1	-
£75,000 - £79,999	1	-	£130,000 - £134,999	4	-
£80,000 - £84,999	1	-	£135,000 - £139,999	-	1
£85,000 - £89,999	-	1	£140,000 - £144,999	-	-
£90,000 - £94,999	-	-	£145,000 - £149,999	-	-
£95,000 - £99,999	1	-	£150,000 - £154,999	-	-
£100,000 - £104,999	2	-	£155,000 - £159,999	-	5
			<b>Total No. of Employees</b>	<b>17</b>	<b>19</b>



## REMUNERATION REPORT

### EMPLOYEES REMUNERATION

The remuneration paid to the Fund's senior employees is as follows:

	Total Remuneration 2018/19	Salary, Fees and Allowances	Variable Remuneration	Total Remuneration 2019/20
Name and Post Title	£000	£000	£000	£000
Doug Heron, Chief Executive Officer (from February 2019)	18	111	25	136
Bruce Miller, Chief Investment Officer	132	109	43	152
Struan Fairbairn, Chief Risk Officer (Head of Legal, Risk and Compliance)	100	85	33	118
John Burns, Chief Finance Officer	102	84	33	117
Helen Honeyman, Head of People and Communications (from January 2020)	-	14	-	14
<b>Total</b>	<b>352</b>	<b>403</b>	<b>134</b>	<b>537</b>

The senior colleagues detailed above have responsibility for management of the LPF group to the extent that they have power to direct or control the major activities of the group (including activities involving the expenditure of money), during the year to which the Remuneration Report relates, whether solely or collectively with other persons.

The remuneration paid to our employees whose remuneration during the year exceeded £150,000 is as follows:

	Total Remuneration 2018/19	Salary, Fees and Allowances	Variable Remuneration	Total Remuneration 2019/20
Name and Post Title	£000	£000	£000	£000
Andrew Imrie, Portfolio Manager	133	108	51	159
Stewart Piotrowicz, Portfolio Manager	132	106	51	157
Jeffrey Saunders, Portfolio Manager	132	102	50	152
Ian Wagstaff, Portfolio Manager	132	106	51	157
<b>Total</b>	<b>529</b>	<b>422</b>	<b>203</b>	<b>625</b>





## REMUNERATION REPORT

Senior officers of the City of Edinburgh Council are also fully remunerated via the Council and no additional remuneration is paid by the Fund. This remuneration is disclosed in the Financial Statements of the City of Edinburgh Council.

The total amount of variable remuneration payable over the next two years if all of the colleagues involved in the arrangements at 31 January 2020 remain in the company's employment is as follows:

	Payable January 2021		Payable January 2022
	2019 Payment 3	2020 Payment 2	2020 Payment 3
	£000	£000	£000
Senior Employee Variable Remuneration	33	50	50
Portfolio Manager Variable Remuneration	125	110	110
Employer National Insurance Contribution	22	22	22
<b>Total</b>	<b>180</b>	<b>182</b>	<b>182</b>

### Colleague Pension Entitlement

Pension benefits for colleagues are provided through the Local Government Pension Scheme.

For colleagues the Local Government Pension Scheme became a career average pay scheme on 1 April 2015. Benefits built up to 31 March 2015 are protected and based on final salary. Accrued benefits from 1 April 2015 will be based on career average salary.

The Scheme's normal retirement age for colleagues is linked to the State Pension Age (with a minimum of age 65).



## REMUNERATION REPORT

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From 1 April 2009, a five-tier contribution system was introduced with contributions from Scheme members being based on how much pay falls into each tier. This is designed to give more equality between the cost and benefits of scheme membership. Prior to 2009, contributions rates were set at 6% for all non-manual colleagues.

The tiers and members' contribution rates for 2019/20 were as follows:

Pensionable Pay (2019/2020)	Rate (%)
On earnings up to and including £21,800 (2018/2019 £21,300)	5.5%
On earnings above £21,800 and up to 26,700 (2018/2019 £21,300 to £26,100)	7.25%
On earnings above £26,700 and up to £36,600 (2018/2019 £26,100 to £35,700)	8.5%
On earnings above £36,600 and up to £48,800 (2018/2019 £35,700 to £47,600)	9.5%
On earnings of £48,800 and above (2018/2019 £47,600)	12.0%

If a person works part-time, their contribution rate is worked out on the whole-time pay rate for the job, with actual contributions paid on actual pay earned.

There is no automatic entitlement to a lump sum. Members may opt to give up (commute) pension for lump sum up to the limit set by the Finance Act 2004.

The value of the accrued benefits has been calculated on the basis of the age at which the person will first become entitled to receive a pension on retirement without reduction on account of its payment at that age; without exercising any option to commute pension entitlement into a lump sum; and without any adjustment for the effects of future inflation.

The pension figures shown relate to the benefits that the person has accrued as consequence of their total local government service, and not just their current appointment.



## REMUNERATION REPORT

The pension entitlement of the LPF Group's senior employees is as follows:

Name and post title	In-year Pension Contributions			Accrued Pension Benefits	
	2018/19	2019/20		As at 31 March 2020	Increase from 31 March 2019
	£000	£000		£000	£000
Doug Heron, Chief Executive Officer (from February 2019)	4	32	Pension	-	-
			Lump Sum		
Bruce Miller, Chief Investment Officer	27	32	Pension	32	3
			Lump Sum	30	2
Struan Fairbairn, Chief Risk Officer (Head of Legal, Risk and Compliance)	21	25	Pension	12	2
			Lump Sum	-	-
John Burns, Chief Finance Officer	21	25	Pension	44	2
			Lump Sum	79	1
Helen Honeyman, Head of People and Communications (from January 2020)	-	4	Pension	-	-
			Lump Sum	-	-
<b>Total</b>	<b>73</b>	<b>118</b>			

The pension entitlement of the LPF Group's colleagues whose remuneration during the year exceeded £150,000 is as follows:

Name and post title	In-year Pension Contributions			Accrued Pension Benefits	
	2018/19	2019/20		As at 31 March 2020	Increase from 31 March 2019
	£000	£000		£000	£000
Andrew Imrie, Portfolio Manager	26	31	Pension	26	3
			Lump Sum	16	1
Stewart Piotrowicz, Portfolio Manager	26	31	Pension	20	3
			Lump Sum	-	-
Jeffrey Saunders, Portfolio Manager	-	-	Pension	-	-
			Lump Sum	-	-
Ian Wagstaff, Portfolio Manager	26	31	Pension	18	3
			Lump Sum	-	-
<b>Total</b>	<b>78</b>	<b>93</b>			



## REMUNERATION REPORT

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### Exit Packages

Exit packages include compulsory and voluntary redundancy costs, pension contributions in respect of added years, ex-gratia payments and other departure costs. There was no payment of any exit packages in 2019/20 or in the previous year.

### Remuneration for Councillors on the Pensions Committee

Councillors on the Pensions Committee are remunerated by the City of Edinburgh Council, no additional remuneration is paid by the Fund.

**Andrew Kerr**

Chief Executive Officer  
The City of Edinburgh Council  
24 June 2020

**Dr Stephen S Moir**

Executive Director of  
Resources  
The City of Edinburgh  
Council  
24 June 2020

**John Burns**

Chief Finance Officer  
Lothian Pension Fund  
24 June 2020



## ADDITIONAL INFORMATION

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### Key documents online

You can find further information on what we do and how we do it, on our website at [www.lpf.org.uk](http://www.lpf.org.uk). To view individual policy documents, click on the links below if viewing online or visit [www.lpf.org.uk/publications](http://www.lpf.org.uk/publications).

- [Actuarial Valuation reports](#)
- [Pension Board constitution](#)
- [Annual Report and Accounts](#)
- [Statement of Investment Principles](#)
- [Pension Administration Strategy](#)
- [Communications Strategy](#)
- [Funding Strategy Statement](#)
- [Service Plan](#)
- [Training and Attendance policy](#)

### Fund advisers

Actuaries:	Hymans Robertson LLP, Exchange Place One, 1 Semple Street, Edinburgh, EH3 8BL
Bankers:	Royal Bank of Scotland, 36 St Andrew Square, Edinburgh, EH2 2YB
Strategic advisers:	Gordon Bagot and Scott Jamieson
Investment custodians:	The Northern Trust Company, 50 Bank Street, Canary Wharf, London, E14 5NT
Investment managers:	Details can be found in the notes to the accounts.
Additional Voluntary Contributions (AVC) managers:	Standard Life, Standard Life House, 30 Lothian Road, Edinburgh, EH1 2DH Prudential plc, 1 Angel Court, London, EC2R 7AG
Property valuations:	CB Richard Ellis Limited, St Martin's Court, 10 Paternoster Row, London, EC4M 7HP
Property Management and Property Fund Accounting:	JLL, 40 Bank Street Canary Wharf   London E14 5EG
Property Legal:	CMS Cameron McKenna Nabarro Olswang LLP, Saltire Court, 20 Castle Terrace, Edinburgh EH1 2EN Addleshaw Goddard LLP, One St Peter's Square, Manchester, M2 3DE
Solicitors:	Lothian Pension Fund In-house



## ADDITIONAL INFORMATION

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### Comments and suggestions

We appreciate your comments and suggestions on this report. Please let us know which sections you found useful and if you have any suggestions for items to be included in the future. Please email your comments to [pensions@lpf.org.uk](mailto:pensions@lpf.org.uk).

### Accessibility

You can get this document on tape, in Braille, large print and various computer formats on request. Please contact the Interpretation and Translation Service (ITS) on 0131 242 8181 and quote reference number 00819. The ITS can also give information on community language translations.

### Contact details

If you would like further information about Lothian Pension Fund and Scottish Home Pension Fund, please contact us the details on the back page if this report.





**LOTHIAN**  
PENSION FUND

Atria One, 144 Morrison St,  
Edinburgh EH3 8EX

**Phone:** 0131 529 4638

**Email:** [pensions@lpf.org.uk](mailto:pensions@lpf.org.uk)

**Web:** [www.lpf.org.uk](http://www.lpf.org.uk)

### The City of Edinburgh Council

#### Statement on the system of internal financial control

1. This statement is given in respect of the internal financial controls operated by The City of Edinburgh Council. As the Council's designated section 95 officer as defined under the provisions of the Local Government (Scotland) Act 1973, I acknowledge my responsibility for ensuring that an appropriate system of internal financial control is in place and its on-going effectiveness regularly reviewed.
2. The system of control can provide reasonable, but not absolute, assurance that material control weaknesses or irregularities do not exist, and that there is no unacceptable risk of material error, loss, fraud or breach of legislation. Consequently, the Council continually seeks to improve the effectiveness of its systems of internal control so that irregularities are either prevented or detected within an acceptable period of time. Tracking of agreed internal audit actions forms a standing item on Corporate Leadership and Senior Management Team agendas, with progress in implementation also regularly reported to the Governance, Risk and Best Value Committee.
3. In view of successive years' staffing reductions and various resulting changes in responsibilities, the self-attestation exercise undertaken early in 2018 was helpful in assessing the extent to which previous improvements had been embedded within service areas, highlighting a need for further action in some areas to implement and sustain the required controls. This exercise has subsequently been complemented, within the Resources Directorate, by quarterly Service Performance and Assurance meetings at which progress in implementation of agreed actions is also considered.

#### Independent assessments of the effectiveness of the system of internal financial control

4. The effectiveness of the Council's internal financial control framework as a whole is subject to annual review by its external auditors, with the principal findings of the [most recent annual assessment](#) reported to the Governance, Risk and Best Value Committee in September 2019. While noting some opportunities for improvement and a need, in some cases, to embed previously-agreed actions, this assessment concluded that the system of internal financial control was well-designed, with no significant deficiencies in its design, implementation or operation. A [follow-up progress report](#) was considered by the Committee in January 2020, with a further update due in July.
5. As part of the Accounts Commission's national studies, an assessment was also reported in May 2020 of the Council's arrangements for the **prevention and detection of fraud in procurement**. The report highlighted only one moderate-level risk (the need to ensure checking of invoice sums with contract rates prior to payment authorisation), a reminder for which has now been sent to all relevant managers. A number of other areas of good practice were also identified, consistent with the Council's high Procurement and Commercial Improvement Programme (PCIP) rating.



## Role of Internal Audit

6. The Internal Audit section operates in accordance with the Chartered Institute of Public Finance and Accountancy's United Kingdom Public Sector Internal Audit Standards (PSIAS). The Section undertakes an annual programme based on an agreed audit strategy. The plan is based on formal assessments of risk and audit needs which are reviewed regularly to reflect evolving risks and changes within the Council. During 2019/20, the section reported to the Head of Legal and Risk. It also has, however, unfettered access to the Chief Executive, Executive Directors, Heads of Service (including the Head of Finance) and elected members of the Council when required.
7. **The Chief Internal Auditor will present her annual audit opinion on the adequacy and effectiveness of the system of internal control (including financial controls) to the Governance, Risk and Best Value Committee in August 2020.** Due to COVID-related disruption and in-year delivery challenges, however, the opinion will necessarily be limited and based upon completion of 70% of the 2019/20 audit plan, subject to the receipt of requested support from Directorates. The Chief Internal Auditor is currently engaging with the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Institute of Internal Auditors (IIA) (who jointly authored the PSIAS) and other Scottish Local Authority Chief Internal Auditors to ensure that the approach to the annual opinion is aligned with any relevant guidance and other Scottish local authorities.
8. With this caveat, given the assessment in the last two years, the opinion is expected to highlight a continuing need for enhancements to the control environment and associated governance and risk management frameworks. The required control improvements implicit in this opinion will be examined and any corresponding required actions (as they relate to financial systems) implemented as a matter of urgency.

## Elements of system of internal financial control

9. The existing system of internal financial control is based on a framework of regular management information, financial rules and regulations, administrative procedures (including segregation of duties), management supervision and a scheme of delegation and accountability. The system is maintained and developed by Council management and includes:
  - **comprehensive budgeting systems;**
  - **preparation and regular review of periodic reports that measure actual financial performance against budgeted net expenditure.** An in-year revenue budget-setting and management internal audit identified a number of areas of good practice but with opportunities for improvement highlighted through the adoption of standardised documentation and procedures and regularising formal “lessons learned” exercises after each year’s process, with an action plan agreed. I am also conscious of significant reductions in recent years in the proportion of service-specific savings subsequently delivered and have put in place arrangements both to provide additional project management resource for more material and/or transformational savings projects and strengthen more general officer and elected member scrutiny at the proposal inception,

development and implementation stages. *While analysis of the provisional year-end position remains on-going, monitoring reports considered by the Finance and Resources Committee during 2019/20 encouragingly pointed to a marked increase in delivery compared to 2018/19;*

- **agreement of targets against which financial and operational performance can be assessed.** Key amongst these financial targets is the achievement of a balanced Council-wide outturn. Based upon the provisional outturn, however, despite the approval at the eight-month stage of additional earmarked reserve funding of £7.9m, this was not achieved in 2019/20 (the first time for thirteen years), with an overall overspend of £5.2m. It should nonetheless be stressed that this outturn also reflects £7.9m of unfunded COVID-related impacts that only became apparent in the last month of the financial year;
- **clearly-defined capital and other expenditure guidelines** communicated to services and set out in the [Finance Rules](#) which were refreshed in June 2019. The [Financial Regulations](#) were also reviewed and minor amendments to their content approved in June 2019;
- a **three-year revenue budget and ten-year capital budget strategy** approved by Council in February 2020;
- **formal project management disciplines** as supported and promoted through the Strategy and Communications section, including senior Finance representation on all major project boards and assurance review panels; and
- **formal governance arrangements operated within both subsidiary and associated companies**, complemented by a strengthened Council observer role and consolidation and active consideration by senior Council officers of a consistent suite of key operational documentation for its principal companies. Service Level Agreements are also in place for finance-related services provided to a range of external bodies.

10. My review of the effectiveness of the internal financial control system is informed by:

- **assurance certificates** on internal control received from all Executive Directors of the Council, service areas and relevant service heads;
- **regular senior management-level consideration of progress in implementing internal audit recommendations**, including self-attestation of previous actions where relevant;
- **governance arrangements in place for subsidiary and associated companies** and an on-going assessment of the effectiveness of these arrangements;
- the **work of managers** within the Council;
- the work of **Internal Audit**; and
- **external audit reports**, in particular the [independent annual report](#) on the Council's financial statements and internal control framework.

11. The Council's financial management arrangements conform with the governance requirements of the CIPFA Statement on the Role of the Chief Financial Officer (2014) as set out in the Application Note to Delivering Good Governance in Local Government Framework, an opinion confirmed as part of recent external audit scrutiny. Having reviewed the framework, it is therefore my opinion that **although a degree of assurance can be placed upon the adequacy and effectiveness of the Group's systems of internal financial control, further improvements, including embedding of actions taken in response to previous recommendations, are still clearly required.** In this context,

I would particularly highlight continuing required improvements to address a number of systemic weaknesses in respect of payroll-related controls, particularly those to address historic, and prevent recurring, overpayments.

12. I have overseen the improvements put in place in response to Finance-specific recommendations made by internal and external audit work during the year, with none outstanding at this time and a number of others in progress. This said, the extent of change and reduction in overall resources in recent years has reinforced the importance of robust, documented and well-understood procedures for key system controls and, in light of the follow-up audits undertaken by both internal and external audit, a priority continues to be to consolidate these improvements, identify any further required actions and gain necessary assurance by regularly assessing their effectiveness. These arrangements have been thoroughly tested during the current COVID pandemic and, in the vast majority of cases, performed well.
13. While its primary impacts are being felt in 2020/21, it would be remiss of me not to make mention of the profound implications of the pandemic on the Council's financial position. As with other public sector organisations, the position is highly fluid, with additional details emerging almost daily. I have, however, sought to be proactive in acknowledging these impacts and put in place a number of corresponding measures to mitigate the corresponding risks, including:
  - **Introducing, from late March, monthly reporting to both CLT and the Policy and Sustainability Committee** on the additional expenditure and reduced income impacts on the Council and its ALEOs under a number of scenarios. Taking into account these forecasts, delivery of approved savings, management of residual pressures and analysis of reserve and other funding, it is intended to develop a revised balanced budget by the autumn;
  - **commencing work to review the impact in terms of timing and cost on the Council's ten-year capital budget strategy and likely achievability of later years' revenue savings approved in February**, in each case emphasising the likely need for further prioritisation to maintain financial sustainability;
  - **overseeing the system of internal controls put in place in respect of a number of newly-introduced funding streams**, including business grants and self-employment payments, as well as **ensuring an appropriate balance is struck between critical service continuity and securing best value with regard to granting any supplier relief**; and
  - **ensuring all finance-related risks are captured and actively monitored** as part of the Council's COVID risk management plan.

Hugh Dunn  
Head of Finance  
31 May 2020

**Annual Report 2020  
of  
Lothian Pension Fund  
and  
Scottish Homes Pension Fund**

**“Statement on the system of internal financial control  
for the year ended 31 March 2020”**

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

In compliance with standard accounting practice, the Chief Finance Officer, Lothian Pension Fund, is required to provide the Chief Executive with a statement of the effectiveness of the internal financial control system of the Funds for the year ended 31 March 2020.

The Funds place reliance upon the internal financial controls within the City of Edinburgh Council's financial systems and the monitoring in place to ensure the effectiveness of these controls. Accordingly, the “Statement on the system of internal financial control” by Hugh Dunn, Head of Finance, City of Edinburgh Council, dated 31 May 2020, refers.

Within this overall control framework, specific arrangements for the Lothian Pension Fund and Scottish Homes Pension Fund are detailed in the Annual Governance Statement. These include:

- identifying the objectives of the Funds in Funding Strategy Statement, Statement of Investment Principles and Service Plan;
- a systematic approach to monitoring service performance by the Pensions Committee, Pensions Audit Sub-Committee, senior officers and stakeholders, including the Pension Board and Independent Professional Observer;
- a structured programme to ensure that Pension Committee members have the required standard of knowledge and understanding of Local Government Pension Scheme matters;
- operating within clearly established investment guidelines defined by the Local Government Pension Scheme Investment Regulations and the Funds' Statements of Investment Principles;
- compliance with the CIPFA Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme;
- with the exception of managed funds, unlisted investments and property, all investments are held under custody by a global custodian. The Funds benefit from the custodian's extensive internal control framework;
- benchmarking of services in terms of standards and cost against other Local Government Pension Scheme funds;
- LPFE and LPFI operating within their respective constitutional documentation and the relevant company regulations;

- LPFI operating within the relevant governance policies and procedures to ensure compliance with the Financial Conduct Authority regulations

The Chief Internal Auditor has provided an “Internal Audit Annual Report and Opinion for the year ended 31 March 2020”, in accordance with the requirement set out in the Public Sector Internal Audit Standards. This opinion, based on internal audit work undertaken during the year, concludes that “the LPF control environment and governance and risk management frameworks are generally adequate but with enhancements required.” Requisite actions are being progressed to secure such control improvements, including affirmation as to the ongoing integrity of supplier systems.

It is my opinion, therefore, that reasonable assurance can be placed upon the adequacy and effectiveness of the system of internal financial control for the LPF Group in administering the Lothian Pension Fund and Scottish Homes Pension Fund.

**John Burns, FCMA CGMA, PgC  
Chief Finance Officer,  
Lothian Pension Fund**

**8 June 2020**

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## **Pensions Audit Sub Committee 2.00pm, Tuesday, 23 June 2020**

### **Risk Management Summary**

#### **Item number 5.7**

#### **1. Recommendations**

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The Pensions Audit Sub Committee (Committee) is requested to:

- 1.1 note the Quarterly Risk Overview and the LPF group's approach to risk management.

#### **Struan Fairbairn**

Chief Risk Officer, Lothian Pension Fund

Contact: Susan Handyside, Governance Manager, Lothian Pension Fund

E-mail: [susan.handyside@edinburgh.gov.uk](mailto:susan.handyside@edinburgh.gov.uk) | Tel: 07771 378238

# Risk Management Summary

## 2. Executive Summary

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- 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

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- 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 against the group's risk appetite, the degree of risk associated in each case and the action taken to mitigate those risks (the Operational Risk Register); and
  - 3.1.2 produce a summary report of the risk register for the Committee and the Pensions Committee which highlights the material risks facing the group 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

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- 4.1 The Operational Risk Register is issued to the Conveners of the Committee and the Pensions Committee and the Independent Professional Observer on a quarterly basis. It is also submitted annually to the Committee for a detailed review.
- 4.2 The Quarterly Risk Overview, as at 18 May 2020, is set out in Appendix 1 to this report for consideration.
- 4.3 An additional meeting of the Risk Management Group was held on 23 April to assess the group risk environment in the prevailing circumstances of the COVID-19 pandemic, and material items included in the risk register. More granular risks arising from the pandemic have also been identified and closely managed at an operational level by the Recovery Group established expressly for this purpose. A more detailed report on the outcomes from this group and the Fund's response to the pandemic has been reported separately to Committee.
- 4.4 The risk management process for the LPF group is integrated within all of the group's governance and controls. In particular, the Committee should be aware of the following:



- 4.4.1 *Risk appetite*: considered and set by the Senior Leadership Team (SLT) in conjunction with the Risk Management Group.
- 4.4.2 *Risk management group*: routine meetings held quarterly and otherwise on an as required basis to consider and assess the LPF group's risk register and wider risk environment and track relevant actions. The group comprises representation across all functions and includes the SLT.
- 4.4.3 *Compliance checklist*: listing critical points of compliance for monitoring and as a reference point for breach reporting. Reviewed and signed off on a quarterly basis by the senior management of the LPF group, which includes SLT, with key actions being tracked by the risk function and relevant business units.
- 4.4.4 *Assurance Overview and Mapping*: providing analysis and oversight of the group's overarching risk assurance framework across the 'four lines of defence', and mapping those points of assurance to relevant risks. This is managed by the risk function, with oversight from SLT, and presented to the Committee annually.
- 4.4.5 *LPF group systems and controls assessment*: managed by SLT and the LPFI and LPFE boards, and reported to Committee and JISP annually.
- 4.4.6 *Third party supplier management*: a supplier management framework is managed on an ongoing basis by the risk function in conjunction with the wider business and overseen by SLT.
- 4.4.7 *Internal Capital Adequacy Assessment Process (ICAAP)*: which is managed on an ongoing basis by the SLT. The ICAAP itself is reviewed and approved at least annually by the LPFI board, with various aspects considered separately and in more detail routinely throughout the year.
- 4.4.8 *ICT oversight and governance procedures*: which are managed by the ICT Oversight Group on an ongoing basis and overseen by the SLT.
- 4.4.9 *People and HR Procedures*: which are managed by the People Group on an ongoing basis and overseen by the SLT and the LPFE board.
- 4.4.10 *Investment Controls and Parameters (LPF Group Controls and Compliance report)*: which are now mostly automated on the CRIMS order management system, managed by the compliance, front and back office functions and overseen by SLT, the LPFI board and JISP (with annual reporting to Committee).
- 4.4.11 *Overall review of governance and the LPF group structure*: managed by SLT and overseen annually by the Committee and Pensions Committee.

4.4.12 *COVID-19*: as above, managed by the Recovery Group on an ongoing basis, in conjunction with the Risk Management Group, and overseen by SLT.

## **5. Financial impact**

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

## **6. Stakeholder/Regulatory Impact**

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6.1 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.

6.2 Except as otherwise stated in the report itself, there are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.

## **7. Background reading/external references**

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7.1 None.

## **8. Appendices**

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Appendix 1 – Quarterly Risk Overview, as at 18 May 2020



# **Quarterly Risk Overview**

**18 May 2020**

## EXECUTIVE SUMMARY

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This risk overview provides a summary of the assessment of the LPF group's risks by the Risk Management Group on 18 May 2020.


The LPF group continues to go through a period of meaningful business transformation, where it is seeking to enhance its wider structure and service delivery, as well as support its strategy to seek mutual benefits by collaborating with other likeminded pension funds. In doing so it has taken on additional operational risk within its appetite. The group is however coming to the "beginning of the end" of this transformational work and so anticipates that many of the risks surrounding these projects will reduce over the next year as they complete and additional LPF group governance and controls are implemented.



The unique feature of this quarter's risk reporting is, of course, the COVID-19 pandemic and, with that in mind, an additional meeting of the Risk Management Group was held in April to assess the impact on the LPF group's business and risks. Many of the immediate risks assessed at that initial meeting have reduced over the period, with the effective operation of the LPF group's business continuity plan and ongoing management of issues to re-position the fund for full remote working. Some assessments remain higher than normal, but these largely reflect the wider environment within which the fund is now operating rather than being a negative reflection of LPF's business resilience by comparison with the sector at large. It is anticipated that these risks will also reduce as either restrictions around the pandemic relax or the business and wider environment continue to adjust to a longer period of remote working.




The overall position remains stable and within appetite in the context of the longer-term risk reduction benefits of the ongoing transformation projects and the circumstances of a global pandemic. However, the Systems & Controls and COVID-19 papers provide a more detailed update on the work being progressed to further mitigate and reduce the risks facing the fund.



## DETAILED OVERVIEW

### UPDATE ON MOST NOTABLE RISKS




Risk & Reference Number	Update	Trend / RAG
<p>Failure of IT systems used in the fund with serious consequences for investment management, benefit administration and oversight activities <b>(7)</b></p>	<p>The core ICT platform has proved to be resilient, with key issues being escalated and prioritised appropriately and many enhancements in LPF’s Digital Strategy already being delivered by the incumbent supplier in response to the pandemic. There are naturally ongoing issues and inefficiencies generated by the significant increase in demand on the platform, but this is currently the same across all businesses and sectors.</p> <p>However, this risk has necessarily increased as a result of the additional reliance placed on ICT functions, and heightened impact of any outages or failure, whilst all LPF group staff work from home in the prevailing circumstances of the COVID-19 pandemic</p> <p>Additional ICT continuity oversight is in place during COVID-19 through the creation of the LPF Recovery Team, which monitors implementation of the business continuity plan and supports the ICT Oversight and Governance Manger/Group by providing enhanced management and monitoring of specific operational issues arising from the circumstances of the pandemic.</p> <p>In addition, LPF continues to identify and resolve ‘business as usual’ issues and progress critical ongoing projects through its ICT Oversight Group and function. Those include continuing to progress (i) the Digital Strategy and appointment of the new ICT provider, (ii) systems access, security governance and supplier diligence, and (iii) resolving laptop availability for new staff.</p> <p>A project group continues to monitor the operation of the Charles River Investment Management System (CRIMS) following its implementation, as well as providing oversight of its supplier. Refinements are identified/tracked and fixes resolved on an ongoing basis.</p>	<p><b>Increase</b></p> 

Risk & Reference Number	Update	Trend / RAG
<p>Business continuity issues <b>(11)</b></p>	<p>The business continuity plan has been implemented successfully and is being refined on an ongoing basis to adapt to the ongoing developments and phases of the pandemic. Business continuity remains good in the circumstances, but the risk has been increased to reflect the fact that the continuity plan is in operation and therefore the LPF group is in a period of special continuity management.</p> <p>LPF's Recovery Group continues to implement, oversee and refine continuity arrangements to further mitigate this risk. The Senior Leadership Team (SLT), ICT Oversight, People and Risk groups also continue to address specific matters alongside the Recovery Group.</p> <p>'Key workers' have been identified and are supported by guidance ensuring that social distancing is adhered to at all times, as well as health and safety regulation. Currently, only critical activities are undertaken in the office by the identified key workers. In addition, the relevant health and safety procedures are in place for homeworkers and LPF has a clear process in place for the reporting of any breach of the Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR).</p> <p>Annual leave continues to be monitored to ensure sufficient cover is in place at all times during lockdown and thereafter.</p> <p>The planned office move is currently on hold with the more immediate priority being the plan, now underway, for the return of staff to the existing office premises. More detail on this is set out in the group systems and controls report.</p>	<p>Increase</p> 
<p>Members' confidential data is lost or made public. Breach of Data Protection Act. <b>(12)</b></p>	<p>There is a potential increased risk of cyber attacks as a result of COVID-19 and LPF, as with the wider business community, has experienced targeted phishing attacks. LPF continues to strengthen controls around the security of members' confidential data, with additional checks to folder security, remote working and other key activities. The use of new facilities by LPF, such as for mail processing and scanning, is under detailed review to ensure these processes continue to be secure.</p>	<p>Increase</p> 

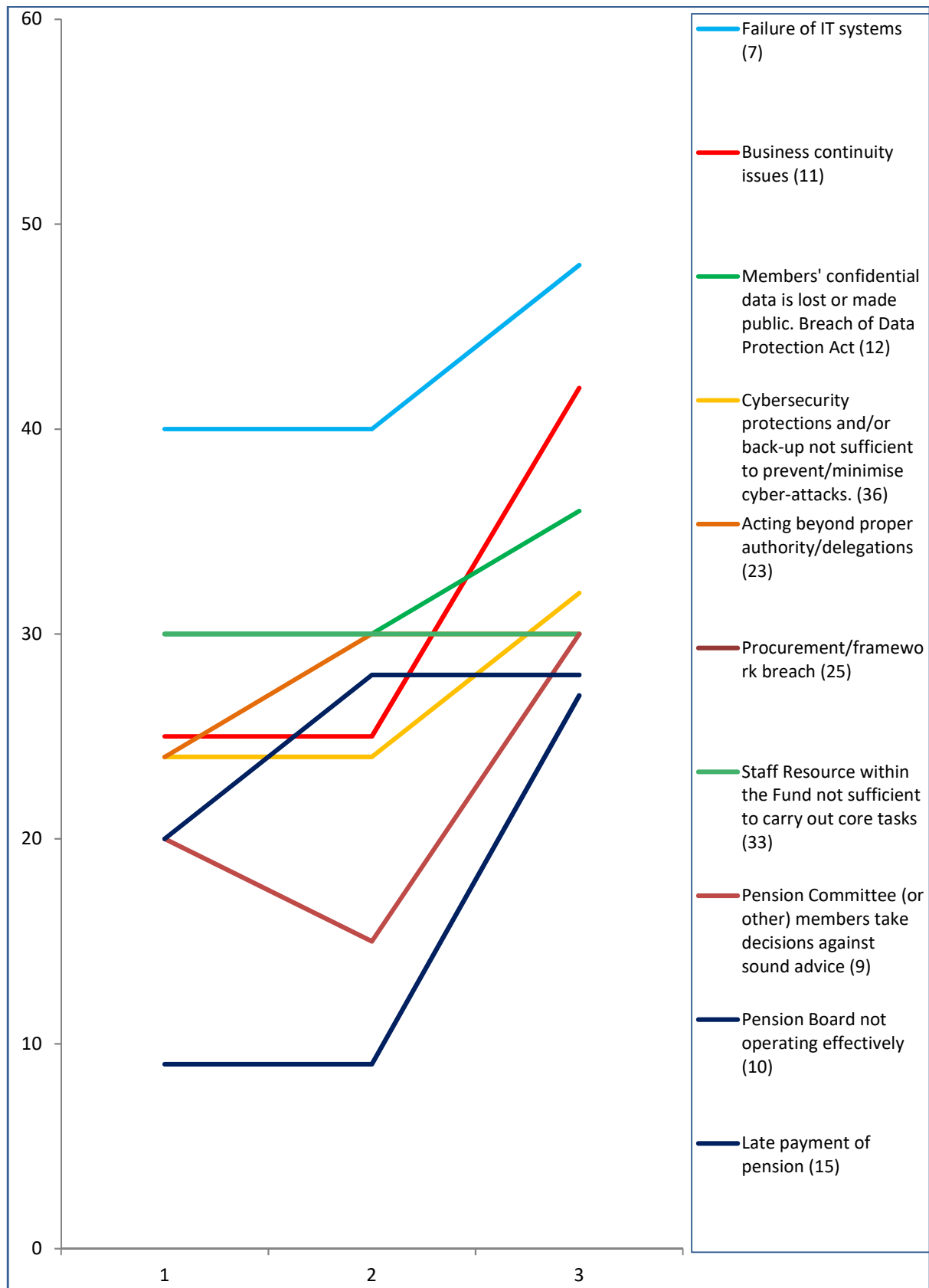
Risk & Reference Number	Update	Trend / RAG
Cybersecurity protections and/or back-up not sufficient to prevent cyber-attacks or minimise their impact <b>(36)</b>	<p>As mentioned above, there is a currently a potential increased risk of cyber attacks due to COVID-19, with LPF having received phishing emails targeting its private markets capital call processes and also purporting to replicate communications from senior management. LPF is communicating key messages to all staff regarding cybersecurity and has reminded employees to be vigilant.</p> <p>The ICT Oversight and Governance Manager continues to review the robustness of systems and processes and is progressing the Digital Strategy, which itself will allow enhancements to controls and governance in this area.</p>	<p><b>Increase</b></p> 
Acting beyond proper authority/delegations. <b>(23)</b>	<p>LPF has paid close attention to the operation of its delegations under the present circumstances, with all the team remote working and with key person dependencies in mind. The group has only required minimal adaption to current processes so far and has sought to introduce supporting systems (e.g. e-signing) where necessary to mitigate any associated continuity risks.</p> <p>LPF is also looking to update and refresh its delegations to take account of: (i) recent appointments and updates arising from its organisational development review, (ii) the operation of the property portfolios, (iii) SM&amp;CR implementation, (iv) the LPF Governance Review, and (v) the implementation of the new Front Office system. In addition, LPF is scheduling further employee communications to reinforce awareness of scheme of delegation requirements and update its new website to ensure its group governance structures are clearer.</p> <p>Due to the prevailing circumstances and the outstanding actions the risk remains on amber, although there has been no breach in existing delegations.</p>	<p><b>Static</b></p> 
Procurement/framework breach <b>(25)</b>	<p>LPF is continuing to work closely and well with CEC's procurment team to best align its procurement processes to the specific needs of the LPF group business and also to satisfy CEC's parent oversight requirements.</p> <p>The risk is static due to the enhanced impact the procurement regime has on LPF's developing business model (sitting unusually within all of the financial services, pensions and public sector regimes) and the fact that it continues to be in the midst of developing new systems, controls and procedures in this area.</p>	<p><b>Static</b></p> 

Risk & Reference Number	Update	Trend / RAG
<p>Staff Resource within the Fund not sufficient to carry out core tasks in conjunction with active or anticipated projects. <b>(33)</b></p>	<p>This risk remains at amber due to the additional resource attributable to significant strategic initiatives such as the implementation of the Digital Strategy and extension of investment management services. However the Organisational Development Review has been successfully implemented, with only one role outstanding, and so LPF anticipates that the risk will reduce over the next few quarters.</p> <p>The recruitment strategy is continuing remotely as LPF continues to mitigate this risk.</p>	<p>Static</p> 
<p>Pensions Committee (or other) members take decisions against sound advice, on political grounds or due to lack of knowledge <b>(9)</b></p>	<p>In April this risk was raised significantly to reflect the onset of COVID-19 lock-down and its impact on governance, with the requirement for emergency powers to be implemented for a brief period which effectively suspended the usual March Committee cycle and by delegating the powers of the administering authority to the Council's Leadership Advisory Panel. There was nevertheless ongoing engagement with the Committee, Board and IPO, with March papers being circulated to ensure continuity and transparency during this challenging period.</p> <p>The risk has subsequently reduced due to the relatively quick reversion to the group's usual governance arrangements for the June Committee, albeit meeting remotely, and in light of the formal clarification in the Council's process that the LPF Group's governance arrangements would be carved out of its own emergency arrangements.</p> <p>The risk will remain amber until it is clear that the June cycle of meetings has operated effectively on a remote basis and along the lines envisaged.</p> <p>LPF continues to engage with the Pensions' Regulator on this, alongside other matters, to ensure due notification is made and appropriate context.</p>	<p>Increase</p> 



Risk & Reference Number	Update	Trend / RAG
<p>Pension Board does not operate effectively to detriment of the Fund (e.g. due to external factors, lack of attendance/participation or not maintaining sufficient levels of knowledge, skill and/or expertise.) <b>(10)</b></p>	<p>In April this risk was increased significantly due to the impact of emergency governance arrangements for the March cycle (in line with the above) and it was similarly reduced at May's meeting of the Risk Management Group.</p> <p>The Pension Board still has two vacancies. The continued requirement to fill these vacancies, and recent levels of turnover, has presented a continuity challenge for LPF and the Pension Board itself.</p> <p>The Pension Board will be discussing a proposal by LPF to reduce the number of board members to 8 (4 member/4 employer) to mitigate this issue.</p> <p>The score will remain amber until the composition of the Board is finalised and the remote arrangements for meetings have been implemented and shown to be effective.</p>	<p>Static</p> 
<p>Failure to pay pensions as they fall due including as a result of administration failure. <b>(15)</b></p>	<p>This risk has increased slightly to reflect the COVID-19 enforced remote working arrangements. The potential for staff absence on health grounds, IT failure and the increase of a potential cyber attack has also fed into the increase in this risk. Pension payments have been identified as one of the five core critical tasks for the fund and as such the Recovery Group are monitoring and supporting processes carefully to mitigate the risk as far as possible.</p>	<p>Increase</p> 
<p>Adverse investment performance causes funding levels to fall requiring higher employer contributions. <b>(1)</b></p>	<p>LPF and the JISP are reviewing investment portfolios in order to understand the COVID-19 impact and continue to best position the fund. In addition, LPF is engaging with the actuary regarding assumptions as part of triennial valuation. This risk has rased due to the potential impact of COVID-19 and until the review is complete and actions are clear.</p>	<p>Increase</p> 

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

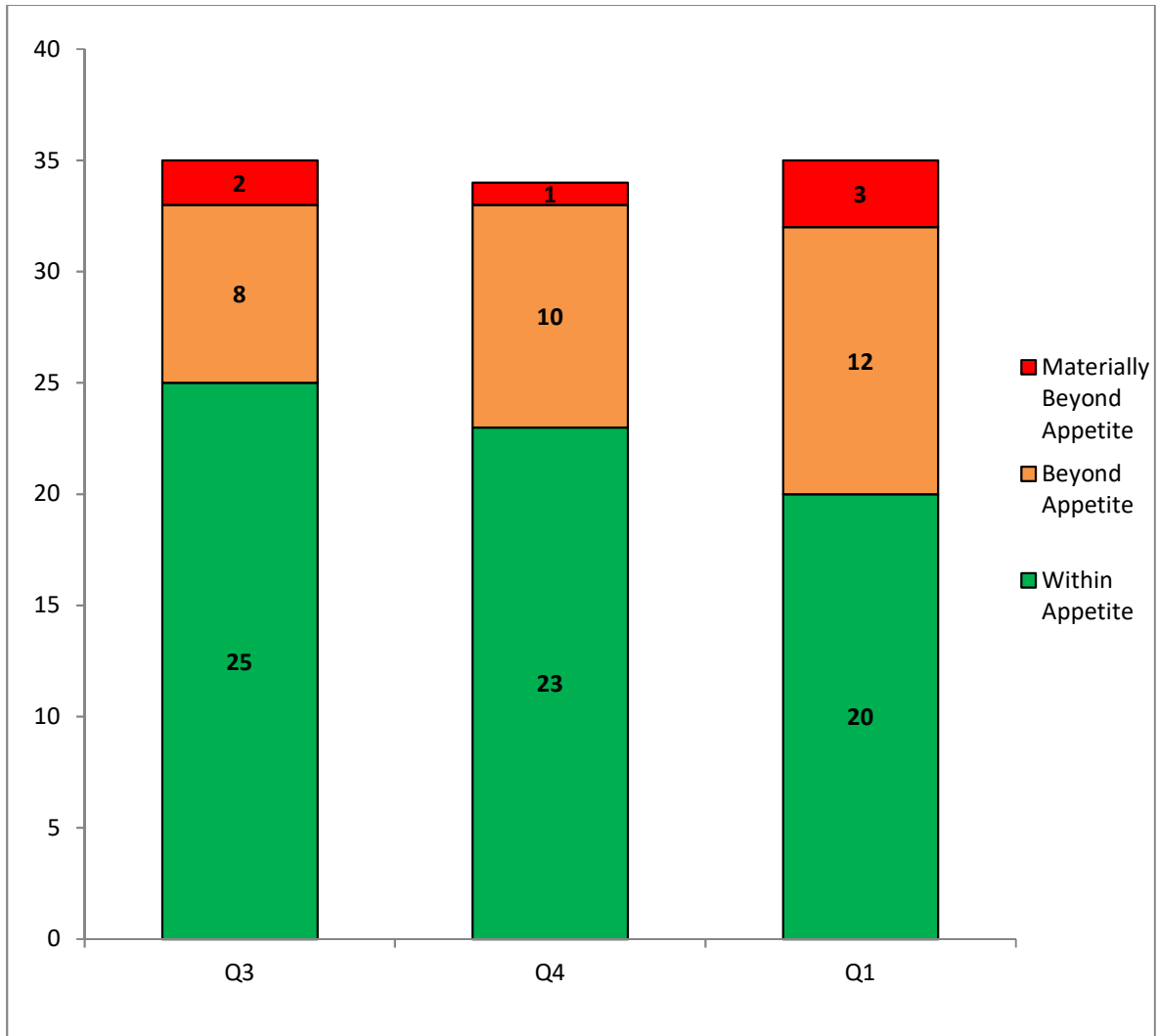


**OTHER KEY POINTS**

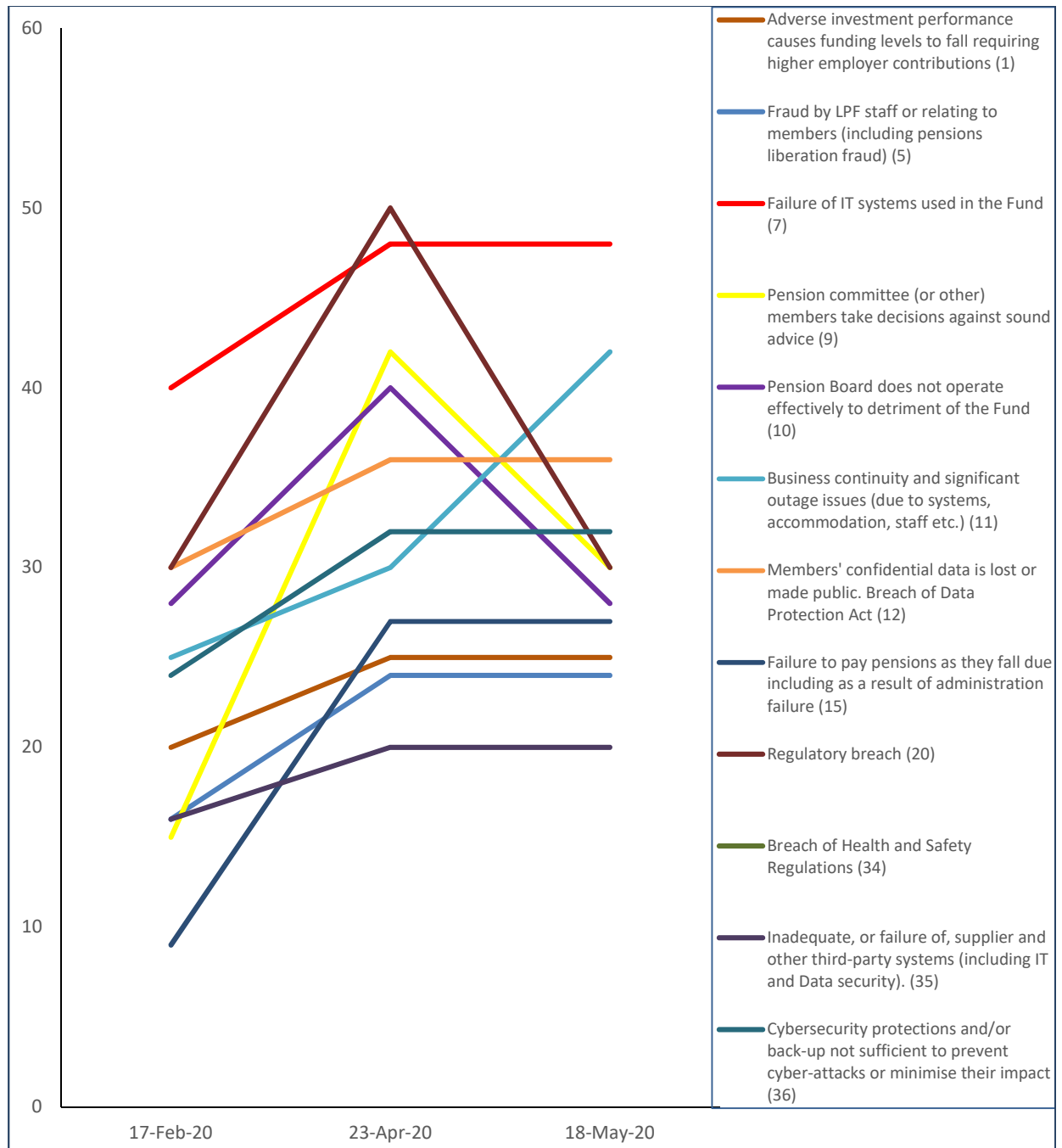
<b>New notable risks</b>	Procurement process compromising ability to secure required resource. (26)
<b>Other new risks</b>	None.
<b>New controls</b>	<p>Communications, staff training and enhanced awareness of fraud risk/cyber risk during COVID-19. (5, 36)</p> <p>Enhanced oversight of Pensions Administration mailbox. (5)</p> <p>Enhanced oversight of Private Market Capital call procedure. (5)</p> <p>Additional Recovery Group oversight. (5, 7, 15, 34)</p> <p>Monitoring and engaging on exercise of emergency powers by CEC. (9, 10)</p> <p>People Group, Risk Group, ICT Oversight Group and SLT continue to address COVID-19 specific matters. (11)</p> <p>Reporting of Injuries, Diseases and Dangerous Occurrences Regulation (RIDDOR). (11)</p> <p>Agile reviews by ICT, Risk and SLT of new systems and technology introduced to account for business continuity during extended COVID-19 remote working. (12)</p> <p>Royal Mail redirect to new scan and sort facility (more enhanced location and supplier diligence ongoing). (12)</p> <p>Initial high-level review of COVID-19 related supplier reliance and resilience carried out focusing on critical suppliers only. This review to cascade down to the next level over time. (19)</p> <p>LPFI ICAAP process. (20)</p> <p>Discretions policy approved. (20)</p> <p>Website updated for COVID-19 (22) and additional communications for employers and members. (22, 29)</p> <p>Extra LPFI board meeting to consider COVID-19 specific issues. (28)</p> <p>Monitoring levels of collaborative partner support required, and appropriate, during COVID-19 period. (33)</p> <p>Monitoring childcare, potential for sickness and other staffing and efficiency matters arising from the prevailing circumstances through Recovery Group and SLT oversight. (33)</p> <p>Recruitment strategy continues remotely. (33)</p>

<b>Eliminated risks</b>	None.
<b>Other notable initiatives / actions</b>	<p>Funding Strategy Statement -proposed changes to Pensions Committee in June 2020, with employer consultation to follow. (3)</p> <p>Liaise with SPPA and SAB re scheme affordability issues, e.g. charitable sector. (3)</p> <p>Additional employer covenant analysis and engagement in response to COVID-19 being carried out with updates provided to all four Councils regarding aligned bodies. (3)</p> <p>SLT prioritising and engaging with LPFE board and the business to ensure key processes remain on track during any extended remote working period. (4)</p> <p>Controlled adaptations of pensions administration procedures for remote working scenarios. All adaptations will be revisited on 1 December 2020 and pension payments suspended if any shortfalls. (5)</p> <p>Monitoring home working impact on processes through line management and team meetings. (5)</p> <p>Roll out of refinements to the performance management process 2021. (6)</p> <p>Review of HR people policies and relaunch of key policies by end 2020. (6)</p> <p>Reviewing onboarding processes and procedures in light of potentially bringing staff into the fund during any lock-down or other remote working scenario. (6)</p> <p>CRIMS Project team monitoring and implementing fixes and refinements to the new order management system (7).</p> <p>Update to the Personal Account Dealing policy to be communicated to staff and the annual disclosure process finalised. (16)</p> <p>Extension of COVID-19 supplier resilience, reliance and 'best value' review. (19)</p> <p>Escalation process underway to address poor PAS performance by employers, e.g. lateness of retiral and leaver information. (30)</p> <p>Appoint a H&amp;S officer for LPF as part of role – make sure LMS new system covers all adequate training. (34)</p> <p>DSE and sickness absence as remote working continues under review. (34)</p> <p>Enhanced engagement with collaborative partners though the pandemic and to maintain committed client service levels. (28)</p>
<b>Material litigation</b>	None.

## ALL RISKS: STATUS OVERVIEW

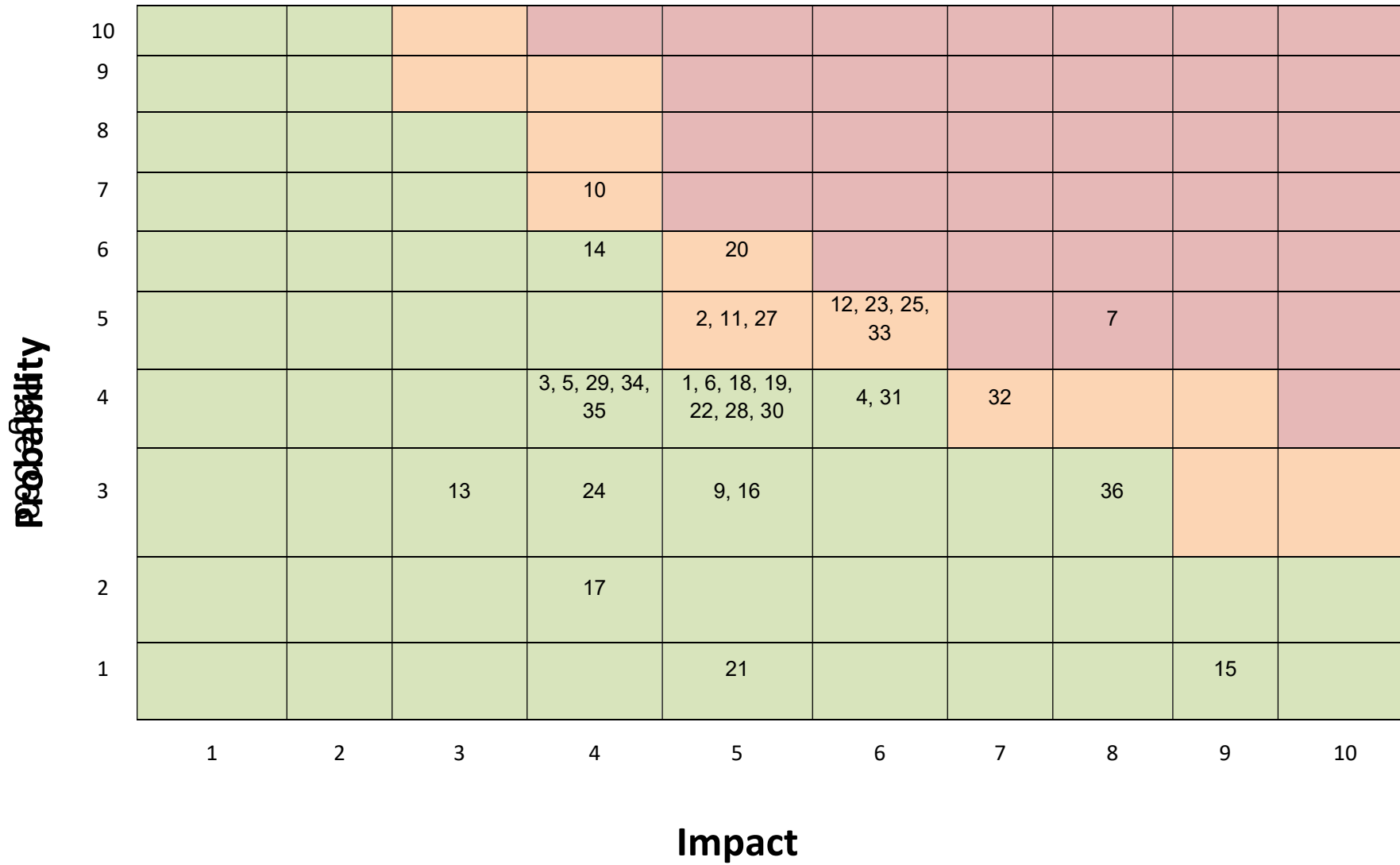


## Immediate term COVID-19 risk movements



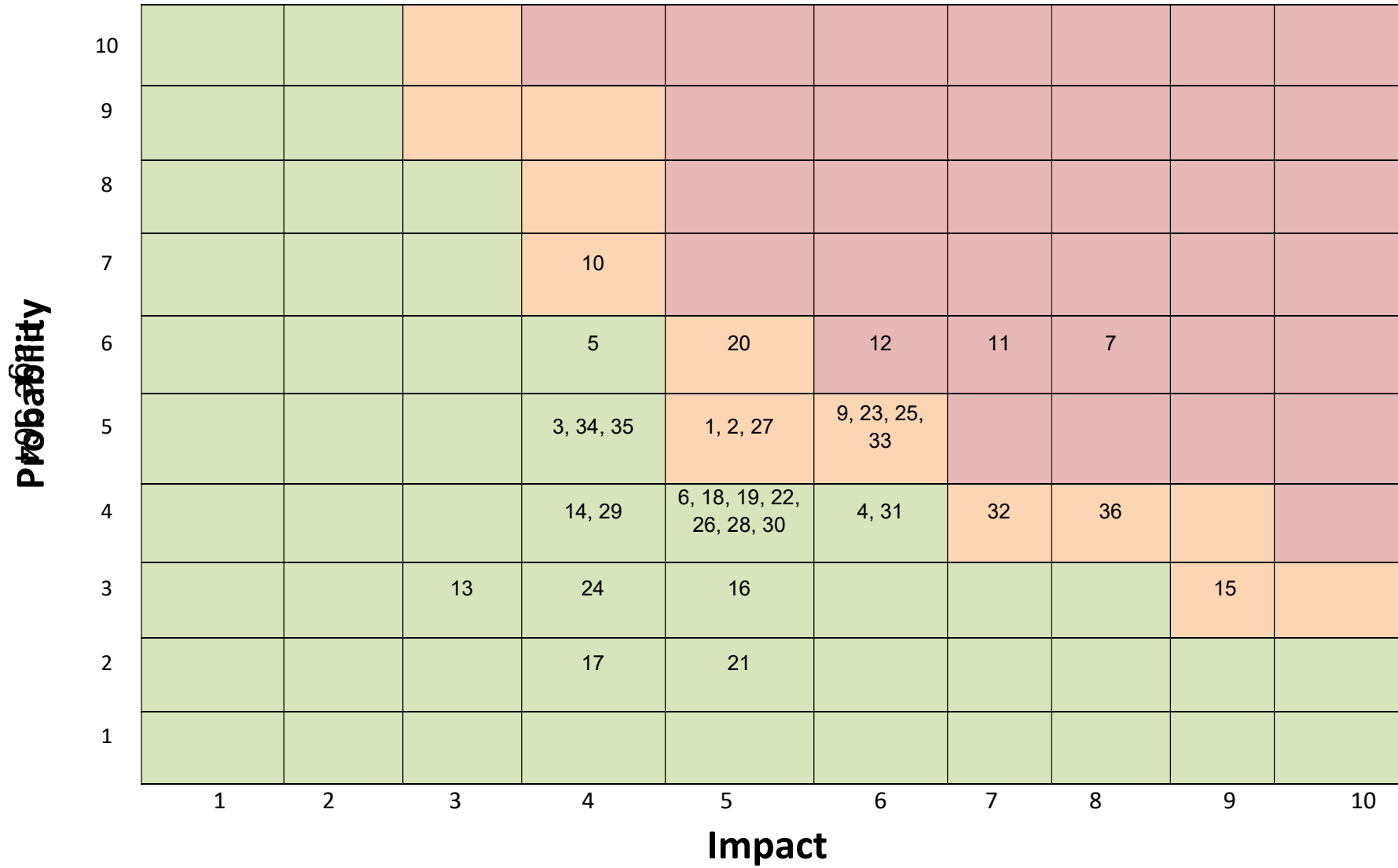
**QUARTER 4**

**2019/20 ALL RISKS: IMPACT AND PROBABILITY OVERVIEW**



QUARTER 1




2020/21 ALL RISKS: IMPACT AND PROBABILITY OVERVIEW





**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 causes 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 Pension fund assets.	24	Inappropriate use of pension fund monies.
6	Staff Negligence.	25	Procurement/framework breach.
		26	Procurement process compromising ability to secure required resource.
	Failure of IT systems used in the fund with serious consequences for investment management, benefit administration and oversight activities.	27	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	<b>Removed.</b>	28	Claim or liability arising from shared services.
9	Committee members take decisions against sound advice.	29	Unauthorised access to PensionsWEB.
10	Pension Board not operating effectively.	30	Incorrect data from Employers leading to fines etc.
11	Business continuity issues.	31	Inadequate contractual protection for services.
12	Members' confidential data is breached.	32	Over reliance on single core service provider.
13	Loss due to stock lending default.	33	Human resource insufficient to carry out active projects.
14	Risk of incorrect pension payments.	34	Breach of health and safety regulations.
15	Failure to pay pensions as they fall due.	35	Inadequate, or failure of, supplier and other third-party systems (including IT and data security).
16	Market abuse by investment team or others.	36	Cybersecurity protections and/or back-up not enough 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

Risk No below	Description	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	Q4 2019/20 Total	Q1 2020/21 Total
1	Investment Performance pressure on employer contributions (1)	●	●	●	●	●	●	●	●	●	●	●	●
2	Adverse Movement - pressure on employer contributions (2)	●	●	●	●	●	●	●	●	●	●	●	●
3	Failure of an employer to pay contributions (3)	●	●	●	●	●	●	●	●	●	●	●	●
4	Retention of key staff (4)	●	●	●	●	●	●	●	●	●	●	●	●
5	Fraud by LPF staff or relating to members (including pension liberation fraud) (5)	●	●	●	●	●	●	●	●	●	●	●	●
6	Staff negligence, maladministration or lack of specialist knowledge (6)	●	●	●	●	●	●	●	●	●	●	●	●
7	Failure of IT systems (7)	●	●	●	●	●	●	●	●	●	●	●	●
8	Risk removed	●	●	●	●	●	●	●	●	●	●	●	●
9	Pension Committee (or other) members take decisions against sound advice (9)	●	●	●	●	●	●	●	●	●	●	●	●
10	Pension Board not operating effectively (10)	●	●	●	●	●	●	●	●	●	●	●	●
11	Business continuity issues (11)	●	●	●	●	●	●	●	●	●	●	●	●
12	Members' confidential data is lost or made public. Breach of Data Protection Act (12)	●	●	●	●	●	●	●	●	●	●	●	●
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	GDPR process in accordance with law (21)	●	●	●	●	●	●	●	●	●	●	●	●
22	Incorrect communication with members (22)	●	●	●	●	●	●	●	●	●	●	●	●
23	Acting beyond proper authority/delegations (23)	●	●	●	●	●	●	●	●	●	●	●	●
24	Inappropriate use of pension fund monies (24)	●	●	●	●	●	●	●	●	●	●	●	●
25	Procurement/framework breach (25)	●	●	●	●	●	●	●	●	●	●	●	●
26	Procurement process compromising ability to secure required resource. (26)	●	●	●	●	●	●	●	●	●	●	●	●
27	Group structure and governance fully compliant and up-to-date. (27)	●	●	●	●	●	●	●	●	●	●	●	●
28	Claim or liability arising from shared services (28)	●	●	●	●	●	●	●	●	●	●	●	●
29	Unauthorise access to PensionsWEB (29)	●	●	●	●	●	●	●	●	●	●	●	●
30	Incorrect data from Employers leading to fines (30)	●	●	●	●	●	●	●	●	●	●	●	●
31	Inadequate contractual protection for services (31)	●	●	●	●	●	●	●	●	●	●	●	●
32	Over reliance on single core service provider (32)	●	●	●	●	●	●	●	●	●	●	●	●
33	Staff Resource within the Fund not sufficient to carry out core tasks (33)	●	●	●	●	●	●	●	●	●	●	●	●
34	Breach of Health and safety regulations (34)	●	●	●	●	●	●	●	●	●	●	●	●
35	Inadequate, or failure of, supplier and other third-party systems (including IT and data security). (35)	●	●	●	●	●	●	●	●	●	●	●	●
36	Cybersecurity protections and/or back-up not sufficient to prevent/minimise cyber-attacks. (36)	●	●	●	●	●	●	●	●	●	●	●	●

## BACKGROUND PROCESS AND PARAMETERS (EXTRACTED FROM RISK REGISTER)

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*The Risk Management Group, and risk register, form part of the LPF group's critical assurance framework, covers all entities within the group and should be read in conjunction with the other forms of assurance set out in LPF's assurance overview document.*

*The register is formally considered by the Risk Management Group quarterly but is also updated on an ad hoc basis where required. The register also takes into account material risks identified by the wider business, including arising from (i) the other oversight groups (e.g. SLT, People, ICT Oversight and/or any relevant project groups), (ii) any prior board, committee and stakeholder feedback, and (iii) compliance monitoring and processes (e.g. breach reporting, whistleblowing).*

*The Risk Management Group itself comprises senior officers of each function within the LPF group, as well as the Senior Leadership Team (SLT). All members are accountable for escalating material risks, with a particular focus on their respective areas, for consideration. If relevant and deemed sufficiently material, the risk will be included in the register and monitored by the risk function in conjunction with the relevant business unit.*

*The approved risk register is tabled and considered by SLT following sign-off to ensure additional oversight and ongoing engagement with any resulting actions. These actions are tracked and followed up by the LR&C team with the business on an ongoing basis. The risk register is also circulated to the conveners of the Pensions Committee and Audit Sub-Committee, Chair of the Pension Board and Independent Professional Observer on a quarterly basis, with summary analysis and reporting provided to those bodies each quarter. In addition, an in-depth risk report is provided to the Audit Sub Committee annually, which includes a review of the full register.*

*The risk register is a continually evolving document and doesn't purport to be a comprehensive list of every risk or potential exposure to which the LPF group entities are subject or involved in managing. It should therefore continue to be read in the context of the LPF group's overall business strategy, risk appetite and assurance map. The risk register may cross-refer to separate operational project management tools or action trackers which monitor relevant items in more granular detail and for which the business units are accountable.*

*Importantly, that risk appetite and assurance structure will flex to ensure that it continues to be proportionate to the size and nature of the business of the LPF group and also adhere to the following industry best practice principles:*

- ❖ *Ensure that the LPF group's risk appetite **aligns with its strategy** and is **set by its senior management team without undue influence** either externally or otherwise across its assurance stack.*
- ❖ *Integrates risk as **a key component of the group's management and decision-making** processes, and so through the spine of its governance and operations.*

- ❖ Engenders an **open, 'live' and engaged risk culture** which seeks to pro-actively identify current and future risks for the business, simplifying layers of controls to ensure this is not stifled, and so...
- ❖ **Not establish or perpetuate systems, controls or processes** which are out of line with, or **disproportionate to, the group's risk appetite**. That can be counterproductive in distracting key focus and resource away from delivering the group's strategy, core function and assurance over a manageable number of critical risks.
- ❖ Remain **aligned to LPF's existing resources** and organisational development.
- ❖ Ensure an **effective and independent risk and compliance function** is maintained, as a general principle and in line with the standards of the UK regulated financial services sector.
- ❖ Ensure appropriate levels of **separation and independence** of each of the **'four lines of defence'**, as a general principle and in line with the standards of the UK regulated financial services sector.
- ❖ Ensure appropriate levels of **co-operation and information sharing** across the **'four lines of defence'**.

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by virtue of paragraph(s) 6, 9 of Part 1 of Schedule 7A  
of the Local Government(Scotland) Act 1973.

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