Public Document Pack

Notice of Meeting and Agenda

Pensions Committee

2.00 pm Wednesday, 23rd June, 2021

Virtual Meeting - via Microsoft Teams

The law allows the 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 Any items under "Private Business" will not be published, although the decisions will be recorded in the minute.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

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1. Quorum Check

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

2. Order of Business

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

3.1 Members of the Committee and members of the Pension 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

4.1 If any

5. Minutes

6. Reports

6.1	Referrals and Recommendations from Pensions Audit Sub-Committee	
6.2	Agenda Planning – report by the Chief Risk Officer, Lothian Pension Fund (circulated)	23 - 30
6.3	LPF Unaudited Annual Report (and Financial Statements) 2021 – report by the Chief Finance Officer, Lothian Pension Fund (circulated)	31 - 246
6.4	Joint Investment Strategy Panel Activity – report by the Chief Executive Officer, Lothian Pension Fund (circulated)	247 - 256
6.5	Annual Investment Update – Lothian Pension Fund – report by the Chief Investment Officer, Lothian Pension Fund (circulated)	257 - 272
6.6	Annual Investment Update – Scottish Homes Fund – report by the Chief Investment Officer, Lothian Pension Fund (circulated)	273 - 278
6.7	Investment Strategy Review – report by the Chief Executive Officer, Lothian Pension Fund (circulated)	279 - 338
6.8	Statement of Investment Principles – report by the Chief Investment Officer, Lothian Pension Fund (circulated)	339 - 360

6.9	Risk Management Summary – report by the Chief Risk Officer, Lothian Pension Fund (circulated)	361 - 374

7. Motions

7.1 If any

8. Resolution to Consider in Private

8.1 The Committee is requested under Section 50(A)(4) of the Local Government (Scotland) Act 1973 to exclude the public from the meeting for the following items of business on the grounds that they would involve the disclosure of exempt information as defined in Paragraphs 1.3 and 6 of Part 1 of Schedule 7A of the Act.

9. Private Reports

9.1	Annual LPF Group Governance Update – report by the Chief Risk Officer, Lothian Pension Fund (circulated)	375 - 464
9.2	ICT Update – report by the Chief Executive Officer, Lothian Pension Fund (circulated)	465 - 468
9.3	Recommendations for Award of Contract in respect of Voting and Engagement Services for Lothian Pension Fund – report by the Chief Investment Officer, Lothian Pension Fund (circulated)	469 - 474

Andrew Kerr

Chief Executive

Committee Members

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

Please note that members of the Pension Board and the Independent Professional Observer will also be invited to attend and participate in the meeting.

Information about the Pensions Committee

The Pensions Committee consists of 5 Councillors and 2 external members and is appointed by the City of Edinburgh Council in its separate capacity as administering authority of the Lothian Pension Fund. The Pensions Committee usually meets 4 times a year (every twelve weeks).

Meeting will be via conference call. The meeting will be monitored by Susan Handyside.

The Committee Term of Reference and Procedural Standing Orders.

Pension Board Members

Jim Anderson, Tony Beecher, Thomas Carr-Pollock, Nick Chapman, Sharon Dalli, Tom Howorth, Darren May, Brian Robertson and Alan Williamson.

Information about the Pension Board

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.

https://www.lpf.org.uk/us .

Independent Professional Observer

Andy McKinnell

Information about the Independent Professional Observer

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 Committee and Pension Board.

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

City of Edinburgh Council Oversight

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 and Dr Stephen S. Moir, Executive Director of Resources for the City of Edinburgh Council, as the Administering Authority for the Fund, to ensure that its statutory functions are being properly carried out.

Lothian Pension Fund Senior Leadership Team

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

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 07771378238, email 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.

Pensions Committee Minutes

2pm, Wednesday 17 March 2020

Present:

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

Pension Board Members present:

Jim Anderson, Thomas Carr-Pollock, Sharon Dalli (Chair), Tom Howorth, Brian Robertson and Alan Williamson.

Other Attendees:

Andy McKinnell, Independent Professional Observer

1. Quorum

The Clerk confirmed that notice of the meeting had been given and that a quorum was present and the Convener declared the meeting open.

2. Order of Business

The Clerk advised there was no change to the order of business.

3. Declaration of Interests

To note there were no declarations of interest.

4. Minutes

Decision

1) To approve the minute of the Pensions Committee of 9 December 2020 as a correct record subject to agreeing to amend item 8 as per the following circulated written amendment by John Anzani:

"Members were advised that the contract for the voting and engagement provider had been tendered during 2019/20 and that the incumbent had been re-appointed after a competitive process overseen by the procurement team at West Midlands Pension Fund. The contract ran from Spring 2020 for a five-year period with a review after 12 months.

A separate competitive tender process for administrative support might ensue if the LAPFF were to change its status as the result of another work stream. However, this initiative had been paused as a result of the pandemic."

2) To approve the minute of the additional meeting of the Pensions Committee of 26 January 2021 as a correct record.

5. Pension Board oversight

The Chair of the Pension Board advised the Committee of the relevant discussion and decisions taken at the Pension Board meeting and confirmed that the Pension Board would provide comment on other relevant matters during the meeting.

6. Agenda planning

An overview of proposed reports for future Pensions Committee and Pensions Audit Sub-Committee meetings and the annual cycle was presented. Information was provided on the timeline for the appointment of the non-elected committee member positions on the Committee.

It was recommended that contract awards should be reported annually rather than six monthly with effect from the next due report in September 2021.

It was also proposed that the Operating Plan should be considered every three years by Committee from the first Plan being considered by Committee in March 2020. The Operating Plan and Budget Updates would continue to be presented to Committee in September, December and March each year.

Decision

1) To note the agenda planning document and that Pension Board members were invited to comment on agenda items during committee meetings.

2) To note the non-elected Pension Committee member appointment timeline.

3) To agree that the contract awards update be presented to Committee annually with effect from September 2021 but to note that any specific substantive contracts would continue to be brought to Committee as necessary.

4) To agree that the Operating Plan update be presented to Committee every three years.

(Reference – report by the Chief Risk Officer, LPF, submitted.)

7. Lothian Pension Fund – Internal Audit Update for the Period 2 November 2020 to 9 February 2021

Details were provided of the progress of Internal Audit assurance activity on behalf of Lothian Pension Fund (LPF) carried out by the City of Edinburgh Council's internal audit team.

Delivery of the three audits included in the 2020/21 Internal Audit Plan approved by Committee in June 2020 had been impacted by the Covid19 pandemic and had commenced in November 2020.

One audit had been finalised, one was in progress and the remaining audit was currently being planned.

As at 10 February 2021, LPF had one medium rated open internal audit finding raised in the Settlement and Custodian Services audit. Further evidence had been provided to support the closure of this finding and was currently being reviewed by Internal Audit.

Two Internal Audit findings, one high and one medium, had been closed on the basis that management had accepted the associated risks.

It had been agreed with LPF management that PwC would deliver two of the three audits included in the 2020/21 Internal Audit Annual Plan under the direction of the Chief Internal Auditor as part of the established Internal Audit co-source arrangements.

PwC would deliver the Bulk Transfers and the Employer Cessation Strategies, Valuations and Exit Calculations audit and the Council's Internal Audit team would progress the remaining agile LPF Technology Model Development audit.

Decision

1) To note progress with delivery of the Lothian Pension Fund 2020/21 Internal Audit Plan.

2) To note progress with implementation of agreed management actions to support closure of LPF internal audit findings raised.

3) To agree that an update be brought to the next Committee on the status and progress of the one remaining outstanding overdue audit finding raised in the Settlement and Custodian Services audit completed in 2019/20.

(Reference – report by the Chief Internal Auditor, CEC, submitted.)

8. Lothian Pension Fund – Proposed Internal Audit Plan for 2021-22

The proposed Lothian Pension Fund (LPF) Internal Audit Plan for the period 1 April 2021 to 31 March 2022 was presented to Committee for approval. The Plan had been developed with the LPF senior management team, the Convener of the Pensions Audit Sub-Committee and the Fund's Independent Professional Observer to ensure that internal audit assurance activity was focused on the most relevant risks for LPF.

Four reviews and ongoing internal audit follow up on implementation of previously raised findings were included in the proposed plan in line with internal audit coverage in previous years. Members noted that LPF might also be included within the scope of any relevant City of Edinburgh Council thematic reviews included in the Council's 20201/22 Internal Audit Plan.

Decision

1) To approve the proposed Lothian Pension Fund 2021-22 internal audit plan.

2) To provide the Pensions Audit Sub-Committee with details of the audits proposed for subsequent years beyond the planned one-year audit plan.

(Reference – report by the Chief Internal Auditor, CEC, submitted.)

9. External Audit Annual Plan 2020/21 by Azets

The Accounts Commission had appointed Scott Moncrieff (now Azets) as external auditor of the Lothian Pension Fund and Scottish Homes Pension Fund for the five-year period 2016/17 to 2020/21.

Nick Bennett, Azets summarised the work plan for the 2020/21 external audit of the Funds. The core elements of the work included:

- An audit of and provision of a specific audit opinion on the 2020/21 annual accounts and related matters
- Consideration and reporting on the Funds' arrangements on the four audit dimensions – governance and transparency, financial management, financial sustainability and value for money
- Any other work requested by Audit Scotland including the contribution to performance audits (including overview reports, performance audit reports and impact reports).

Decision

1) To note the planned programme of work to support the statutory audit 2020/21 as set out in Appendix 1 of the report by Azets.

2) To note that progress against the LPF External Audit Annual Plan 2020/21 would be reported to future meetings of the Pensions Audit Sub-Committee and the Pensions Committee.

3) To note that the External Auditor had confirmed that the planned reporting on induction arrangements referenced in Appendix 1 of the report by Azets for Board members would also include Committee members.

(Reference – report by the Chief Finance Officer, LPF, submitted.)

10. Funding Strategy Statement Update

As required under the Local Government Pension Scheme (Scotland) Regulations 2018, the Lothian Pension Fund's (LPF) funding Strategy Statement (FSS) had been reviewed as part of the actuarial valuation process to ensure that it remained appropriate. The FSS set out a summary of the Fund's approach to funding liabilities.

Due consideration had been given to:

- Actuarial valuation results
- Consultation feedback from Fund employers
- Guidance from Hymens Robertson, the Fund's Actuary

An initial consultation with employers had been carried out in July 2020 with a further consultation on the draft FSS in December 2020 and a summary of responses received was presented to Members.

Decision

1) To note the summary of responses received as part of the consultation process set out in paragraphs 4.18, 4.19 to 4.20 of the report.

2) To approve the revised Funding Strategy Statement.

(Reference – report by the Chief Finance Officer, LPF, submitted.)

11. Actuarial Valuation for Lothian Pension Fund 2020

Lothian Pension Fund (LPF) was legally required to undertake an actuarial valuation once every three years. The Actuary assesses the financial health of the Fund and sets the employer contribution rates required for the next three years.

The actuarial valuation of LPF had been undertaken based on data as at 31 March 2020 and was presented to Members.

The results as at 31 March 2020 took into account the following changes which had taken place since the previous valuation in 2017:

- The merger with the Lothian Buses Pension Fund which was approved by Committee in March 2018 and took place on 31 January 2019
- The transfer of the assets and liabilities of Homeless Action Scotland to the Scottish Homes Pension Fund following its exit from the Lothian Pension Fund on 12 July 2018.

Decision

To note the results of the 2020 Actuarial Valuation report for the Lothian Pension Fund.

(References – Pensions Committee 11 December 2019 (item 5) and 24 June 2020 (item 13); report by the Chief Finance Officer, LPF, submitted.)

12. Actuarial Valuation for Scottish Homes Pension Fund 2020

The Scottish Homes Pension Fund was legally required to undertake an actuarial valuation once every three years. The Actuary assesses the financial health of the Fund and sets the employer contribution rates required for the next three years.

The results of the actuarial valuation of the Scottish Homes Pension Fund as at 31 March 2020 was presented to Members.

The funding level at 31 March 2020 was 117.7% increased from 104.7% from the 2017 actuarial valuation. This Actual Funding Level (AFL) of 117.7% was greater than the Target Funding Level (TFL) of 94.5% as specified in the Scottish Government Guarantee. No deficit contributions were therefore required from the Scottish Government (as Guarantor) for the period from 1 April 2021 to 31 March 2024.

The Scottish Government would, however, be required to pay a total of £90,000 per annum towards the cost of administration expenses over the three years from 1 April 2021 to 31 March 2024.

Decision

1) To note the results of the 2020 actuarial valuation for the Scottish Homes Pension Fund.

2) To note that the funding level of the Scottish Homes Pension Fund at 31 March 2020 was 117.7%.

3) To note that the Actual Funding Level (AFL) of 117.7% was greater than the Target Funding Level (TFL) of 94.5% as specified in the Scottish Government Guarantee.

4) To note, therefore, that no deficit contributions were required from the Scottish Government (as Guarantor) for the period from 1 April 2021 to 31 March 2024.

5) To note that the Scottish Government was required to pay a total of £90,000 per annum towards the cost of administration expenses over the three years from 1 April 2021 to 31 March 2024.

(Reference – report by the Chief Finance Officer, LPF, submitted.)

13. LPF Cost Benchmarking

The annual results from benchmarking of investment costs for the Lothian Pension Fund and pension administration costs for the LPF and Scottish Homes Pension Fund were presented.

LPF's annual report for 2019/20 had identified £34.9m of total management expenses with investment costs (£30.0m) representing by far the largest proportion of the total as expected.

Decision

1) To note the report.

2) To note that the CEM Investment Cost Effectiveness Analysis to 31 March 2020 and the interim CEM Pension administration benchmarking report 2020 had been provided on a confidential basis to the Conveners of the Pensions Committee and the Pensions Audit Sub-Committee and the Independent Professional Observer.

(Reference – report by the Chief Executive Officer, LPF, submitted.)

14. Operating Plan Update

An update was provided on progress against the 2020-2021 Operating Plan, performance indicators and the actions carried out to enable the Fund to meet its key objectives. The Plan centred around the following six broadly defined strategic goals and formed the basis of the work ahead of the Fund in 2020/21:

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

An underspend was projected for the financial year and overall progress was being made against the objectives for 2021/21.

Decision

1) To note progress of the Fund against the 2020-2021 Operating Plan.

2) To note the specific updates on performance indicators, Pension Regulator standards and compliance and membership and cashflow monitoring.

(Reference – report by the Chief Finance Officer, LPF, submitted.)

15. Operating Plan and Budget for 2021/22

The Lothian Pension Fund (LPF) 2021/22 Operating Plan was presented together with the proposed budget for 2021/22 and an indicative budget for 2022/23. The Plan also set out the priorities over the forthcoming financial year and performance targets for the service.

Decision

1) To approve the updates to the Operating Plan for 2021/22.

2) To approve the future review of the generic Operating Plan on a triennial basis.

3) To approve the budget for 2021/22.

4) To note the indicative budget for 2022/23.

(Reference – report by the Chief Executive Officer, LPF, submitted)

16. Risk Management Summary

In line with Lothian Pension Fund's (LPF) ongoing risk management procedures, an overview was provided of its risk analysis as at 8 February 2021.

The LPF Group's Risk Appetite Statement was also presented in order to provide important context on how the Risk Management Group assessed the Group's risks. It was proposed that this would be routinely considered and reviewed by the Pensions Audit Sub-Committee annually alongside the full Risk Register and Risk Assurance Overview as part of its indepth review of risk management.

An update was also provided on Brexit related impact and risks. The direct impact on the Fund was limited but there continued to be meaningful uncertainty at this time and potential for material indirect impact.

Decision

1) To note the quarterly risk overview as at 8 February 2021.

2) To approve the LPF Group's Risk Appetite Statement.

3) To note the update on Brexit related impact and risk.

(References – Pensions Committee 9 December 2020 (item 13); report by the Chief Risk Officer, LPF, submitted.)

17. Employers Participating in Lothian Pension Fund

The Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the following item of business on the grounds that it would involve the disclosure of exempt information as defined in Paragraphs 1.3 and 6 of Schedule 7(A) of the Act.

An update was provided on current matters affecting employers participating in the Lothian Pension Fund.

Decision

Detailed in the confidential schedule, signed by the Convener, with reference to this minute.

(Reference – report by the Chief Finance Officer, LPF, submitted.)

18. Lothian Pension Fund Group – Contract Awards (Period 1 July to 31 December 2020)

The Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the following item of business on the grounds that it would involve the disclosure of exempt information as defined in Paragraphs 1.3 and 6 of Schedule 7(A) of the Act.

Information was provided on the scope of contracts awarded by the Lothian Pension Fund Group in the period 1 July to 31 December 2020.

Decision

Detailed in the confidential schedule, signed by the Convener, with reference to this minute.

(Reference – report by the Chief Procurement Officer, City of Edinburgh Council, submitted.)

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

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Pensions Committee Minutes

2pm, Wednesday 24 March 2021

Present:

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

Pension Board Members present:

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

Other Attendees:

Andy McKinnell, Independent Professional Observer.

1. Quorum

The Clerk confirmed that notice of the meeting had been given and that a quorum was present and the Convener declared the meeting open.

2. Order of Business

The Clerk advised there was no change to the order of business.

3. Declaration of Interests

To note there were no declarations of interest.

4. Motions

None.

5. Project Forth

The Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the following item of business on the grounds that it would involve the disclosure of exempt information as defined in Paragraphs 1.3 and 6 of Schedule 7(A) of the Act.

Details were provided of a proposed collaboration within the Local Government Pension Scheme.

The consultant's report on the proposed collaboration was submitted to Members for consideration.

Decision

Detailed in the confidential schedule, signed by the Convener, with reference to this minute.

(References – Pensions Committee 29 September 2020 (item 18) and 9 December 2020 (item 11); report by the Chief Executive Officer, LPF, submitted.)

by virtue of paragraph(s) 1, 5 of Part 1 of Schedule 7A
of the Local Government(Scotland) Act 1973.

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Pensions Committee

2.00pm, Wednesday, 23 June 2021

Agenda Planning

1. Recommendations

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

Contact: Susan Handyside, Governance Manager, Lothian Pension Fund

E-mail: susan.handyside@edinburgh.gov.uk | Tel: 07771 378238

Agenda Planning

2. Executive Summary

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

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, an agenda planning document is submitted each quarter.

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

4. Main Report

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

4.2 Two changes have been made to the agenda planning cycle this quarter, the Pensions Administration Strategy (PAS) has been moved to September 2022 instead of March this is to ensure the cycle is balanced evenly throughout the year. In addition, the Administering Authority Discretions Policy has been added to the agenda to be presented biennially alongside PAS in September 2022.

4.3 It is also proposed that an additional meeting of the Committee be held in September of this year to consider an update in relation to Project Forth.

September 2021

Pensions Committee	Audit Sub Committee
• Referrals / recommendations from Pensions Audit Sub Committee • Employer Covenant Review	• Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund • Irrecoverable overpayment of pensions – decisions made under delegated authority

• Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund • Annual Report by External Auditor (if available) • Contract Awards Update • Operating Plan Update • Risk Management Summary • Employers Participating in the Lothian Pension Fund	• Fraud Prevention • Risk Management Summary

December 2021

Pensions Committee	Audit Sub Committee
• Referrals/ recommendations from Pensions Audit Sub Committee • Annual Report by External Auditor (if not available in Sept) • Benchmarking • Stewardship and Engagement • Operating Plan and Budget Update • Risk Management Summary	• Annual Report by External Auditor (if not available in Sept) • EU Tax Claims and Other Income Tax Recoveries • Pensions Data Quality • Investment Income Review-Cross-Border Withholding Tax • Global Custody Services Performance • Risk Management In-depth review

Future Pensions Committee and Audit Sub Committee dates

Please note that Pensions Committee and Audit Sub Committee meetings will be held virtually until further notice. The Committee meeting dates for 2021/22 are set out below:

Pensions Committee	Audit Sub Committee
• Wednesday, 29 September 2021, 2.00pm, venue/virtual meeting (tbc) • Additional September 2021 meeting (tbc) • Wednesday, 8 December 2021, 2.00pm, venue/virtual meeting (tbc) • Tuesday, 22 March 2022, 2.00pm, venue/virtual meeting (tbc) • Wednesday, 29 June 2022, 2.00pm, venue/virtual meeting (tbc)	• Monday, 27 September 2021, 2.00pm, venue/virtual meeting (tbc) • Tuesday, 7 December 2021, 2.00pm, venue/virtual meeting (tbc) • Tuesday, 28 June 2022, 2.00pm, venue/virtual meeting (tbc)

5. Financial impact

5.1 None.

6. Stakeholder/Regulatory Impact

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

7.1 None.

8. Appendices

Appendix 1 – LPF's Annual Agenda Planning Cycle

Frequency	Pensions Committee	Audit Sub Committee	Month
Biennial	Administration Strategy (biennial from March 2016) next review due September 2022	N/A	September
	Administering Authority Discretions Policy. Next review due September 2022	N/A	September
Annually	Audit Plans (Internal and External)	*Draft internal audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee, the CEO (LPF) and, if appropriate, the Independent Professional Observer.*	March
	Policies and Strategies Update (including revised Pension	N/A	March
	LPF 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	N/A	June
		LPF Group Controls and Compliance	June
	Employer Covenant Review	N/A	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	Irrecoverable overpayment of pensions – decisions made under delegated authority	September
	N/A	Fraud Prevention	September
	Lothian Pension Fund Contract Awards Report	N/A	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	Pensions Data Quality	December
	N/A	Global Custody Services Performance	December
	N/A	Risk Management: In-depth review	December
Semi Annually	Employers Participating in Lothian Pension Fund	N/A	March & September
3 Times per year	Operating Plan and Budget Update	N/A	March[1], September & December
	Referrals / recommendations from Pensions Audit-Sub	N/A	June, September & December
Quarterly	Risk Management Summary	Risk Management Summary (In-depth report in December)	March, June, September and December

[1] The March update will have the dual purpose of an operating plan update, budget review and budget approval for the forthcoming financial year.

Frequency	Pensions Committee	Audit Sub Committee	Month
Every 3 years	Actuarial Valuation: LPF SHPF Funding Strategy Statement Operating Plan (as from March 2020)	N/A	December or March March
As required	Delegated authorities (provider appointments) Discretions (death grants etc.) N/A Regulatory Update Investment Strategy Reviews (at least every 3 years) Next due June 2021	N/A N/A Internal Audit Reports N/A N/A	

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Pensions Committee

2.00pm, Wednesday, 23 June 2021

LPF Unaudited Annual Report (and Financial Statements) 2021

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the unaudited Annual Report (and Financial Statements) for the year ended 31 March 2021 for Lothian Pension Fund and Scottish Homes Pension Fund

John Burns
Chief Finance Officer, Lothian Pension Fund

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

E-mail: jason.koumides@edinburgh.gov.uk | Tel: 0131 529 6245

Susan Macfarlane, Communications Partner – People and Communications, Lothian Pension Fund

Email: Susan.Macfarlane@edinburgh.gov.uk | Tel: 0131 529 4626

LPF Unaudited Annual Report (and Financial Statements) 2021

2. Executive Summary

2.1 The purpose of this report is to present the unaudited Annual Report (and Financial Statements) for the year ended 31 March 2021 for Lothian Pension Fund and Scottish Homes Pension Fund.

2.2 A copy of the unaudited Pension Funds' Annual Report 2021 is attached as Appendix 1.

2.3 Lothian Pension Fund (Group) net asset valuation as at 31 March 2021 highlights a significant recovery from the prior year's fall in global and UK equity markets, with the total of £8,694m reflecting an increase of £1,215m (16.2%).

2.4 Given its mature membership profile, net assets of the Scottish Homes Pension Fund fell from £166.1m to £157.5m as at 31 March 2021, a decrease of £8.6m (5.2%).

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.

The Local Authority Accounts (Scotland) Regulations 2014

3.2 These stipulate that "The Annual Accounts must be submitted to the auditor no later than 30th June immediately following the financial year to which the Annual Accounts relate". It is within the Pensions Committee's remit to consider the unaudited Annual Report for the pension funds.

The Local Authority (Capital Finance and Accounting) (Scotland) (Coronavirus) Amendment Regulations 2021

Amendment of the Local Authority Accounts (Scotland) Regulations 2014

3.3 These regulations amend the dates of approval for signature of audited annual accounts, namely, "by 31 October 2021 in respect of the accounts for the financial year 2020-2021, and 30 September in each subsequent year, in respect of the accounts for the immediately preceding financial year". Publication of the audited annual accounts for 2020-21 must be undertaken by 15 November 2021, with, in future years, reversion to the previous deadline of 31 October.

3.4 Lothian Pension Fund does not intend to utilise the provisions made in *The Local Authority (Capital Finance and Accounting) (Scotland) (Coronavirus) Amendment Regulations 2021* to revise the timetable for its Annual Accounts completion.

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 2021. These consolidated financial statements combine those of the Fund (the parent entity) and its controlled entities (the investment staffing company, LPFE Limited, and now also LPFI Limited) as defined in International Accounting Standard (IAS) 27.

4. Main Report

LPF Unaudited Annual Report 2021

4.1 A copy of the unaudited Annual Report (and Financial Statements) for the year to 31 March 2021 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 Lothian Pension Fund (Group) net asset valuation as at 31 March 2021 highlights a significant recovery from the prior year's fall in global and UK equity markets, with the total of £8,694m reflecting an increase of £1,215m (16.2%).

4.4 Given its mature membership profile, net assets of the Scottish Homes Pension Fund fell from £166.1m to £157.5m as at 31 March 2021, a decrease of £8.6m (5.2%).

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 2020, with commentary by the actuary of the experience over the subsequent year.

5. Financial impact

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

6. Stakeholder/Regulatory Impact

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.

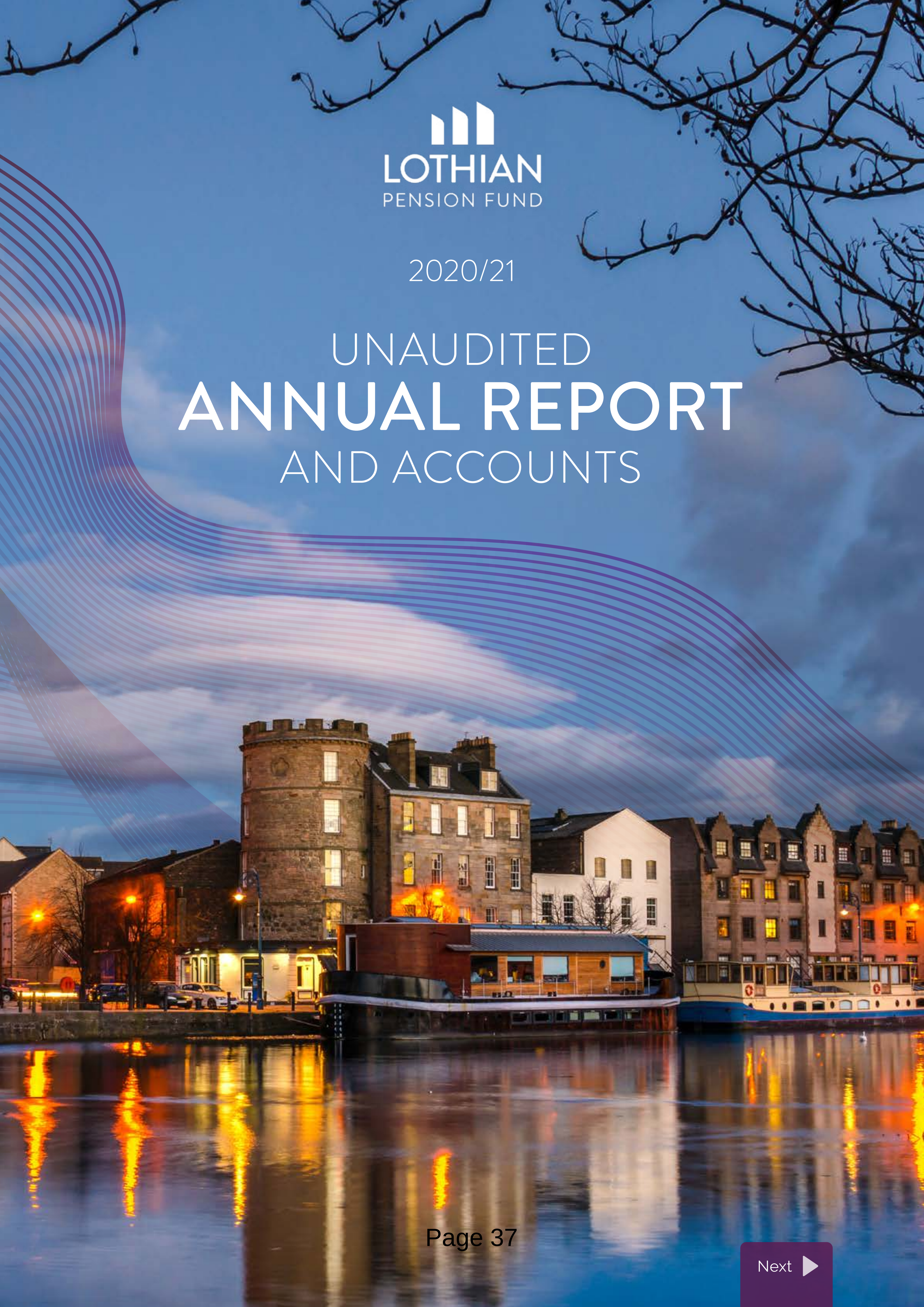
6.2 There are no adverse governance, compliance or regulatory implications as a result of this report.

7. Background reading/external references

7.1 None.

8. Appendices

Appendix 1 - Unaudited Annual Report (and Financial Statements) 2021 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



LOTHIAN PENSION FUND

2020/21

UNAUDITED ANNUAL REPORT AND ACCOUNTS

MANAGEMENT COMMENTARY / FOREWORD

Report by the Convener of the Pensions Committee

In August 2020 I was appointed Convenor of the Pension Committee. The world continued to face an unprecedented situation with the Coronavirus affecting the lives of us all. Nevertheless, the team have shown professionalism and diligence throughout this period, remaining focussed on providing our scheme members and employers with the excellent service they have come to expect.

During the year Doug and his leadership team have continued to work towards the strategic goals for the Fund, supported by the Committee. Excellent progress was made, including implementing the LPF Digital Strategy, contributing to the SPPA consultation to address discrimination, as well as preparation for the implementation of the new legislation. In addition, I'd like to recognise the considerable work undertaken for the Fund's Actuarial Valuation this year.

It has been a pleasure to get to know the other Committee Members and the Pension Board Members over the last year. The success of the Fund depends on all of us and I would like to thank the Committee, Pension Board, employers and all the Fund's employees for their continued commitment in delivering an uninterrupted service to members through these challenging and difficult times.

Councillor Rob Munn
Convener, Pensions Committee

MANAGEMENT COMMENTARY / FOREWORD

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 virtually over the year due to the continued covid restrictions, but otherwise, thankfully, were largely unaffected by the restrictions and met three times as scheduled. The key activities over the last year included consideration of the Annual Report, reports and plans from internal and external audits, group controls and compliance, data quality, fraud and the quarterly risk update, as well as an annual in-depth review of the LPF risk register that we consider in December.

The Pensions Audit Sub-Committee provides referrals and recommendations to the Pension Committee and has a valuable role in providing additional scrutiny of the pension funds and further assurance for our scheme members and employers of good governance and oversight within LPF.

Councillor Cameron Rose
Convener, Audit Sub-Committee

Report by the Chair of the Pension Board

I was appointed as Chair of the Pension Board in April 2020, having served as employer representative on the Pensions Board since 2016. The Pension Board comprises five representatives from both employers and members. Vacancies have arisen during the year and the Pensions Board has had an active role in the revision of the Fund's nomination and appointments policy to support the fulfilment of these vacancies.

The Board's primary function is to assist the administering authority, as Scheme Manager, 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 augmented by both officers of the Fund (on their specific areas of expertise) and by the Fund's Independent Professional Observer.

The Board has convened four times over the year, and also had representation at the Pension Committee meetings and the Audit Sub Committee meetings. Board members have maintained regular communication via email and retained access to relevant information despite restrictions on face-to-face meetings. Due to current restrictions, meetings will continue to be held remotely in line with the usual governance arrangements for the Fund.

MANAGEMENT COMMENTARY / FOREWORD

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 important role. This necessary training is delivered jointly for both Board and Committee whenever possible. In addition, each member has had the opportunity to attend a variety of online seminars, webinars and other pension related virtual training to broaden their pensions knowledge.

Along with its usual primary functions, during this year the Board has also: reviewed their composition and updated its constitution; provided feedback to the Fund's governance review; established regular links with the national Scheme Advisory Board; and applied key focus on governance in relation to performance updates from the Fund, reporting duties of breaches in law and the application of strain costs.

I am delighted to continue as Chair of the Board for another year. With upcoming legislative changes to consider, such as The Pension Regulator's revised code of practice and pension remedy as a result of age discrimination in public service pension reform, it is set to be another busy year ahead.

Sharon Dalli
Employer representative, Chair of the Pension Board

MANAGEMENT COMMENTARY / FOREWORD

Report by the Independent Professional Observer

As the Fund's Independent Professional Observer, 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.

I have more than 30 years of pension experience working with pension trustees on topics including investment, actuarial guidance and governance.

I 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, Pension Committee meetings, Audit Sub Committee meetings and, once a year, the joint Investment Strategy Panel. I also contribute and attend all of the LPF training events.

Andy McKinnell
Independent Professional Observer

WHAT OUR MEMBERS SAY:

'Lothian Pension Fund have administered pensions in both public sector organisations I have worked in. It was really straightforward to combine them, and I've always found LPF very easy to contact and helpful.'

Sarah Hughes-Jones, Information Compliance Manager, City of Edinburgh Council

MANAGEMENT COMMENTARY / FOREWORD

Report by the LPFE Chair

LPFE provides the necessary people capacity and capability to the Lothian Pension Fund group to enable the administration of the Funds. Over the last year we met virtually on six occasions and considered key items including our remuneration policy, resourcing, Covid-19 contingency planning, as well as the results and actions from our 'Engage Survey' for our colleagues. We also appointed an additional Non-Executive Director in February 2021 to further enhance our governance. In addition, an update of our activities is reported to the Pension Committee each year. I would like to thank all our colleagues and the Pension Committee for their commitment and hard work over an exceptional and challenging year.

Dr Stephen S. Moir
LPFE Chair
Executive Director of Resources, The City of Edinburgh Council

Report by the LPFI Chair

LPFI provides regulated investment advisory and portfolio management service for LPF and the group's collaborate partner funds. The LPFI Board met on ten occasions (virtually) over the last year where we oversaw the extension of the company's services to include portfolio management mandates to partner funds, in addition to the existing investment strategy and private market deal execution and monitoring support. The LPFI board also appointed an additional Non-Executive Director in January 2021. An update on our activities is reported to the Pension Committee each year. I am proud of the team and their achievements over the year, which has been a landmark year in so many ways, and look forward to providing an excellent service to LPF and our partner funds over the next year.

Hugh Dunn
LPFI Chair
Head of Finance, The City of Edinburgh Council

MANAGEMENT COMMENTARY / FOREWORD

Report by the CEO

There for members and their families in a difficult year

When we launched our Operating Plan in February of last year, we didn't know that disruption on an unprecedent scale was just weeks away, as a global pandemic impacted the lives and livelihoods of people around the world. We closed our office in March 2020 and asked colleagues to work from their homes as recommended by official guidance. In the days and weeks that followed, we devoted time and effort to ensuring those arrangements were resilient enough to deliver in full on our five critical functions:

1. Paying pension benefits as they fall due
2. Processing high-priority member tasks on time
3. Resolving beneficiary enquiries
4. Caring for our colleagues
5. Protecting our assets

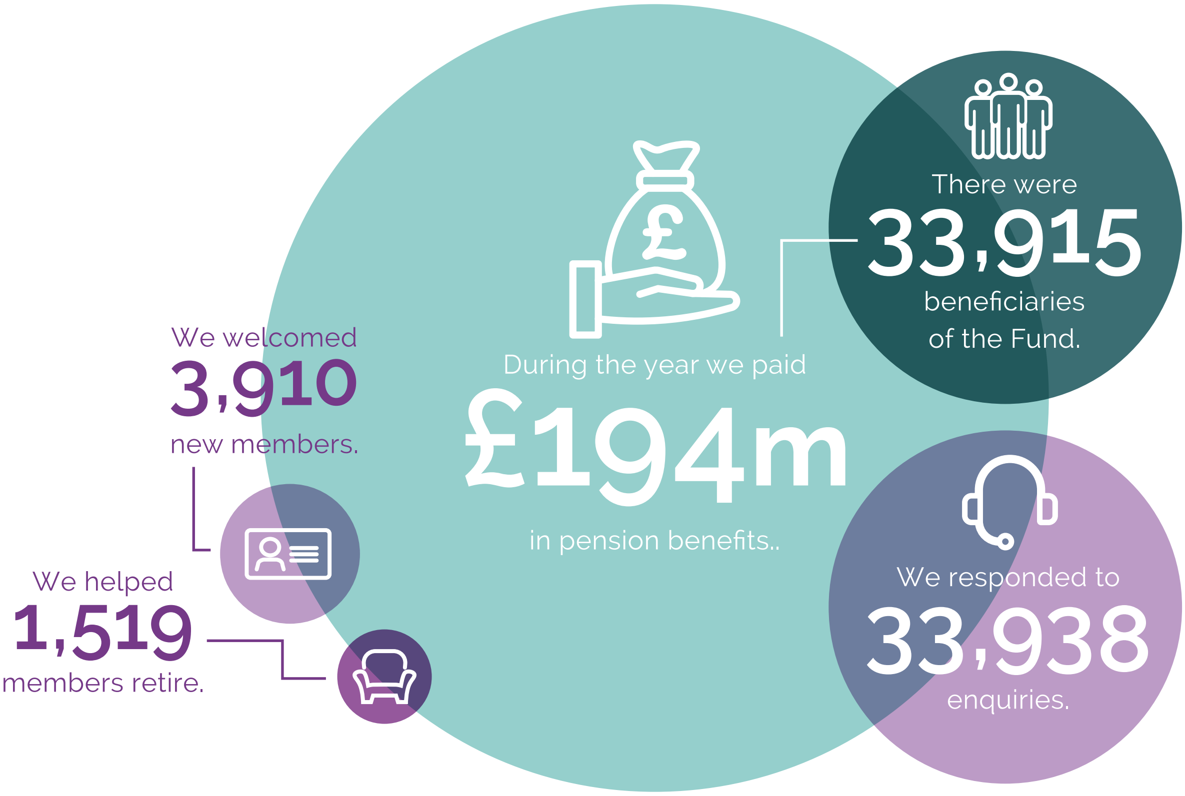
As we adapted to this way of working, we were able to devote time to our major projects and then to discretionary strategic initiatives. I'm incredibly humbled by the efforts of the 79 colleagues who make up the LPF team and whose complete focus on our members ensured we achieved a satisfaction score of 97%.

As a result of the demands to adapt to new service delivery challenges, we took the decision to outsource our mail handling and scanning activities to a high resilience service provider, and we terminated preliminary talks concerning our move to a larger office property in favour of adapting our existing offices for what's expected to be a blended occupation model in the short-term.

MANAGEMENT COMMENTARY / FOREWORD

During the year we paid £194.3m (19/20: £185.8m) in pension benefits to 33,915 beneficiaries of the Fund, responded to 33,938 enquiries, welcomed 3,910 new members and helped 1,519 members move into retirement.

We also led a bulk transfer programme that saw all active, deferred and pensioner members of Visit Scotland consolidate into Lothian Pension Fund, resulting in some 519 new members and a range of funding and administrative benefits accruing to Visit Scotland as a sponsoring employer within the LGPS.



Secure benefits and a higher funding level

Benefits in Lothian Pension Fund are protected by a statutory guarantee and members can be confident their pensions will be paid when they fall due. Every three years we're required to appoint an independent actuary to undertake a valuation. The most recent valuation was conducted with a reference date of 31 March 2020 and the results are included in this report. The total valuation level for Lothian Pension Fund was 106%. Put simply, this is a measurement of the sufficiency of the assets the Fund holds today to meet the benefits members have earned and expect to receive in the future. A valuation above 100% is a positive result, but benefit obligations increase every day and the Fund is required to generate positive asset returns and collect contributions to ensure the funding level remains sufficient.

The total assets of the Fund at the end of year were £8,697.8m (19/20: £7,480.3m).

MANAGEMENT COMMENTARY / FOREWORD

Progress with our Operating Plan

Despite the strain of the pandemic and the new ways of working, we were able to make good progress towards delivering the six strategic outcomes outlined in our Operating Plan:

- 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

You can read more about our progress throughout this report.

The LGPS in Scotland

Lothian Pension Fund is one of 11 funds within the Local Government Pension Scheme (LGPS) in Scotland. In 2018 the Scottish Scheme Advisory Board (SSAB) 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 only accessible at greater scale.

During 2019, the SAB commissioned and received a report from an independent subject matter expert on the responses and related pension fund case studies. During 2020, the SAB agreed to appoint a consultant to consider the matter further. This work has the potential to result in material change for the LGPS funds in Scotland, including Lothian Pension Fund.

Developments will be reported to our members and other stakeholders at the appropriate time.

McCloud and the matter of historic age discrimination

With McCloud, the Court ruling that age protections are discriminatory, we've studied various versions of the proposed remedy from HM Government and participated in the consultation administered by the Scottish Public Pensions Agency (SPPA). The remedy seems set to allow at least some members to fall back to the old rules and benefit schedules and then to retain the option to elect into the new rules if they're deemed beneficial. Such election may not be required when the remedy is finalised, and the member can therefore back a number of horses.

MANAGEMENT COMMENTARY / FOREWORD

This will almost certainly require us to collate additional data on individual circumstances, generate tens of thousands of calculations and supply parallel benefit schedules to members each year. The precise remedy and date of implementation remains uncertain and therefore provides us with the opportunity to examine our resourcing levels and train additional administrators. However, the effect and demands will go beyond the Fund and our sponsoring employers will also feel the effect. We depend on them to provide us with data on the employment records of our members and we remain exposed to any limitations in their resourcing levels or systems.

Beyond McCloud, we also face uncertainty on the implementation of any cost cap measures. The cost cap is the means of protecting employers, or public finances, from excessive cost of benefit accrual by varying employee contributions or benefit levels such that they remain within a corridor. The 2017 cost cap was paused in response to the uncertainty of McCloud, but it could well come back into play when McCloud has been implemented and compound the difficulties of complexity within the LGPS.

Affordability of pensions

During the year, we provided each of our 72 employers with an updated valuation schedule containing a view of their unique share of the assets and liabilities of the Fund. This was measured on both an ongoing (assets remain invested) and cessation (assets are deployed to lower yield, stable strategies) basis, with the latter providing a view of net obligations to or from the Fund in the case of an exit. We also assisted two employers with a managed exit from the Fund and we have a total of 17 funding agreements in place with employers in respect of satisfying their obligations to the Fund in respect of their employees.

Oversight and governance of the Fund

In the preceding sections there's comment from Sharon on behalf of the Board, from Rob on behalf of the Committee, from Cameron, on behalf of the Audit Committee, and from Andy as our Independent Professional Observer. Each of these roles and the bodies they represent performs a vital function in supporting the governance of Lothian Pension Fund. Beyond fulfilling their prescribed roles, each has provided me and the colleagues in the Fund with encouragement, counsel and guidance, and on behalf of the team, I wish to express our collective gratitude.

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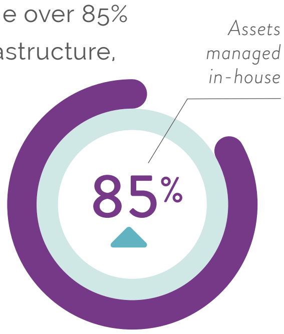
Doug Heron
Chief Executive Officer
Lothian Pension Fund
23 June 2021

GOVERNANCE AND RISK

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 106% funded at our last valuation in 2020, managing 89,148 records of 79,064 members and 72 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 is 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 vehicle in 2015 which provides investment advisory, deal execution and portfolio management services to the group and certain external partner LGPS funds.

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 over 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. This includes our Annual Report and Accounts of the Fund, Statement of Investment Principles, Funding Strategy Statement and Pensions Administration Strategy and Pensions Discretions Policy.

The Pensions Committee and Pensions Audit Sub-Committee

COLLEAGUE PROFILE **Jake Machin - Pensions Administrator**

Jake started working at LPF as a Pensions Administrator in January 2019. As well as carrying out general pension administration tasks, Jake was responsible for creating a new process for deferred members of the scheme to access their benefits due to ill-health. Jake says:

"I love the variety in my role and being able to make a difference for our members. I'm currently on the project team that's implementing the pension regulators pledge to fight pension scams and help protect our members' futures."

GOVERNANCE AND RISK

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. This year, however, the Pension Committee held an additional two meetings. Although the coronavirus pandemic and the continued restrictions have changed the way the committee work, LPF's governance structures 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 2020/21:

COMMITTEE MEMBERS FROM 1 APRIL 2020 - 31 MARCH 2021

PENSIONS COMMITTEE	PENSIONS AUDIT SUB COMMITTEE
Councillor Rob Munn (Interim Convener)	Councillor Cameron Rose (Convenor)
Councillor Alasdair Rankin (Convenor to August 2020)	Councillor Maureen Child
Councillor Maureen Child	John Anzani (Member representative)
Councillor Neil Ross	
Councillor Steve Burgess	
Councillor Cameron Rose	
John Anzani (Member representative)	
Richard Lamont (Employer representative, VisitScotland	

GOVERNANCE AND RISK

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 LPF 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 three vacancies as of 31 March 2021.

MEMBER REPRESENTATIVES

Jim Anderson	Unison (Chair)
Thomas Carr Pollock	GMB
Brian Robertson	Unite
Thomas Howorth	Unison
Vacancy	

EMPLOYER REPRESENTATIVES

Sharon Dalli	Police Scotland
Darren May	Scottish Water
Alan Williamson	Edinburgh College
Lesley Henderson	(Resigned 02/11/2020)
Vacancy	

In May 2021 LPF filled the two vacancies, appointing Nick Chapman, Lothian Valuation Joint Board, as an Employer Representative and Tony Beecher Lothian Buses, as a Member Representative.

GOVERNANCE AND RISK

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.

All new members of the Pensions Committee and Pension Board attend induction training. Other training provided internally covered topics including governance, the pension regulator code of practice, cyber security, risk management, ESG, benchmarking and valuation training.

Committee and Board representatives also attended external conferences, held virtually this year, including the LGPS Seminar Scotland in October, as well as a variety of LAPFF, PLSA and Hymans Robertson webinars.

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 who joined the LPF governance arrangements later in the year. Pensions Committee members collectively attended 203 hours of training as at 31 March 2021 and members of the Pension Board undertook 215 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 external independent advisers on the JISP meet at least quarterly with senior officers.

This year, the three funds undertook a procurement process to appoint the external independent advisers to the JISP. The advisers appointed are Scott Jamieson, Kirstie MacGillivray and Stan Pearson.

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

The JISP advises the three pension fund administrating authorities on implementation of their respective investment strategies. The assets of Lothian Pension Fund, Falkirk Council Pension Fund and Fife Council Pension Fund remain separate including the Scottish Homes Pension Fund being separate to Lothian Pension Fund.

GOVERNANCE AND RISK

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 LPF). 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 LPF) and is supervised by a board of directors chaired by the Council's Head of Finance. Both the boards of LPFI and LPFE comprise two independent non-executive directors (Leslie Robb and Andy Marchant). Andy Marchant being appointed as a further non-executive director for both LPFE and LPFI in 2021.

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 investments, finance and operations, people and communications, ICT oversight and governance, legal, risk, and compliance.

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 2021 comprised:

- Doug Heron, Chief Executive Officer
- Bruce Miller, Chief Investment Officer
- Struan Fairbairn, Chief Risk Officer, (Legal, Risk, Compliance and Governance)
- John Burns, Chief Finance Officer
- Helen Honeyman, Head of People and Communications

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, Director of LPFE Board)
- Katy Miller, Head of Human Resources (Director on LPFE board)

GOVERNANCE AND RISK

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, Fund officers have advised the Board and Joint Secretaries. There's more information on the Scheme Advisory Board at 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. 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
- 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 8 February 2021, 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.

Description	Impact	Probability	Risk Score
Failure of IT leading to poor ICT responsiveness, legal exposure and cost/risk implications	8	6	48
Business continuity and significant outage issues (due to systems, accommodation, staff etc.)	7	6	42
Members' confidential data is lost or made public. Breach of Data Protection Act	6	6	36
Cybersecurity protections and/or back-up not sufficient to prevent cyber-attacks or minimise their impact	8	4	32

GOVERNANCE AND RISK

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
1011
CLEANERS
LOTHIAN
PENSION FUND

INVESTMENT

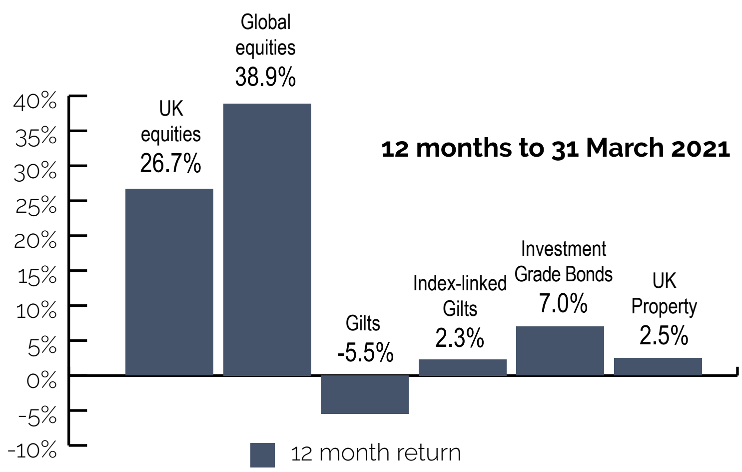
Investment markets

For the 12 months to 31 March 2021, UK equities (FTSE All Share) returned +27%, while global equities (MSCI ACWI, in GBP) returned +39%. The rise in global equities for sterling-based investors was offset by a stronger pound (global equities returned +51% in local currency terms). Sterling had weakened sharply alongside equity markets in March 2020 in response to the widening COVID-19 (coronavirus) pandemic, before stabilising and then strengthening over the period as risk assets recovered.

Credit spreads, which had spiked higher when equity markets sold off in March 2020, recovered strongly ending the period close to their pre-crisis lows. Government bond yields re-tested lows in May 2020 before rising gradually over much of the year, spiking higher on vaccine developments in November then accelerating further on fiscal stimulus expectations with the confirmation of Democratic candidate Joe Biden as US president-elect in December.

As vaccine roll-outs gained momentum, with the UK to the fore, rising economic optimism supported risk assets, such as equities. Commodity prices also rose as manufacturing activity continued to recover and investor attention, in the latter part of the period, turned increasingly towards recovery sectors such as retail, property, travel and leisure, which had been most negatively impacted by lockdowns. Inflation expectations moved sharply higher in the first quarter of 2021, which caused bond yields to rise and prices to fall.

The graph below shows index returns over 12 months to 31 March 2021 for a range of asset classes.

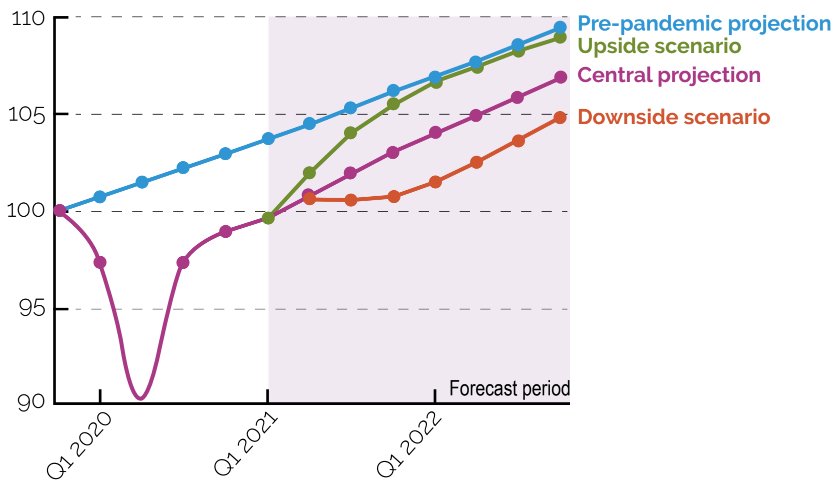


Source: FTSE, Bloomberg, MSCI, Portfolio Evaluation

INVESTMENT

Investment markets

The speed with which economies have recovered from the COVID-19 downturn is shown in the World GDP index chart below, alongside the most recent March 2021 forecasts by the OECD. The latest projections provide a much more optimistic outlook than most would have envisaged 12 months ago during the depths of the downturn. The recovery was aided by unprecedented levels of monetary and fiscal support, which cannot be sustained indefinitely; market participants will need to deal, at some point, with the prospect of that support tapering off.



Source: OECD Interim Economic Outlook, March 2021

COLLEAGUE PROFILE Gillian de Candole – Portfolio Manager

Gillian joined LPF in September 2020 as a Fund Manager in our real assets team. She's responsible for delivering our external real estate strategy and supporting the delivery of the broader real assets' strategy, which includes infrastructure and forestry investment. Gillian also co-leads our Responsible Investment and Stewardship activities, addressing our commitment to responsible allocation and management of capital to create sustainable value for beneficiaries, the economy and society. Gillian says:

"I like working at LPF primarily because I get to work with a great team of skilled people, who (despite the challenges of remote working) create a friendly, welcoming, can-do culture, focused on a clear vision of sustainable, long-term investment to deliver our beneficiaries' pensions."

RESPONSIBLE INVESTMENT

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 will incorporate ESG issues into investment analysis and decision-making processes

PRINCIPLE 2:

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

PRINCIPLE 3:

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

PRINCIPLE 4:

We will promote acceptance and implementation of the Principles within the investment industry

PRINCIPLE 5:

We will work together to enhance our effectiveness in implementing the Principles

PRINCIPLE 6:

We will 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. Their independent appraisal of Lothian Pension Fund's approach is made publicly available on our website www.lpf.org.uk and a summary of the latest evaluation is shown below. It highlights that our 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	Lothian Score	Median Score
	01. Strategy & Governance	A+	A
Indirect - Manager Selection, Appointment & Monitoring			
<10%	02. Listed Equity	A	A
<10%	05. Fixed Income - Corporate Non-Financial	A	A
<10%	07. Private Equity	A	A
<10%	08. Property	A	A
10-50%	09. Infrastructure	A	A
Direct & Active Ownership Modules			
>50%	10. Listed Equity - Incorporation	A	A
>50%	11. Listed Equity - Active Ownership	A	B

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 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. To assist our many stakeholders better understand the philosophy behind our overall approach to Responsible Investment, we released our Statement of Responsible Investment Principles (SRIP) in summer 2020. In this document, we lay out in detail our implementation of responsible investment on an asset class by asset class basis, as well as outlining how we utilise all the tools at our disposal to achieve our stewardship aims.

RESPONSIBLE INVESTMENT

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. In 2020, the FRC announced a significant update to the Stewardship Code, which requires the publication of a detailed report covering 12 different principles for asset owners. LPF will publish a Stewardship Code 2020 report during 2021.

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.

EOS at Federated Hermes (EOS)
We've been clients of 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

The Institutional Investor Group on Climate Change (IIGCC)

We recently joined IIGCC to further the work we do alongside other like-minded asset owners. IIGCC is a network of over 300 European investors representing over €37tn in assets. The workstreams at IIGCC include the Policy Programme; the Corporate Programme; the Investor Practices Programme; and the Paris Aligned Investor Initiative. IIGCC recently produced an investor guide entitled the 'Net Zero Investor Framework' and we're currently investigating its suitability for implementation.

Climate Action 100+ (CA100+)

CA100+ is an international collaborative initiative by institutional 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.

RESPONSIBLE INVESTMENT

Transition Pathway Initiative

[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 and 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.

Local Authority Pension Fund Forum

WHAT OUR MEMBERS SAY:

The service I receive from LPF is excellent and has been consistently excellent since day 1 in 2011. It is highly unusual, in this day and age, to receive a high quality service from knowledgeable staff that are extremely helpful. Nothing is too much trouble. I never take this for granted. Exceptional.'

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 BT, 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.

We commit significant resources to engagement activity, most of which is undertaken by our voting and engagement service provider and partner, EOS at Federated Hermes (EOS).

EOS at Federated Hermes 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) highlights 12 main themes for engagement over the three-year period 2020-22.

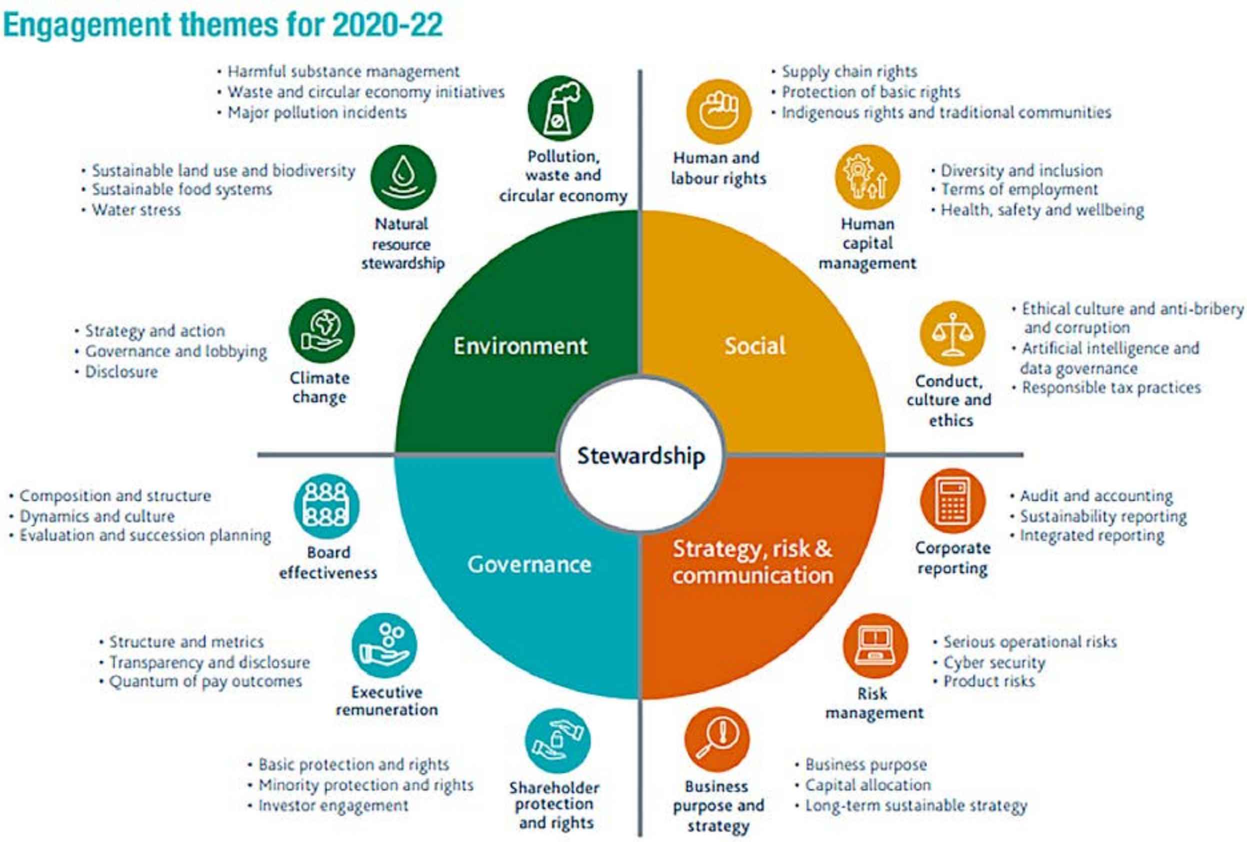
RESPONSIBLE INVESTMENT

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 Fortum, 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 acquired a controlling stake in Uniper, one of Europe's largest fossil-fuel based generators, and is likely to merge the two businesses in 2022.

We've had a series of meetings with the CFO, CEO and chair of Fortum and delivered a statement (see page 50) at their 2020 virtual AGM. Our ongoing work with management is beginning to result in significant changes in policy. Following Uniper's 2035 net zero commitment announcement in early 2020, Fortum followed up with a similar announcement in December 2020. The company now aims to be carbon neutral in the European business by 2035 and has announced specific plans for the closure of 6GW of coal capacity by 2025, and a 50% reduction in carbon output by 2030 (as compared to 2019 levels). Further to this we've challenged company management on several occasions regarding corporate lobbying activities, and a policy review was announced by the company at their 2021 AGM.

Fortnum still needs to undertake a a great deal of work , particularly around its plans for decarbonisation in the Russian business, but the company is taking many of the right steps. It's been a long-time supporter of carbon pricing, and its top management has entered an open and honest dialogue with the climate action 100+ engagement group.

RESPONSIBLE INVESTMENT

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 our behalf based on pre-agreed policies. These are Baillie Gifford, who manage equity assets for LPF, and EOS, our voting and engagement partner.

During 2020 we updated our policy for stock lending, and we now automatically recall all loaned stock for voting purposes, allowing us to vote 100% of our holdings at 100% of the relevant meetings.

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.

While our last shareholder proposal was filed in 2019 at BP, we've been involved in the filing of a number of resolutions since then that haven't made it into the shareholder ballot. This typically occurs when management has responded to engagement and changed course at the last moment, allowing us to withdraw the resolution voluntarily. Recent changes in the approach of the US Securities and Exchange Commission have made it more difficult to enter shareholder resolutions on US shareholder ballots.

Climate Change

As of March 2021, 191 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.

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 our 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 we're challenging companies to improve their disclosure and is rapidly integrating the specifics of climate change into the risk management and governance of LPF. Over the last few years, we've undertaken substantial work on the issue.

RESPONSIBLE INVESTMENT

Climate Change – Governance

In accordance with training policy, members of the Pensions Committee and Pension Board are required to undertake a minimum of 21 hours training. Each year, our provider of voting and engagement services is invited to present to and interact with the Committee and Board. During 2020/21, 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 is encapsulated in the recommendations agreed when adopting the new Statement of Responsible Investment Principles in June 2020:

- To continue to measure and report on carbon-equivalent emissions throughout the equity portfolios
- To continue our work with Climate Action 100+
- To continue to research and support the deployment of new impact capital into projects set to benefit from the transition to a low carbon economy
- To assess the carbon intensity of all assets (using estimates if necessary) by the end of the 2022 reporting cycle, supported by external managers and GPs
- Using data from the Transition Pathway Initiative (TPI), to engage alongside our collaborative partners to encourage companies to adopt business models and strategies that are in line with the aims of the Paris agreements. Our ambition is that all holdings covered by TPI will have achieved a level 4 assessment and have a business plan whose carbon performance is in-line with the Paris agreement or better by 2025
- Using data from the TPI, we'll not subscribe to new equity and fixed income issuance from companies whose business plans are not aligned with the aims of the Paris agreements at the time of the fundraising.

The Committee and Board considers climate related issues as part of its annual review of our approach to Stewardship. Climate-related risks and opportunities are an integral part of our overall investment process for LPF. The Pensions Committee is responsible for setting investment strategy and delegates implementation of strategy 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

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* that we've commissioned suggests that divestment at best is ineffective, and at worst provides a clear disincentive for management to change.

Our approach to engagement relies heavily on our engagement and voting partner, EOS at Federated Hermes (EOS).

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 road shows and investment conferences.

In addition, we've joined the Climate Action 100+ investor initiative and are actively participating in engagement with one of the 167 target companies in its list of systemically important carbon emitters.

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 low carbon transition as well as the physical risks of climate change.

*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

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 quantitively 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.

While it's widely acknowledged that Climate Change is one of the great issues facing society, it's one of several risks that we 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_2/\$M sales). We use a carbon efficiency 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. In practice, however, investment managers use a variety of data on individual companies to assess prospects rather than a single carbon metric.

RESPONSIBLE INVESTMENT

	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/$M sales)	**Year on year change**	**2021 Weighted Average Carbon Intensity** (tons CO2/$M sales)	**Year on year change**
LPF All Equities	328.6	325.2	-1.0%	294.9	-9.3%	270.1	-8.4%
MSCI ACWI	218.9	200.2	-8.5%	178.1	-11.1%	155.1	-12.9%
LPF All Equities & Corporate Bonds						266.0	

Source: MSCI

These numbers are presented on the basis of Scope 1 and 2 carbon emissions. Recent advances in data and methodology, especially in the adoption of a new approach to standardised emissions counting pioneered by the Partnership for Carbon Accounting in Financials (PCAF) allow us to present combined data for our equity and corporate bond holdings. We have an ambition to report all our carbon intensity data across all our assets in the 2022/23 annual report.

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.

Global Real Estate Sustainability Benchmark (GRESB) data in the infrastructure and real estate asset classes is tracked and incorporated into reporting in these areas.

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.

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

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.

RESPONSIBLE INVESTMENT

Infrastructure Investment

Our 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 our investment strategy.

Over the last 15 years, we've developed our reputation, networking and execution capabilities to secure access to investment opportunities within this market niche. Our 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, we committed over £150 million in infrastructure investment during 2020/21.

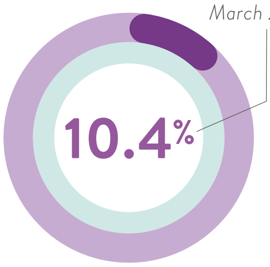
We have a long-standing commitment to responsible investment. In addition to becoming a signatory of the PRI (Principles of Responsible Investment) in 2008, we've subscribed to GRESB (Global Real Estate Sustainability Benchmark) to further enhance our analysis of environmental, social and governance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

At 31 March 2021, 92% of the Infrastructure portfolio value was invested in assets/funds which were also signatories of the PRI and 27% of funds participated in the 2020 GRESB Infrastructure Assessment. Most of our 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 our portfolio.

Infrastructure investments represented 10.4% of the value of Lothian Pension Fund assets at 31 March 2021, comprising one of the largest and most diversified allocations among UK LGPS funds. Of the total infrastructure investment of £892 million (31 March 2020: £962 million), the majority is invested in the UK.

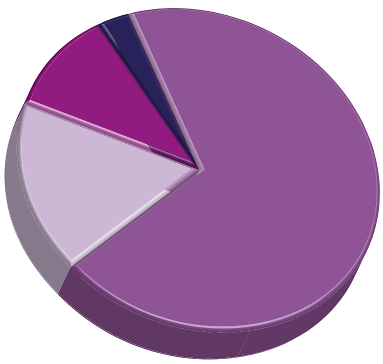


RESPONSIBLE INVESTMENT

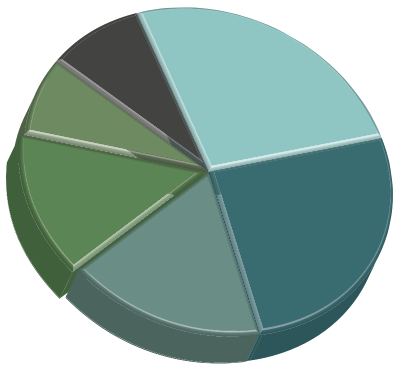
During 2020/21, Lothian Pension Fund completed investments in five secondary fund interests and made one co-investment. Approximately £86 million has been invested over the year in UK, European and Global infrastructure assets. During the same period, £168 million has been distributed/returned to the fund. Of note, there were two successful realisations generating proceeds of more than £60 million and recording a net internal rate of return of 20% and a total value to paid-in multiple of 2x. A sale of another of the larger assets was agreed, which crystallised proceeds of approximately £35 million in April 2021.

The geographic and sector diversification for Lothian Pension Fund infrastructure (as percentage of infrastructure asset value of £892m at 31 March 2021) is shown in the charts below.

GEOGRAPHIC DIVERSIFICATION



SECTOR DIVERSIFICATION



Infrastructure investments in the UK contributed 75% (or £667 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, 15% of the infrastructure portfolio is invested in renewable energy.

Since March 2020, the impact of COVID-19 on our 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.

This has largely insulated the portfolio from material adverse financial impacts derived from COVID-19.

During the year, the fund allocated c. £69 million to investments in UK social infrastructure, transport and utilities. New opportunities continue to be appraised.

ENGAGE Newsletter

Engage is our regular newsletter on Responsible Investment. We release two issues a year to highlight the important and progressive work we're doing as a leader in the responsible investment space.

Past issues have included how we have manged the response to COVID-19 in our commercial property, profit and purpose at Kering, how LPF's portfolio companies have been at the forefront of the COVID-19 vaccine development and routes to a low carbon economy, amongst many other subjects. Our recent role in supporting the Engine No 1 slate of directors that have shaken up the Exxon board and stunned the oil and gas industry will be outlined in the next issue – keep your eye out for its release!.

FUNDING STRATEGY STATEMENT

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

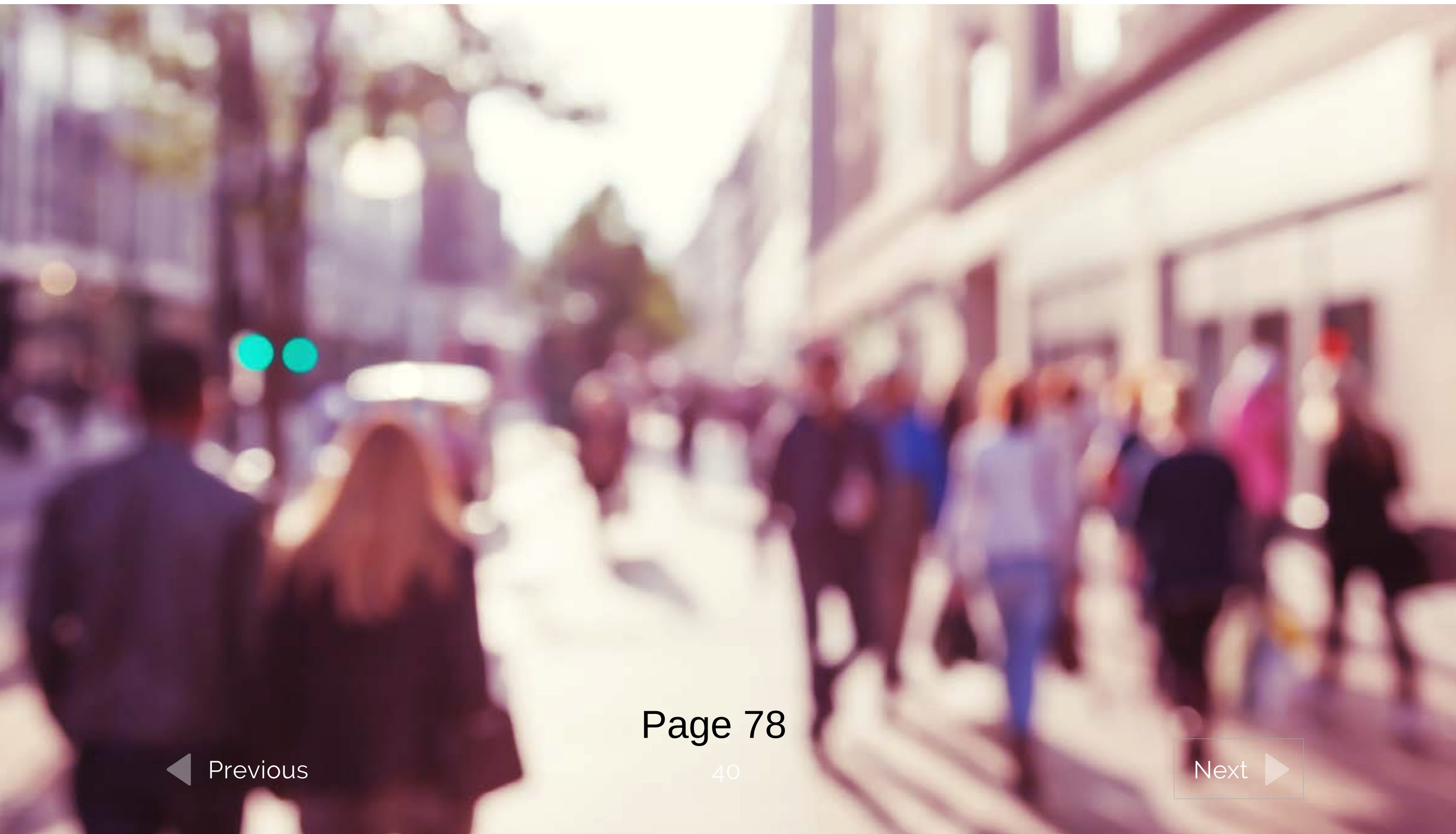
The purpose of the Funding Strategy Statement is to:

- 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

The Funding Strategy Statement was revised at the 2020 Actuarial Valuation and reflects CIPFA guidance: "Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme 2016".

Key changes include:

- The introduction of a new risk-based (stochastic) approach to setting employer contribution rates. This takes into consideration specific employer circumstances, including the assessment of the employer's covenant, and also considers expected future economic conditions. This approach isn't suitable for all employers. Contribution rates for employers closed to new entrants are instead set using a deterministic method, using a single set of assumptions. Such employers are expected to leave the fund sooner and therefore current market conditions are more relevant.
- The introduction of a salary strain mechanism as a way of recognising the cost of higher than anticipated salary increases by any individual employer at the point at which pay awards are granted, rather than letting the cost be met over a much longer time period.

As required by Scheme Regulations, the fund consulted with employers as part of the review 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 LPF's Statement of Investment Principles also available at www.lpf.org.uk.

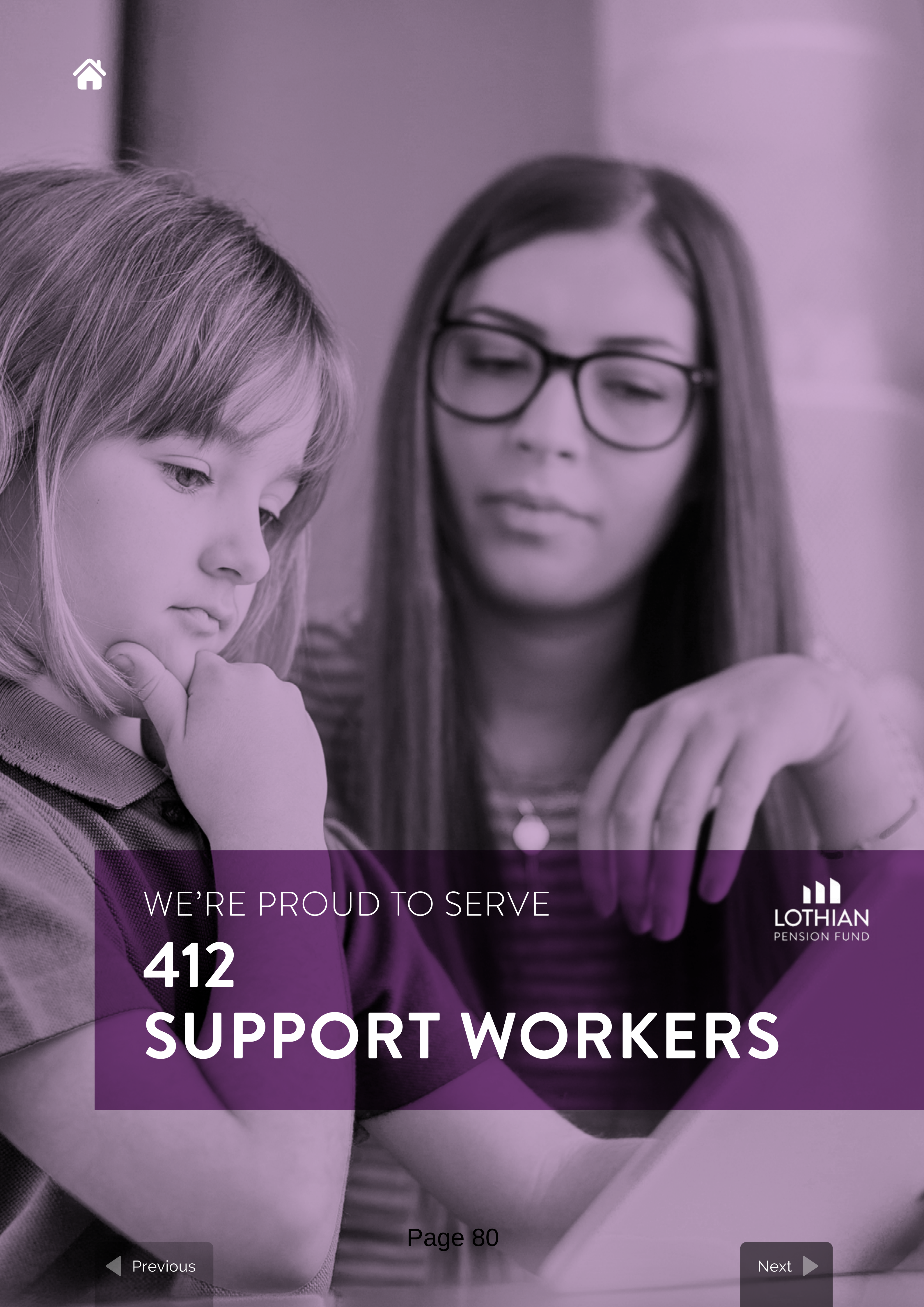
The next triennial valuation for both funds will be undertaken as at 31 March 2023.

COLLEAGUE PROFILE

Lucy Pemberton – Pensions Administrator

Lucy joined as a Trainee Pensions Administrator in January 2019 and recently qualified as a Pensions Administrator. Her main responsibilities are processing members' benefits and answering any questions they might have. Lucy also plays an important role in helping our new trainees. Lucy says:

"I enjoy working at LPF because I'm part of a great team that makes every day fun and I love knowing that we're providing a really important service to our members."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PENSION FUND

FINANCIAL PERFORMANCE

Administration expenses

A summary of the Fund's administrative expenditure for 2020/21, 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 £31,030k against the budget of £31,921k represented an underspending of £891k (2.8%) for the Fund.

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

- **Employees – £335k underspend.** Following an organisational design review earlier in the year, recruitment delays led to an underspend. Most of these vacant posts have now been filled. Variable pay awards were also substantially lower than the full budgeted award.
- **Transport and premises - £237k underspend.** The Fund has postponed its move into new premises and plans to reassess the position next year. In the meantime, the current office has been refurbished to comply with social distancing requirements, which will also improve future marketing potential for the unit.
- **Supplies and Services – £332k underspend.** Underspending occurred against budget for investment systems, while the roll out of a secure document management and governance portal has been delayed to after the transition of IT provider.
- **Investment managers fees - Invoiced – £1,119k underspend.** Charges on external managed portfolios are based on market values. Over the financial year the Fund took approximately £200m of externally managed funds under internal management.
- **Investment managers fees- Uninvoiced - £713k overspend.** Above budget spend is the result of an increase in investment property operational costs, most of which was the result of void costs due to the ongoing pandemic.
- **Support Costs – £180k underspend.** Contained within the budget was a period of parallel running between CGI and the new ICT provider. The contract with the new provider started on the 1st April 2021 so this overlapping period did not take place in the 2020/21 financial year.
- **Income – £605k under-recovery.** Income in relation to collaborative partners is based on a cost sharing mechanism. Due to underspend against budget, in particular property costs, as well as the lower than expected deal flow in relation to collaborative investments, income was below budget.

LOTHIAN PENSION FUND

FINANCIAL PERFORMANCE

	Approved budget	Actual outturn	Variance
	£000	£000	£000
Employees	5,986	5,651	(335)
Transport and premises	499	262	(237)
Supplies and services	2,115	1,783	(332)
Investment managers fees - invoiced*	4,700	3,581	(1,119)
Investment managers fees - uninvoiced*	18,700	19,413	(713)
Other third-party payments	1,495	1,495	-
Capital funding - depreciation	249	243	(6)
Direct Expenditure	**33,744**	**32,428**	**(1,316)**
Support costs	519	339	(180)
Income	(2,342)	(1,737)	605
Total net controllable cost to LPF	**31,921**	**31,030**	**(891)**

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

Reconciliation to total costs	**Actual outturn**
	£000
Actual outturn on budgeted items above	31,030
Securities lending revenue included in income above	537
Investment management fees deducted from capital – performance related element	9,733
IAS19 LPFE retirement benefits	3,281
LPFE deferred tax on retirement benefits	(623)
Corporation tax	5
Total cost to LPF (inclusive of full cost investment management fees)	**43,963**
Per fund accounts	
Lothian Pension Fund Group	43,857
Scottish Homes Pension Fund	106
Total	**43,963**

FINANCIAL PERFORMANCE

LOTHIAN PENSION FUND

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 17 March 2021, 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.

	2020/21 Projected	2020/21 Accruals basis	2020/21 Cash Basis
Income	**£000**	**£000**	**£000**
Contributions from employers	191,000	191,463	194,223
Contributions from employees	50,750	51,193	51,055
Transfers from other schemes	5,500	62,308	49,894
	247,250	**304,964**	**295,182**
Expenditure			
Pension payments	(188,000)	(187,565)	(187,565)
Lump sum retirement payments	(58,000)	(50,205)	(51,222)
Refunds to members leaving service	(550)	(551)	(551)
Transfers to other schemes	(9,000)	(5,734)	(5,734)
Administrative expenses	(2,600)	(2,879)	(2,859)
	(258,150)	**(246,934)**	**(247,931)**
Net additions/(deductions) from dealings with members	**10,900**	**58,030**	**47,251**

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

For the first time in five years, LPF has seen a net addition in value from our dealings with our members. This is not a trend that's expected to continue, this gain being the result of the consolidation of the multi fund employer Visit Scotland. It's worth highlighting that although this bulk transfer had been highlighted to Pensions Committee, the inflow had been excluded from the projection owing to the uncertainty of the transfer value.

FINANCIAL PERFORMANCE

Cash-flow (cont.)

Lothian Pension Fund	Actual	Cash flow forecast									
	2020 /2021 £m	2021 /2022 £m	2022 /2023 £m	2023 /2024 £m	2024 /2025 £m	2025 /2026 £m	2026 /2027 £m	2027 /2028 £m	2028 /2029 £m	2029 /2030 £m	2030 /2031 £m
Pensions income	305.0	252.3	255.5	258.8	262.1	265.5	268.9	272.3	275.9	279.5	283.2
Pensions expenditure	(246.9)	(260.0)	(270.0)	(280.5)	(291.5)	(303.0)	(315.0)	(327.6)	(340.8)	(354.6)	(369.0)
Net pensions cash flow	58.1	(7.7)	(14.5)	(21.7)	(29.4)	(37.5)	(46.1)	(55.3)	(64.9)	(75.1)	(85.8)
Net investment income	**228.7**	**235.0**	**239.7**	**244.5**	**249.4**	**254.4**	**259.5**	**264.7**	**270.0**	**275.4**	**280.9**

The above figures are the estimated annual cash flow on pensions activity and investment income for the next ten years. The forecast is based on the 2020/21 actual cash flows (included for comparison) adjusted for actuarial assumptions.

Throughout the forecast period it's expected that investment income will provide multiple cover for negative net pensions cash flow, with no asset sales being required to fund on going pensioner payments.

SCOTTISH HOMES PENSION FUND

	2020/21 Projected	2020/21 Accruals basis	2020/21 Cash Basis
Income	**£000**	**£000**	**£000**
Administration charge	70	70	70
Expenditure			
Pension payments	(6,720)	(6,619)	(6,619)
Lump sum retirement payments	(750)	(734)	(721)
Transfers to other schemes	(100)	-	-
Administrative expenses	(70)	(64)	(64)
	(7,640)	**(7,417)**	**(7,404)**
Net additions/(deductions) from dealings with members	**(7,570)**	**(7,347)**	**(7,334)**

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 which is in line with the prior year.

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

FINANCIAL PERFORMANCE

Cash-flow (cont.)

Scottish Homes Pension Fund	Actual	Cash flow forecast									
	2020 /2021 £m	2021 /2022 £m	2022 /2023 £m	2023 /2024 £m	2024 /2025 £m	2025 /2026 £m	2026 /2027 £m	2027 /2028 £m	2028 /2029 £m	2029 /2030 £m	2030 /2031 £m
Pensions income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pensions expenditure	(7.3)	(7.2)	(7.0)	(6.9)	(7.0)	(6.8)	(6.7)	(6.5)	(6.4)	(6.3)	(6.0)
Net pensions cash flow	(7.3)	(7.2)	(7.0)	(6.9)	(7.0)	(6.8)	(6.7)	(6.5)	(6.4)	(6.3)	(6.0)
Net investment income	**2.0**	**2.0**	**1.9**	**1.9**	**1.8**	**1.7**	**1.7**	**1.7**	**1.6**	**1.6**	**1.5**

The estimated annual cash flows for Scottish Homes Pension Fund is based on actuarial analysis of the fund's membership profile. Although investment income is below the annual pension outgoings, no asset sales are required to meet the shortfall. Instead the all gilt investment strategy incorporates these cash flow requirements, with redemption dates of gilts tying into the fund's liquidity needs.

2020 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 2020. The valuation set employer contribution rates for the three year period from 1 April 2021. The Funding Strategy Statement was reviewed and amended following consultation with employers.

For Lothian Pension Fund, the funding level increased from 98% at 31 March 2017 to 106% at this valuation. The deficit of £145million at 31 March 2017 is now a surplus of £408 million at 31 March 2020.

Lothian Pension Fund requires 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 2020 was 117.7%, increased from 104.7% from the 2017 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 2023.

FINANCIAL PERFORMANCE

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."

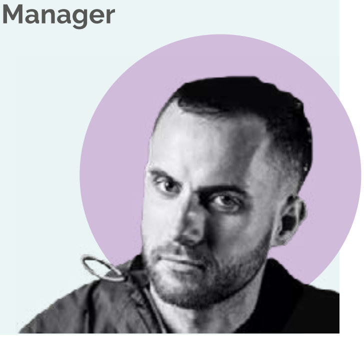
The revised guidance changed the disclosure of fees for fund of funds investment arrangements. A 'fund of funds' is an investment holding a portfolio of other investment funds rather than investing directly in funds. Typically, fees are payable to the 'fund of funds' manager as well as to the managers 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 to CIPFA, Audit Scotland and the Scottish Local Government Pension Scheme Advisory Board (SLGPSAB), the Committee's and

COLLEAGUE PROFILE **Sean Reid - Compliance and Risk Manager**

Sean joined LPF in September 2020 as our Compliance and Risk manager. Sean is responsible for the day-to-day management of the compliance and risk functions and helps colleagues to proactively identify and manage risks to ensure good outcomes for our members. Sean says:

"I enjoy working at LPF as it has an inclusive culture and I can make a difference for our members."



FINANCIAL PERFORMANCE

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.

WHAT OUR MEMBERS SAY:

'I have other pensions and I wish they were as good as Lothian Pension Fund.'

FINANCIAL PERFORMANCE

	Lothian Pension Fund		Scottish Homes Pension Fund	
	2019/20	2020/21	2019/20	2020/21
	£000	£000	£000	£000
Investment management expenses in compliance with CIPFA guidance	31,443	37,468	104	112
Investment management expenses per financial statements	32,398	38,479	104	112
Disclosure in excess of CIPFA guidance	955	1,011	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. Although the disclosure in excess of CIPFA guidance for 2020/2021 (£1,011K), is broadly in line with the previous year (£955K), it's expected that over time these disclosures will continue to fall. Crucially, 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

Investment cost benchmarking

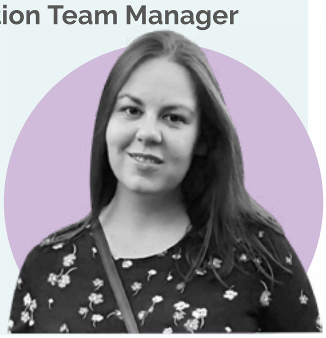
Investment strategy focuses on risk-adjusted returns net of costs. The Fund has participated in investment cost benchmarking provided by CEM, an independent benchmarking expert for global pension funds with a database of 307 pension funds representing £7.4 trillion in assets. To provide a fair comparison, 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 2020) showed that LPF's investment costs 0.36% of average assets were significantly lower than CEM's benchmark cost of 0.51%, an equivalent annual saving of approximately £11.6m. 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.

COLLEAGUE PROFILE **Gillian Angus – Pensions Administration Team Manager**

Gillian joined LPF in December 2015 as a Trainee Pensions Administrator and has worked her way up to the role of Pensions Administration Team Manager. Gillian's role is very varied and includes co-ordinating work and training for the pensions administration team to ensure that they're able to resolve member complaints and meet their KPIs. Gillian is currently working as part of a project team to review our year end processes. Gillian says:

"I like working at LPF because the people are fantastic, and the job is very interesting."



PERFORMANCE AND ADMINISTRATION

Key Performance Indicators 2020/21

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.

2019/2020		Target	2020/2021
Retained	Maintain Customer Service Excellence Standard (CSE) (Annual assessment)	Retain	Retained
Met	Audit of Annual Report and Accounts	Unqualified opinion	Not yet assessed
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%
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 1.31*	Not met 1.06*
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 rescheduled and took place in January 2021
** Sharpe ratio*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PERFORMANCE AND ADMINISTRATION

Value for Money
Pension Administration Benchmarking

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 many 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 to enhance customer satisfaction
- Sharing of information and ideas with peers
- A review of performance trends over time.

The outputs and analyses have served to supplement internal performance management information. However, the Chartered Institute of Public Finance and Accountancy (CIPFA) has stated that, 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.

The Pensions Administration Standards Association (PASA)

Holding PASA Accreditation is the gold standard for quality in pensions administration. We're proud to hold accreditation, as we believe that it's important that we can demonstrate that we're carrying out our role as a LGPS efficiently and effectively. The PASA standards are an excellent external validation of these capabilities.

We chose to apply for accreditation with PASA in 2017 as its standards are specific and relevant to the pensions industry and would ensure the levels of services provided by LPF were in line with both the Pension Regulator's Codes of Practice as well as best practice in pension administration services in the private sector. PASA accreditation is valid for three years, so we were delighted to achieved reaccreditation in December 2020.

PERFORMANCE AND ADMINISTRATION

A summary of the benchmarking, based on 2019/20 data as reported to Pensions Committee in March 2021, is below:

- Lothian Pension Fund's cost per member of £24.19 falls within the very wide range of local authority funds of c£14 to £42 and the cost is lower than the average of all funds of £30.33
- The composition of a fund's membership impacts costs. Active members represent 38.6% of Lothian Pension Fund membership compared with an average of 33.1%. Pensioners represent 34.7% compared with 29.4%, with the consequence that deferred members represent a lower proportion of membership (23.6%) than the typical fund. 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 our colleagues holding relevant pension administration qualifications (54%) is significantly higher than the average (32%)
- In addition, our administration performance is above average for 13 of the 16 industry standard indicators in certain instances, by a considerable margin.

We participated in the pension administration survey carried out by CEM for the first time in 2019. This gave us further insight into pension administration cost and quality of service and we're pleased to continue the survey in 2020.

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 a significantly larger size than us. CEM's benchmarking results categorised our pension administration service as "low cost; high service standard".

WHAT OUR MEMBERS SAY:

'I am very happy with the services provided, and I know that if I have any queries, I can easily get in touch via email and phone.'

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 2020/21 remains above the 92% target at 97%.

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 26,776 processes in 2020/21 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 2020/21, 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 2020/21, there were two Stage 2 disputes, both of which are included in the statistics below.

Reason for dispute	Stage 1 outcome	Stage 2 outcome	On-going
Not allowing a Cash Equivalent Transfer Value (CETV) within 12 months of Normal Retirement Date (NRD)	1 not upheld	1 not upheld	0
Non return of contributions on re-joining LGPS	1 not upheld	0	0
Awards, e.g. early payment of deferred pension on health grounds	1 not upheld		1
The amount of Cash Equivalent Transfer Value (CETV) payable for a Pension Credit Member	1 upheld		0

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

PERFORMANCE AND ADMINISTRATION

Our data

We issued 100% of benefit statements by the statutory deadline of 31 August 2020. This is the third year in a row we've achieved this target which was 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 our employer data portal, and we audit submissions to ensure the continuation of data accuracy.

We utilise 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 96.7% respectively for common data and 96.9% and 99.3% for conditional data. The quality of data continues to be considered to be of a high standard.

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Customer Service Excellence (CSE)

We're proud to have held the Customer Service Excellence (CSE) Award (previously known as Charter Mark) since 2008.

The CSE Awards were established to provide a practical tool for service providers to drive customer-focused change within their organisation. It has helped us to become even more efficient and effective and provide an excellent service to our members and employers.

Yearly formal assessments are carried out by a licenced certification body and we're delighted to have received successful inspections for the last 13 years.

Visit Scotland – Direction Order by Scottish Ministers

As an LGPS employer, VisitScotland participated in all 11 funds in Scotland. New staff employed were offered membership in Lothian Pension Fund (LPF), with VisitScotland's participation in the other ten funds being on a closed (to new entrants) basis. In 2019, VisitScotland identified an opportunity to rationalise their Local Government Pension Scheme (LGPS) participation and consolidate administration and communications into one fund, Lothian Pension Fund. Approval of Pensions Committee to this transfer of obligations was granted in September 2019, which enabled Visit Scotland to seek the authority of Scottish Ministers.

The Local Government Pension Scheme (Miscellaneous Amendments) (Scotland) Regulations 2020 amended Schedule 4 of the 2018 Regulations, to specify that the Scottish Ministers may, upon application of a Scheme employer, by a written direction, substitute a different administering authority as the appropriate administering authority for a person or class of persons.

Accordingly, this request was made by VisitScotland and following requisite statutory consultation, the formal Direction Order was issued by Scottish Ministers in August 2020.

LPF initiated a major administration and communications project to undertake bulk transfer of these members from all ten ceding funds.

The project to transfer members, assets and liabilities from the ten ceding funds to LPF as the receiving fund, was split over two tranches to reduce risk and smooth the effort required by key stakeholders at peak times.

The effective date for tranche 1 was 30 September 2020 and included broadly similar funds, where there were limited complexities around the pensioner payroll given the commonality of software system and member Additional Voluntary Contribution (AVC) arrangements. This transfer was completed successfully moving Strathclyde, North East and Fife Pension Funds to LPF. From October 2020, LPF became the administrators for members from those ceding funds in scope of the transfer.

Visit Scotland – Direction Order by Scottish Ministers (cont.)

The effective date for tranche 2 was 31 December 2020, transferring the remaining seven funds to LPF. This more complex transfer, dealt with different payroll providers, which required an additional data validation step. Members across two funds held AVCs which had to be transferred to comparable LPF funds. This tranche was completed successfully moving the remaining funds to LPF. From January 2021, LPF became the administrators for members from all those ceding funds in scope of the transfer.

Ceding Fund	Transferring Members - Actives	Transferring Members - Deferreds	Transferring Members - Pensioners	Transferring Members - Total
1st Tranche				
Strathclyde	6	53	28	87
North East Scotland	1	35	40	76
Fife	5	7	17	29
2nd Tranche				
Tayside	10	31	49	90
Falkirk	5	25	32	62
Highland	8	39	56	103
Scottish Borders	1	8	7	16
Dumfries and Galloway	5	7	19	31
Shetland	1	5	4	10
Orkney	0	4	4	8
Total	**42**	**214**	**256**	**512**

The asset transfer payments from all ceding funds, as determined by the Actuary, were sent to LPF on 31 March 2021, which progressed the transfer close to completion, subject to any potential "true-up" payments (reconciling actual asset returns from the transfer date to the payment date, refined from the investment market roll-up adjustment). [Payments etc. to be confirmed]

The project's success was a result of good working relationships and high engagement across all stakeholders. Regular project meetings with ceding funds and the project team were key to tracking progress and identifying and remedying areas of concern and ultimately delivering the project to plan and budget.

PERFORMANCE AND ADMINISTRATION

Rectification of age discrimination - McCloud and Sargeant judgements

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.

On 4 August 2020, the Scottish Public Pensions Agency (SPPA) issued a statutory consultation on the proposed remedy, with this closing in October 2020. As anticipated, it's proposed that a comparison will be made between the benefits payable under the current rules with the entitlements which would have been paid if the Scheme had not changed in 2015, and with any higher sum being paid to the member. This protection will apply automatically and members who meet the qualifying criteria won't need to take any action. Many members' benefits won't change or will only see a small increase because of low salary growth since the new scheme was introduced.

As the changes will be backdated to April 2015 and apply to qualifying members who left the LGPS after that date, implementation of the remedy is expected to be extremely challenging from both administration and communications perspectives. SPPA has not yet published its formal response to its consultation. In March 2021, SPPA advised administering authorities that rectification regulations should come into force in April 2023 (one year later than anticipated).

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, 96.82% of key procedures in 2020/21 were completed on 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 2020/21.

	Health	Early-age 60 to NPA	Early-age 55 to 59	Redundancy	Late	Other	TOTAL
Lothian Pension Fund	86	418	248	140	167	101	**1160**
Scottish Homes Pension Fund	0	0	0	0	0	0	**0**

PERFORMANCE AND ADMINISTRATION

The table below shows performance against key procedures in 2019/20.

2019/20		Target	2020/21
93.5%	Proportion of critical pensions administration work completed within standards – individual performance within this indicator are shown below	Greater than 91%	96.8%
97.6%	Provide a maximum of one guaranteed Cash Equivalent Transfer Value (CETV) within 10 working days of receiving a request	90%	94.0%
98.8%	Pay lump sum retirement grant within seven working days of receiving all the information we need from the member	95%	98.8%
97.6%	Acknowledge of the notification of the death of a member to next of kin within five working days.	95%	94.6%
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%
97.8%	Notify early leavers entitled to deferred benefits of their rights and options within 10 days of being informed of end of pensionable service.	90%	96.3%
75.2%	Proportion of non-key procedures completed within standard including Additional Regular Contributions, responding to member communications, updating nominations and maintaining the member database.	75%	78.1%
92.8%	Notification of dependant benefits within five working days of receiving all necessary paperwork	95%	93.2%
94.8%	Payment of CETV within 20 working days of receiving all completed transfer out forms	95%	98.1%
64.2%	Provide transfer-in quote within 10 working days of receiving the Cash Equivalent Transfer Value (CETV) from member's previous pension provider.	95%	86.1%
77.3%	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%	88.8%
89.3%	Pay a refund of contributions within seven working days of receiving the completed declaration and bank detail form.	90%	99.3%
82.6%	Estimate requested by employer of retirement benefits within 10 working days	90%	99.5%
90.8%	Pay any lump sum death grant within seven working days of receipt of the appropriate documentation	95%	99.3%

PERFORMANCE AND ADMINISTRATION

Combatting pension scams – The Pensions Regulator's Pledge

The Pension Regulator is asking trustees, providers and administrators to make a pledge to do what they can to protect scheme members and follow the principles of the Pension Scams Industry Group (PSIG) Code of Good Practice.

We were very keen to sign up to the Pledge because it demonstrates our commitment to combat pension scams, shows intent to protect our members and tells members and the pensions industry that we're committed to stopping scammers in their tracks. A project team was given the objective of thoroughly reviewing our administration and communications procedures to enable requisite self-certification that we've met the "six steps" within TPR's "The Pledge", with a target date of 31 March 2021.

To do this, we needed our administrators, as well as our Pensions Committee and Board members, to take the following steps:

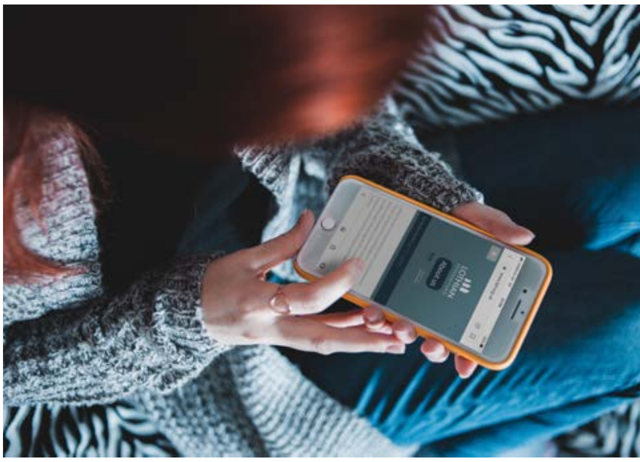
- Get to know the warning signs of a pension scam; this will help you to assess the level of risk when members make transfer and cash drawdown requests
- Regularly warn members about the risk of scams
- Encourage members asking for cash drawdown to get guidance
- Take appropriate due diligence measures by carrying out checks on pension transfers and documenting pension transfer procedures
- Clearly warn members about high-risk transfers
- Report concerns about a scam to the authorities and communicate this to the scheme member

We're delighted to report that this important member assurance has been attained.

PERFORMANCE AND ADMINISTRATION

Online services

In 2020/21, we continued our move towards providing as many services digitally wherever possible. Digital has become part of everyday life and we saw an increase in use during the Covid pandemic. Better digital services encourage members to engage with their pension and use our website and online service as their first port of call for answers. We continue to redesign how we work to meet current and future needs of our customers by rethinking what we do to provide the right information and service for our members and employers. Members can now securely upload documents via our online service and carry out processes such as requesting payment of deferred benefits, obtaining a transfer value and claiming a refund. Before the pandemic, we started to move towards providing forms online, and this was increased for the majority of processes once lockdown began.



We provide pension payslips and P60s online for all our members via My Pension Online. Information for members is also available via email, phone and via our website and we've also introduced a help hub to answer frequently asked questions. We currently have 35,200 (43%) members registered for the online service (including 52.5% of all our active members) and we're continuing to work to increase these numbers.

Our employers also use a variety of digital services including providing monthly contribution returns via a secure transfer portal. This allows data to be automatically uploaded to the pension software system which significantly improved the provision of employer data, allowed automation of tasks and considerably simplified the year end processes.

WHAT OUR MEMBERS SAY:

'I inherited a part of my husband's pension on his death. Your service was personal, professional and sympathetic at a very difficult time. I thank you for that.'

PERFORMANCE AND ADMINISTRATION

Unclaimed Monies Account

When a member leaves the Fund with less than two years membership they're entitled to a refund, a transfer to another pension provider or to defer their decision for five years. Where we don't receive a response, we now hold these records as 'Status 9: Frozen Refund' with a marker to show why the money has not been paid out. Examples of reasons for the refund not yet being paid include when the member has elected to delay making their decision for five years, or where the member no longer lives at the address we hold and is therefore 'gone away'.

Over the last year we've contacted members with an unpaid refund to encourage them to take payment of their money. As of 11 May 2021, this exercise has resulted in the Fund making payment to 175 members which represents £76,848.90 of money previously classed as unclaimed.

It's our intention in September 2021 to start contacting members whose money is still not paid out. By now recording details as to why the refund is unclaimed, we can target communications to specific groups to continue making these payments. We aim to make this an annual exercise.

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. 2020/21 was a challenging year for the Fund and employers due to the Pandemic. Despite this however, our officers took a variety of approaches to improve employer performance, including:

- Providing training to payroll/HR colleagues via Microsoft Teams
- Presenting performance updates at virtual meetings
- Escalating to senior officers at annual employer meetings
- Monitoring with employers where performance has been particularly poor.

To improve service to members, indirect costs can now be recovered from an employer if any persistent and ongoing administration failures occur, with no improvement demonstrated or if they're unwilling to resolve the identified issues.

We monitor employer performance against the standards set out in the Pension Administration Strategy. Results are reported to employers in an annual performance report, with more regular reporting for larger employers.

Overall employer performance for 2020/21 is shown below, with 2019/20 shown for comparison purposes.

		2019/20			2020/21		
Case type	Target (working days)	Number received	Number within target	% within target	Number received	Number within target	% within target
New members	20	7,489	4,554	61%	4,314	3,294	76%
Leavers	20	3,632	1,450	40%	2,580	1,214	47%
Retirements	20	1,374	512	37%	1,160	469	40%
Deaths in Service	10	16	10	63%	20	11	55%

PERFORMANCE AND ADMINISTRATION

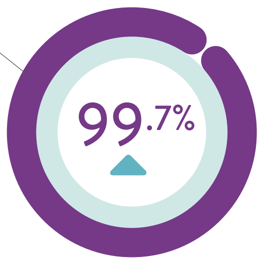
Our largest employers are now submitting new starters through i-Connect which has improved the performance this year. We expect further improvement next year with only exceptional cases not being met in target.

Whilst the provision of leaver information within target has improved, a high percentage are still being received out of target. Two of our largest employers were faced with a high amount of historical cases identified from year end and this has impacted the fund result negatively. We continue to provide missing leaver queries to employers monthly and are confident that employers are now mainly focussing on 'business as usual' cases.

Most retirement information continued to be provided out of target. Similar to last year, just over a quarter of retirements out of target are received between 10 and 19 days before the member's retirement date, but just under 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		
TOTAL			**27**

Contributions by value paid on time



99.7% 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 2020/21 as late contributions weren't received significantly later than the 19th.

PERFORMANCE AND ADMINISTRATION

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've worked for the City of Edinburgh Council for 11 years and have never had to worry about my pension as I know it's safe with Lothian Pension Fund'.

Ann Duff, Senior Communications Officer, City of Edinburgh Council

OUR COLLEAGUES

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.

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:

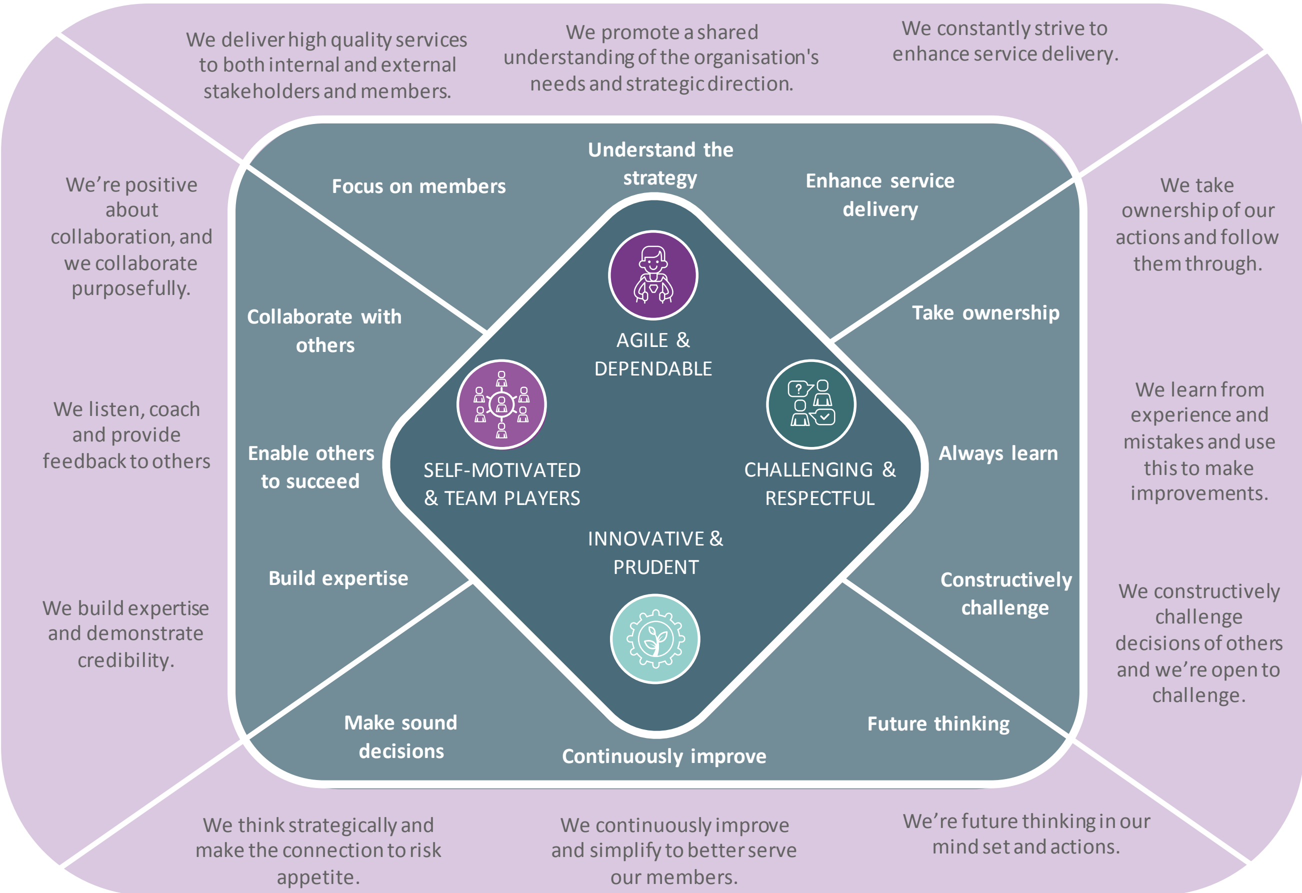
Agile and dependable
• We approach work with an open and flexible attitude and take responsibility to manage our work effectively and efficiently. We also embrace new processes in a consistent and reliable way.
Self-motivated and team players
• We actively participate as individuals, taking pride and 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 March 2021 our permanent headcount was 56% female and 44% 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 continue our work on 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
447
COOKS
LOTHIAN
PENSION FUND

OUR COLLEAGUES

Gender Balanced

We continue to work towards our goal of being fully gender balanced across the organisation by 2030.

- As at 31 March 2021 we have, on aggregate, 35% women in our top three leadership layers and across the whole company, 56% of our workforce are women
- Our mean gender pay gap is 29.3% (median: 0.36%)
- 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. During 2020, we recruited 16 colleagues, 69% of these were women.

Performance and Reward

During the second half of 2020 our focus was on the launch of our new performance management process for 2021. In preparation for the launch, we rolled out new role profiles and underpinned them with the values and standards specific to each role. This completes the performance management practice and how we assess individual performance and suitability of candidates in the recruitment process. We introduced our colleagues to the new performance management process through training on our learning portal. To complement the training, we held question and answer sessions and supported our colleagues and managers whilst they started to build their goals and objectives for 2021.

Our approach to performance management provides clarity for our colleagues about how their contribution and performance links to our vision and values. We are transparent with our pay structures to ensure our colleagues understand that they're paid fairly for their performance in line with industry best practices.

We make sure that colleagues have a common awareness of the financial and economic factors affecting LPF's performance through fortnightly all colleague calls and quarterly events. More information on our remuneration policies and employee share plans can be found later in this document.

OUR COLLEAGUES

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 implemented ComplianceServe, a new digital e-learning platform, in the first half of 2020, giving our colleagues the opportunity to expand their own development as well as complete our quarterly core learning. This new platform allows us to regularly report on our company learning targets and our colleagues can record all their continued professional development (CPD) in one place.

Health and Wellbeing

We firmly believe that colleague wellbeing is linked to a successful and happy workforce. 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' wellbeing very seriously and to support this, we launched a suite of Moments that Matter documents focusing on mental health, physical health, financial health and life changing events. These documents are aimed to help colleagues and managers recognise signs and symptoms of wellbeing concerns and where to find help and support.

We also run weekly virtual WorkFit fitness classes to help keep our colleagues healthy and moving during lockdown.

Management commentary approved by:

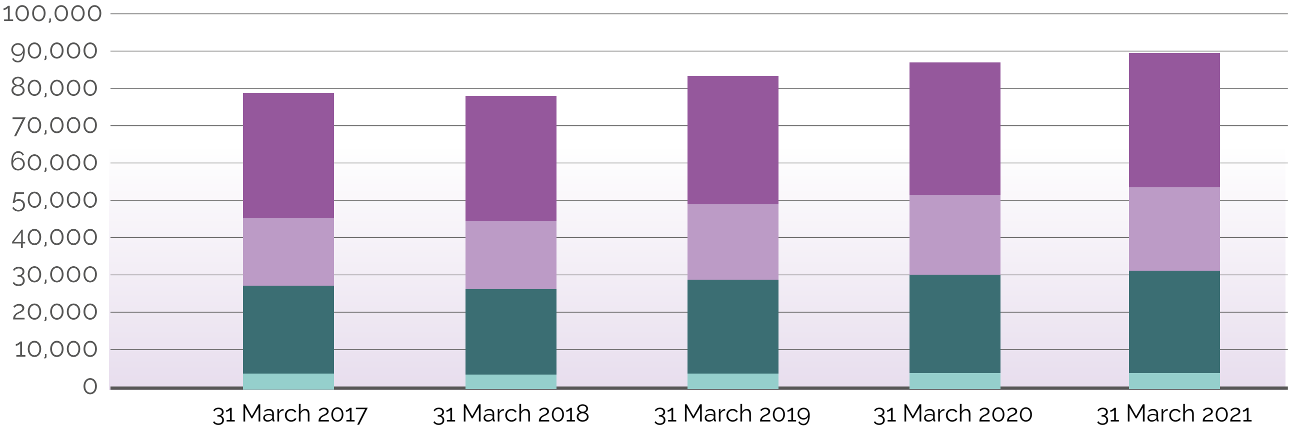
Andrew Kerr
Chief Executive Officer
The City of Edinburgh Council
23 June 2021

Doug Heron
Chief Executive Officer
Lothian Pension Fund
23 June 2021

John Burns
Chief Finance Officer
Lothian Pension Fund
23 June 2021

LOTHIAN PENSION FUND INVESTMENT STRATEGY

LOTHIAN PENSION FUND MEMBERSHIP



	31 March 2017	31 March 2018	31 March 2019	31 March 2020	31 March 2021
Active	33,526	33,528	34,569	35,655	35,863
Deferred	18,381	18,384	20,269	21,406	21,644
Pensioners	23,595	23,119	25,295	26,668	27,704
Dependants	4,202	3,825	4,168	4,172	4,152
Total	79,704	78,856	84,301	87,921	89,363

Investment Strategy

The fund's current investment strategy was approved by the Pensions Committee in December 2018. In order to provide suitable investment strategies for the differing requirements of employers, the fund 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 Main Strategy maintains significant exposure to real investments, such as Equities and Infrastructure, which have a history of protecting and growing purchasing power.

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 Employer Strategy. The liabilities funded by the 50/50 strategy represent a further 1% of total liabilities.

LOTHIAN PENSION FUND INVESTMENT STRATEGY

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 Buses strategy was unchanged through 2020/21.

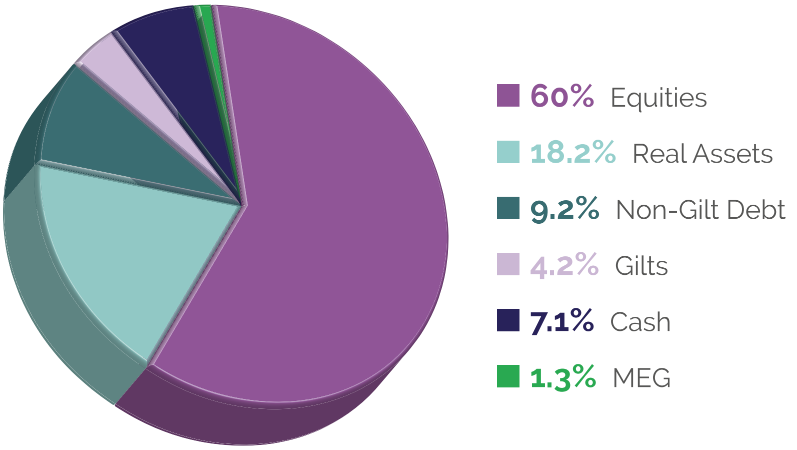
Following the results of the 2020 actuarial valuation, work is currently underway to review investment strategy.

The table below presents total fund strategy, which is the weighted average of the four employer strategies also shown.

LOTHIAN PENSION FUND 31 March 2021	Main strategy	Mature Employer strategy	50/50 strategy	Buses strategy	Total fund strategy
Equities	65.0%	0.0%	32.5%	35.0%	62.1%
Real Assets	18.0%	0.0%	9.0%	17.5%	17.7%
Non-Gilt Debt	10.0%	0.0%	5.0%	20.0%	10.5%
Gilts	7.0%	100.0%	53.5%	27.5%	9.6%
Cash	0.0%	0.0%	0.0%	0.0%	0.0%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

LOTHIAN PENSION FUND INVESTMENT STRATEGY

ACTUAL ASSET ALLOCATION TOTAL FUND STRATEGY 31 MARCH 2021



A key objective of the fund's investment strategy is to avoid unrewarded risk, and significant steps were taken more than seven 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 and there were no significant changes over 2020/21.

Just under 90% 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.

While the fund continues to make new commitments to infrastructure, the actual allocation to real assets has decreased somewhat this year from 22% to 18%. This reduction in weighting is predominantly as a result of an exceptional 27% gain in equities over the last twelve months against broadly flat performance from real assets. Almost 60% of this exposure is invested in infrastructure and approximately one third is invested in property. While the COVID-19 pandemic

LOTHIAN PENSION FUND INVESTMENT STRATEGY

has hit the property sector hard, the in-house team have worked proactively with tenants to agree rent holidays, deferments and other concessions to help manage the impact of the pandemic on assets and maximise long term tenant retention and income collection.

The Non-Gilt Debt allocation has been increasing modestly 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 2020/21 from 7.8% to 9.2% with additional investment in investment grade corporate bonds and a new allocation to US Treasury Inflation Protected Securities (TIPS). 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 5% to 4.2%, which, in common with the Non-Gilt Debt allocation, remains below its long-term strategy target, which is 7%. There were no significant changes over 2020/21. The UK government confirmed plans to align the RPI with the CPI from 2030, following a consultation with bondholders in which we took part. The fund retains exposure, as index-linked gilts provide some insurance against an unexpected rise in inflation and a return broadly in line with the fund's liabilities. However, having benefited from uncertainty following the EU referendum and subsequent Brexit, real yields and inflation expectations are comparatively low and high respectively in an international context. As a result, the fund added to diversification within the Non-Gilt Debt allocation instead.

Investment performance

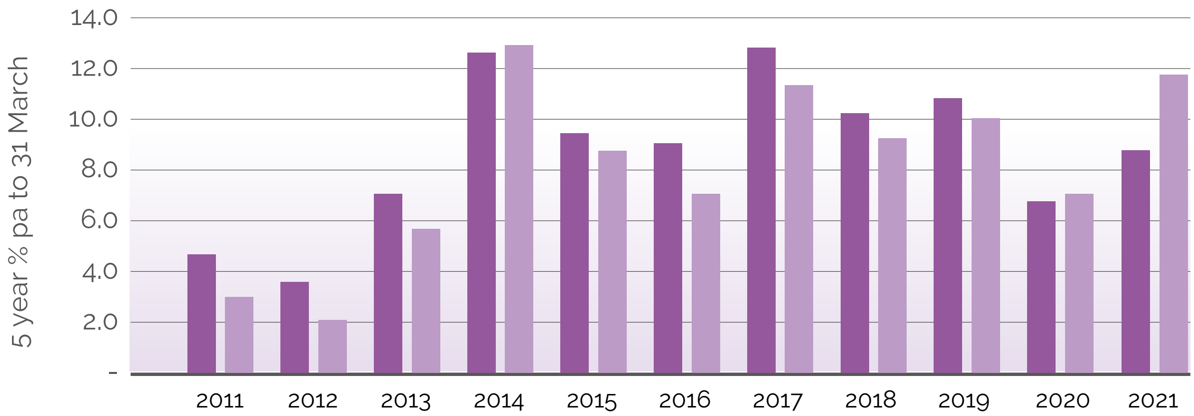
The fund's performance over the last year and over longer-term timeframes is shown in the table below.

Annualised returns to 31 March 2021 (% per year)	1 year	5 years	10 years
Lothian Pension Fund	15.5	8.5	8.1
Benchmark*	24.0	11.8	9.4
Average Weekly Earnings (AWE)	4.1	2.7	2.1
Consumer Price Index (CPI)	0.7	1.8	1.7

**Comprises equity, 'gilts plus', gilts and cash indices*

LOTHIAN PENSION FUND INVESTMENT STRATEGY

ANNUALISED 5 YEARLY RETURNS ENDING 31 MARCH (% PER YEAR)



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Fund	4.7	3.6	7.1	12.7	9.5	9.1	12.9	10.3	10.9	6.8	8.5
Benchmark	3.0	2.1	5.7	13.0	8.8	7.1	11.4	9.3	10.1	7.1	11.8
Relative	1.7	1.5	1.4	-0.3	0.7	1.9	1.5	1.0	0.8	-0.3	-3.2

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 over the twelve months to March 2021 was very strong in absolute terms though notably weak relative to benchmark. This was broadly driven by equities where the global index (MSCI ACWI in GBP) gained 38.9% over the period. In-line with strategy, the fund's broadly lower risk equities increased at a lesser, but still robust, 26.8% over the period. This has significantly impacted the five-year figures. The fund's objective is to meet the strategic benchmark return over five and ten-year periods with lower risk. Given the recent negative relative returns, the fund is now 3.2% p.a. behind benchmark over five years (+8.5% vs +11.8%) and a more modest 0.6% p.a. behind over ten years. These returns have been achieved with lower levels of volatility (approximately 90% of benchmark risk).

It should be noted that the fund isn't expected to behave like the benchmark in the short term for two main reasons: portfolios aren't constructed to track the market capitalisation benchmarks, and private market benchmarks aren't 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 declined and remain exceptionally low.

LOTHIAN PENSION FUND INVESTMENT STRATEGY

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. While this had broadly resulted in the fund behaving as expected, lagging the benchmark during strong markets and declining less through periods of weakness, market behaviour through the pandemic has been unusual and extreme.

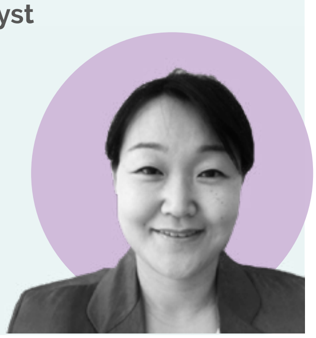
With COVID-19 being the catalyst for notable market declines in early 2020, those stocks that had led the market in prior years also held up the best. While certain parts of the market saw their businesses essentially shut down overnight, many technology stocks were work-from-home winners and held up far better than the traditionally more defensive shares. These investments also lead the subsequent rally from the lows of March 2020 and, unsurprisingly, Lothian Pension Fund's low risk equities made lower gains. With the announcement of vaccines and a potential route back to "normality", the market strength has broadened in recent months. The Fund continues to adopt a diversified approach both across and within asset classes, though maintains an emphasis on lower volatility equities that we believe should serve us well over the long term.

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 (7.7% vs 8.8%) and ten-year (7.2% vs 8.0%) periods.

COLLEAGUE PROFILE **Miko Zhou – Senior Investment Analyst**

Miko joined LPF in March 2020 as our Senior Investment Analyst. Miko conducts fundamental research on the fund's investments and identifies potential opportunities to help fund managers make investment decisions. Miko says:

"I enjoy delivering for our members by identifying opportunities to ensure that the long-term growth of the fund provides sufficient funding for benefits payment to our scheme members."

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LOTHIAN
PENSION FUND

LOTHIAN PENSION FUND ACCOUNT FOR YEAR ENDED 31 MARCH 2021

This statement shows a summary of the income and expenditure that the Lothian 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
2019/20	2019/20			2020/21	2020/21
£000	£000		Note	£000	£000
		Income			
184,818	184,818	Contributions from employers	4	191,463	191,463
49,508	49,508	Contributions from members	5	51,193	51,193
6,036	6,036	Transfers from other schemes	6	62,308	62,308
240,362	**240,362**			**304,964**	**304,964**
		Less: expenditure			
179,229	179,229	Pension payments including increases	7	187,565	187,565
58,809	58,809	Lump sum retirement payments	8	42,816	42,816
7,081	7,081	Lump sum death benefits	9	7,389	7,389
722	722	Refunds to members leaving service		584	584
1	1	Premiums to State Scheme		(33)	(33)
30,660	30,660	Transfers to other schemes	10	5,734	5,734
2,496	2,467	Administrative expenses	11a	2,879	4,132
278,998	**278,969**			**246,934**	**248,187**
(38,636)	**(38,607)**	**Net (withdrawals)/additions from dealing with members**		**58,030**	**56,777**
		Returns on investments			
232,842	232,842	Investment income	12	228,657	228,657
(500,724)	(500,724)	Change in market value of investments	14, 19b	969,236	969,236
(32,398)	(32,230)	Investment management expenses	11b	(38,479)	(39,725)
(300,280)	**(300,112)**	**Net returns on investments**		**1,159,414**	**1,158,168**
(338,916)	**(338,719)**	**Net increase in the fund during the year**		**1,217,444**	**1,214,945**
7,819,234	**7,817,463**	**Net assets of the fund at 1 April 2020**		**7,480,318**	**7,478,744**
7,480,318	**7,478,744**	**Net assets of the fund at 31 March 2021**		**8,697,762**	**8,693,689**

LOTHIAN PENSION FUND
NET ASSETS AS AT 31 MARCH 2021

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

Lothian Pension Fund				Lothian Pension Fund	
Parent	Group			Parent	Group
31 March 2020	31 March 2020			31 March 2021	31 March 2021
£000	£000		Note	£000	£000
		Investments			
7,444,652	7,444,652	Assets		8,686,123	8,686,123
(1,965)	(1,965)	Liabilities		(89,409)	(89,409)
7,442,687	**7,442,687**	**Net investment assets**	**13**	**8,596,714**	**8,596,714**
		Non current assets			
5,256	5,256	Debtors	23	5,587	5,587
658	658	Computer systems		625	625
590	-	Share Capital		590	-
-	424	Deferred tax	28a	-	1,047
6,504	**6,338**			**6,802**	**7,259**
		Current assets			
4,924	4,924	The City of Edinburgh Council	27	4,152	4,152
38,168	39,038	Cash balances	20,27	80,021	80,922
18,118	18,447	Debtors	24	32,533	32,976
61,210	**62,409**			**116,706**	**118,050**
		Non current liabilities			
-	(2,232)	Retirement benefit obligation	29	-	(5,513)
-	(15)	Creditors		-	(13)
-	**(2,247)**			**-**	**(5,526)**
		Current liabilities			
(30,083)	(30,443)	Creditors	25	(22,460)	(22,808)
(30,083)	**(30,443)**			**(22,460)**	**(22,808)**
7,480,318	**7,478,744**	**Net assets for the fund**		**8,697,762**	**8,693,689**

LOTHIAN PENSION FUND ACCOUNTS

The unaudited accounts were issued on 23 June 2021.

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 don't 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.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

1 Statement of Accounting Policies

The statement of accounting policies for all funds can be found on page XX.

2 Lothian Pension Fund Group

Basis of consolidation, presentation of financial statements and notes

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

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

Because the controlled entities activities are primarily focused on the provision of services to the Fund, its consolidation has a limited impact on the figures included in the Fund Account and Net Assets Statement of Lothian Pension Fund. An additional column has been added in both the Fund Account and Net Assets Statement, with the figures prior to consolidation being identified as "Parent" and after consolidation as "Group". In the notes to the accounts, where there is a difference between the parent and group figures they're 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 approval by the Boards of LPFE Limited, and LPFI Limited their respective audited financial statements for 2020/21. The figures used in the consolidation are therefore from the unaudited financial statements of both companies.

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

3 Events after the Reporting Date

Weslo Housing Management ("Weslo") transfer of engagements to Link Group Limited ("Link")

Owing to financial difficulties, Weslo Housing Management was placed in 'intervention status' by the Scottish Housing Regulator in 2019. Link Housing Association was selected as Weslo's preferred partner and following requisite ballot of its tenants, lender consents and stakeholder authorisations, a 'transfer of engagements' was effected on 1 June 2021. With the employer's membership of Lothian Pension Fund terminating concurrent with the transfer to Link, a bespoke commercial agreement between Link Housing Association and Lothian Pension Fund was proposed to address the accrued pension liabilities. Suitable provision has been made to reflect the cessation valuation by the Fund's Actuary, once this has been calculated. An oral update was provided by officers to the Pensions Committee on 17 March 2021. It (the Committee) acknowledged the balance of factors taken into consideration by the Fund to secure the best available outcome, and that the Executive Director of Resources and the Convener of the Pensions Committee would be consulted once the terms of the agreement were finalised.

On 15 April 2021, in accordance with delegated authority provisions, the Executive Director of Resources affirmed his support to the agreement "having reflected carefully upon the legal advice, the responses (by the Chief Executive Officer, Lothian Pension Fund, to questions from the Chair of the Pensions Board) and to the position in respect of the tenants supporting the move to Link" and "also (recognising) that this is an atypical funding agreement." This agreement between LPF and Link was duly signed, with an effective date of 7 May 2021.

LPFI Share Capital Issue

As part of the LPFI's ongoing compliance with the FCA rules, the fund is required to carry out an Internal Capital Adequacy Assessment Process (ICAAP) to determine its regulatory capital held from time to time. LPFI's process assessed that it was required to inject additional capital to retain the requisite surplus and so the fund financed an additional £100k of share capital for LPFI in June 2021 for that purpose. All of LPFI's regulatory capital is nevertheless retained in cash on deposit earning interest under the group's institutional cash investment programme.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

4 Contributions from employers

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

	2019/20	2020/21
By category	**£000**	**£000**
Primary Contribution (future service)	170,896	179,426
Secondary Contribution (past service deficit)	7,821	7,991
Strain costs	2,931	2,497
Cessation contributions	3,170	1,549
	184,818	**191,463**

	2019/20	2020/21
By employer type	**£000**	**£000**
Administering Authority	64,051	68,087
Other Scheduled Bodies	96,189	100,485
Community Admission Bodies	23,402	21,207
Transferee Admission Bodies	1,176	1,684
	184,818	**191,463**

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's a surplus, there may be a contribution reduction; if there's 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.

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.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

5 Contributions from members

By employer type	2019/20 £000	2020/21 £000
Administering Authority	17,508	18,359
Other Scheduled Bodies	25,295	26,296
Community Admission Bodies	6,375	6,150
Transferee Admission Bodies	330	388
	49,508	**51,193**

6 Transfers in from other pension schemes

	2019/20 £000	2020/21 £000
Group transfers	-	58,318
Individual transfers	6,036	3,990
	6,036	**62,308**

7 Pensions payable

By employer type	2019/20 £000	2020/21 £000
Administering Authority	80,152	82,489
Other Scheduled Bodies	82,455	87,431
Community Admission Bodies	16,383	17,371
Transferee Admission Bodies	239	274
	179,229	**187,565**

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.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

As "unfunded payments" are discretionary benefits, they're 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.

8 Lump sum retirement benefits payable

	2019/20	2020/21
By employer type	**£000**	**£000**
Administering Authority	19,335	15,476
Other Scheduled Bodies	31,809	22,285
Community Admission Bodies	7,420	4,919
Transferee Admission Bodies	245	136
	58,809	**42,816**

9 Lump sum death benefits payable

	2019/20	2020/21
By employer type	**£000**	**£000**
Administering Authority	2,874	3,670
Other Scheduled Bodies	2,497	3,304
Community Admission Bodies	1,635	379
Transferee Admission Bodies	75	36
	7,081	**7,389**

10 Transfers out to other pension schemes

	2019/20	2020/21
	£000	**£000**
Group transfers	20,504	-
Individual transfers	10,156	5,734
	30,660	**5,734**

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

11a Administrative expenses

	LPF Parent 2019/20	LPF Group 2019/20	LPF Parent 2020/21	LPF Group 2020/21
	£000	£000	£000	£000
Employee costs	1,501	1,484	1,766	1,996
System costs	417	419	367	368
Actuarial fees	103	103	220	220
External/Internal audit fees	69	71	63	66
Legal fees	12	12	19	19
Printing and postage	152	152	192	192
Depreciation	34	34	73	73
Office costs	116	116	117	117
Sundry costs less sundry income	92	115	62	98
IAS19 retirement benefit adjustments - see note 29	-	(25)	-	1,214
Deferred tax on retirement benefit obligation - see note 28	-	(10)	-	(231)
Corporation tax	-	(4)	-	-
	2,496	**2,467**	**2,879**	**4,132**

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 twofunds are allocated on a defined basis.

COLLEAGUE PROFILE

Bruce Howieson - IT System manager

Bruce is one of our longest serving colleagues, having worked at LPF for 33 years. Bruce provides IT cover for the Fund and ensures that colleagues' IT needs are met to allow them to perform their roles. Bruce says:

"I like working at LPF as we have a great team of colleagues. As my role supports all departments, it provides me with different challenges and the opportunity to work with colleagues with a variety of different abilities and skills."

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

11b Investment management expenses

	LPF Parent 2019/20	LPF Group 2019/20	LPF Parent 2020/21	LPF Group 2020/21
	£000	£000	£000	£000
External management fees -				
invoiced	4,423	4,423	3,474	3,474
deducted from capital (direct investment)	16, 343	16,343	22,222	22,222
deducted from capital (indirect investment)	955	955	1,011	1,011
Securities lending fees	115	115	107	107
Transaction costs - Equities	2,479	2,479	2,049	2,049
Property operational costs	3,121	3,121	3,865	3,865
Third party - Invest property service charge expense	-	-	3,337	3,337
Third party - Invest property service charge income	-	-	(3,337)	(3,337)
Employee costs	2,560	3,251	3,040	3,581
Custody fees	390	390	377	377
Engagement and voting fees	119	119	121	121
Performance measurement fees	94	94	84	84
Consultancy fees	71	71	100	100
Research fees	462	462	568	568
System costs	555	559	715	717
Legal fees	201	267	176	224
Depreciation	118	118	166	166
Office costs	127	127	140	140
Sundry costs less sundry income	265	(586)	264	(760)
IAS19 retirement benefit adjustments - see note 30	-	(52)	-	2,067
Deferred tax on retirement benefit obligation - see note 29	-	(21)	-	(393)
Corporation tax	-	(5)	-	-
Corporation tax gains utilised by CEC group	-	-	-	5
	32,398	32,230	38,479	39,725

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

11b Investment management expenses (cont.)

	Total	Management /Expense fees	Performance related fee	Transaction costs
2020/2021	**£000**	**£000**	**£000**	**£000**
Bonds	96	96	-	-
Equities	5,745	3,629	67	2,049
Pooled investment vehicles	22,988	13,059	9,667	262
Property	3,865	3,865	-	-
Cash and FX contacts	34	34	-	-

	Total	Management /Expense fees	Performance related fee	Transaction costs
2019/2020	**£000**	**£000**	**£000**	**£000**
Bonds	89	89	-	-
Equities	6,378	3,846	53	2,479
Pooled investment vehicles	17,104	13,916	2,945	243
Property	3,821	3,821	-	-
Cash and FX contacts	44	44	-	-

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).

The external investment management fees (deducted from capital) above include £9.7m (£9.6m direct, £0.1m indirect) in respect of performance-related fees compared to £3.0m in 2019/20 (£2.9m direct, £0.1m indirect).

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

It should be noted that Lothian Pension Fund's disclosure on investment management fees exceed CIPFA's "Accounting for Local Government Pension Scheme Management Costs" revised guidance on cost transparency which came into effect from 1st April 2016. Consistent with previous years, the Fund recognises fees deducted from investments not within its direct control (such as fund of fund fees) to give a full picture of its investment management costs. Further details can be found in the "Investment management cost transparency" section of the Management Commentary.This further disclosure highlights an extra £1m in costs (2020 £1m).

11c Total management expenses

In accordance with CIPFA guidance, the analysis below considers the combined administration and investment management expenses in notes 11b and c and splits out the costs to include a third category covering oversight and governance expenditure.

	LPF Parent 2019/20	LPF Group 2019/20	LPF Parent 2020/21	LPF Group 2020/21
	£000	£000	£000	£000
Administrative costs	2,255	2,251	2,479	3,698
Investment management expenses	29,974	29,699	36,049	36,061
Oversight and governance costs	2,665	2,747	2,830	4,098
	34,894	**34,697**	**41,358**	**43,857**

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

12 Investment income

	2019/20	2020/21
	£000	£000
Income from bonds	3,526	1,486
Dividends from equities	163,388	157,622
Unquoted private equity and infrastructure	40,419	48,952
Income from pooled investment vehicles	3,134	2,710
Gross rents from properties	23,914	21,207
Interest on cash deposits	2,213	282
Stock lending and sundries	577	537
	237,171	**232,796**
Irrecoverable withholding tax	(4,329)	(4,139)
	232,842	**228,657**

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 2020/21 £5,684k of the stated income relates to tax yet to be received. At the 31st March 2021 £14,901k (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.

WHAT OUR MEMBERS SAY:

'I'm impressed by the efficient and friendly service. Thank you.'

13 Net investment assets

	31 March 2020	31 March 2021
Investment assets	**£000**	**£000**
Bonds		
Public sector fixed interest	-	80,041
Public sector index linked gilts quoted	457,536	609,751
	457,536	**689,792**
Equities		
Quoted	4,197,089	5,044,875
	4,197,089	**5,044,875**
Pooled investment vehicles		
Private equity, infrastructure, private debt & timber	1,395,193	1,330,128
Property	86,954	81,836
Other	174,366	203,557
	1,656,513	**1,615,521**
Properties		
Direct property	367,494	366,125
	367,494	**366,125**
Derivatives		
Derivatives - forward foreign exchange	15,228	625
	15,228	**625**
Cash deposits		
Deposits	681,472	933,452
	681,472	**933,452**
Other investment assets		
Due from broker	44,128	2,131
Dividends and other income due	25,176	33,602
	69,304	**35,733**
Total investment assets	**7,444,636**	**8,686,123**
investment liabilities		
Derivatives		
Derivatives - forward foreign exchange	(22)	-
	(22)	**-**
Other financial liabilities		
Due to broker	(1,927)	(89,409)
	(1,927)	(89,409)
Total investment liabilities	**(1,949)**	**(89,409)**
Net investment assets	**7,442,687**	**8,596,714**

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

14a Reconciliation of movement in investments and derivatives

	Market value at 31 March 2020*	Purchase at cost & derivative payments	Sale & derivative receipts	Change in market value	Market value at 31 March 2021*
	£000	£000	£000	£000	£000
Bonds	457,535	231,988	(9,904)	10,173	689,792
Equities	4,197,090	1,680,866	(1,848,176)	1,015,095	5,044,875
Pool investment vehicles	1,656,512	285,797	(306,304)	(20,484)	1,615,521
Property	367,494	15,036	-	(16,405)	366,125
Derivatives - futures	-	-	-	-	-
Derivatives - forward foreign exchange	15,206	7,838	(14,740)	(7,679)	625
	6,693,837	**2,221,525**	**(2,179,124)**	**980,700**	**7,716,938**
Other financial assets / liabilities					
Cash deposits*	681,474			(11,511)	933,452
Broker balances*	42,200			47	(87,278)
Investment income due*	25,176			-	33,602
	748,850			**(11,464)**	**879,776**
Net financial assets	**7,442,687**			**969,236**	**8,596,714**

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.

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	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	448,502	(253,708)	89,340	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
	7,200,000	**2,440,641**	**2,430,166**	**(516,637)**	**6,693,838**
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
	586,960			**15,913**	**748,849**
Net financial assets	**7,786,960**			**(500,724)**	**7,442,687**

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

14b Reconciliation of fair value measurements within level 3

	Market value at 31 March 2020	Level 3 transfers		Purchases at cost & derivative payments	Sale & derivative receipts	Unrealised gains / (losses)	Realised gains / (losses)	Market value at 31 March 2021
Pooled investments	£000	in	out	£000	£000	£000	£000	£000
Infrastructure	935,570	-	-	87,990	(149,829)	(52,836)	44,312	865,207
Property	46,527	-	-	(1,725)	(722)	(3,042)	288	41,326
Private equity	62,875	-	-	532	(9,021)	(8,343)	6,607	52,650
Timber	129,707	-	-	1,398	(2,781)	(9,544)	213	118,993
Private debt	267,039	-	-	56,492	(21,241)	(8,884)	(127)	293,279
Freehold property	367,494	-	-	15,036	-	(16,405)	-	366,125
	1,809,212	**-**	**-**	**159,723**	**(183,594)**	**(99,054)**	**51,293**	**1,737,580**

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.

LOTHIAN PENSION FUND
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15 Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2021

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	59,450	106,867	454	-
One to six months	USD	CHF	3,920	3,459	171	-
Open forward currency contracts at 31 March 2021					625	-
Net forward currency contracts at 31 March 2021						625
Prior year comparative						
Open forward currency contracts at 31 March 2020					15,228	(22)
Net forward currency contracts at 31 March 2020						15,206

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.

16 Investment managers and mandates

		Market value at 31 March 2020	% of total 31 March 2020	Market value at 31 March 2021	% of total 31 March 2021
Manager	**Mandate**	**£000**	**%**	**£000**	**%**
In-house	UK all cap equities	212,547	2.9	270,091	3.1
In-house	UK mid cap equities	91,095	1.2	139,441	1.6
Total UK equities		**303,642**	**4.1**	**409,532**	**4.7**
In-house	European ex UK equities	197,939	2.7	233,489	2.7
In-house	US equities	202,460	2.7	294,331	3.4
Total regional overseas equities		**400,399**	**5.4**	**527,820**	**6.1**
In-house	Global high dividend	1,016,988	13.7	1,151,317	13.4
In-house	Global low volatility	980,951	13.2	1,123,487	13.1
In-house	Global multi factor value	899,426	12.1	1,180,663	13.7
Harris	Global equities	177,602	2.4	123,565	1.4
Nordea	Global equities	290,006	3.9	304,529	3.5
Baillie Gifford	Global equities	121,808	1.6	190,966	2.2
Total global equities		**3,486,781**	**46.9**	**4,074,527**	**47.3**
In-house	Currency hedge	15,222	0.2	454	-
Total currency overlay		**15,222**	**0.2**	**454**	**-**
Total listed equities		**4,206,044**	**56.6**	**5,012,333**	**58.1**
In-house	Private equity unquoted	62,875	0.8	52,650	0.6
In-house	Private equity quoted	65,591	0.9	95,255	1.1
Total private equity		**128,466**	**1.7**	**147,905**	**1.7**
Total equity		**4,334,510**	**58.3**	**5,160,238**	**59.8**
In-house	Index linked gilts	400,458	5.4	362,864	4.2
In-house	Mature employer gilts	113,039	1.5	115,400	1.3
Total inflation linked assets		**513,497**	**6.9**	**478,264**	**5.5**
In-house	Indirect property	86,954	1.2	81,836	1.0
In-house	Property	464,317	6.2	468,996	5.5
In-house	Infrastructure unquoted	935,570	12.6	865,207	10.1
In-house	Infrastructure quoted	26,087	0.4	26,564	0.3
In-house	Timber	129,707	1.7	118,993	1.4
Total real assets		**1,642,635**	**22.1**	**1,561,596**	**18.3**
Baillie Gifford	Corporate bonds	32,211	0.4	35,061	0.4
In-house	Private debt	267,039	3.6	293,279	3.4
In-house	Sovereign bonds	168,108	2.3	318,284	3.7
In-house	Investment Grade Credit	116,394	1.6	142,087	1.7
Total debt assets		**583,752**	**7.9**	**788,711**	**9.2**

16 Investment managers and mandates (cont)

		Market value at 31 March 2020	% of total 31 March 2020	Market value at 31 March 2021	% of total 31 March 2021
Manager	**Mandate**	**£000**	**%**	**£000**	**%**
In-house	Cash	367,144	4.9	607,008	7.1
In-house	Transitions	1,149	0.0	897	0.0
Total cash and sundries		**368,293**	**4.9**	**607,905**	**7.1**
Net financial assets		**7,442,687**	**100.0**	**8,596,714**	**100.0**

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

17 Securities lending

During the year Lothian Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2021, £118.8m (2020 £132.6m) of securities were released to third parties. Collateral valued at 104.7% (2020 107.0%) of the market value of the securities on loan was held at that date.

18 Property holdings

	2019/20	2020/21
	£000	**£000**
Opening balance	411,978	367,494
Additions	2,096	15,036
Disposals	(22,303)	-
Net change in market value	(24,277)	(16,405)
Closing balance	**367,494**	**366,125**

As at 31 March 2021, there were no restrictions on the realisability of the property or the remittance of income or sale proceeds. As at 31 March 2021, the Fund had no contractual obligation for any further construction costs.

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

	2019/20	2020/21
	£000	**£000**
Within one year	17,886	19,579
Between one and five years	52,629	62,000
Later than five years	69,701	116,218
	140,216	**197,797**

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19 Financial Instruments

19a 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's no difference between the carrying value and fair value.

Classification of financial instruments - parent	31 March 2020			31 March 2021		
	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	457,536	-	-	689,792	-	-
Equities	4,197,089	-	-	5,044,875	-	-
Pooled investments	1,656,513	-	-	1,615,521	-	-
Property leases	-	-	-	-	-	-
Derivative contracts	15,228	-	-	625	-	-
Margin balances	-	-	-	-	-	-
Cash	-	681,472	-	-	933,452	-
Other balances	-	69,304	-	-	33,602	-
	6,326,366	**750,776**	**-**	**7,350,813**	**967,054**	**-**
Other assets						
City of Edinburgh Council	-	4,924	-	-	4,152	-
Cash	-	38,168	-	-	80,021	-
Share Capital	-	590	-	-	590	-
Debtors - current	-	18,119	-	-	32,533	-
Debtors - non-current	-	5,256	-	-	5,587	-
	-	**67,057**	**-**	**-**	**122,883**	**-**
Assets total	**6,326,366**	**817,833**	**-**	**7,350,813**	**1,089,937**	**-**

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

Classification of financial instruments - parent (cont)	31 March 2020			31 March 2021		
	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 Investment liabilities	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Derivative contracts	(22)	-	-	-	-	-
Other investment balances	-	-	(1,927)	-	-	(87,278)
	(22)	**-**	**(1,927)**	**-**	**-**	**(87,278)**
Other liabilities						
Creditors	-	-	(30,084)	-	-	(22,460)
Liabilities total	**(22)**	**-**	**(32,011)**	**-**	**-**	**(109,738)**
Total net assets	**6,326,344**	**817,833**	**(32,011)**	**7,350,813**	**1,089,937**	**(109,738)**

	31 March 2020	31 March 2021
Total net financial instruments	**7,112,166**	**8331,012**
Amounts not classified as financial instruments	368,152	366,750
Total net assets - parent	**7,480,318**	**8,697,762**

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NOTES TO THE FINANCIAL STATEMENTS

19a Classification of financial instruments (cont)

Classification of financial instruments - adjustments to parent to arrive at group	31 March 2020			31 March 2021		
	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
Other assets	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Cash	-	870	-	-	901	-
Share capital	-	(590)	-	-	(590)	-
Debtors - current	-	328	-	-	443	-
Debtors - non-current	-	424	-	-	1,047	-
	-	**1,032**	**-**	**-**	**1,801**	**-**
Assets total	**-**	**1,032**	**-**	**-**	**1,801**	**-**
Other liabilities						
Retire. benefit obligation	-	-	(2,232)	-	-	(5,513)
Creditors	-	-	(359)	-	-	(348)
Creditors - non current	-	-	(15)	-	-	(13)
Liabilities total	**-**	**-**	**(2,606)**	**-**	**-**	**(5,874)**
Total net assets	**-**	**1,032**	**(2,606)**	**-**	**1,801**	**(5,874)**

Total net financial instruments		**(1,574)**		**(4,073)**
Total net assets - parent		**7,478,744**		**8,693,689**

19b Net gains and losses on financial instruments

	2019/20	2020/21
	£000	**£000**
Designated as fair value through fund account	(491,886)	997,105
Loans and receivables	15,913	(11,464)
Financial liabilities at amortised cost	-	-
Total	**(475,973)**	**985,641**
Gains and losses on directly held freehold property	(24,751)	(16,405)
Change in market value of investments per fund account	**(500,724)**	**969,236**

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19c 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 aren't available; for example, where an instrument is traded in a market that isn't 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 isn't 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.

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NOTES TO THE FINANCIAL STATEMENTS

19c Fair Value Hierarchy (cont)

	31 March 2021			
	Level 1	Level 2	Level 3	Total
Investment assets at fair value through fund account	**£000**	**£000**	**£000**	**£000**
Bonds	-	866,752	-	866,752
Equities	5,044,875	-	-	5,044,875
Pooled investment vehicles	26,597	40,509	1,371,455	1,438,561
Derivatives	625	-	-	625
Cash deposits	933,452	-	-	933,452
Investment income due	33,602	-	-	33,602
Non-financial assets at fair value through profit and loss				
Property	-	-	366,125	366,125
Total investment assets	**6,039,151**	**907,261**	**1,737,580**	**8,683,992**
Investment liabilities at fair value through fund account	**(87,278)**	**-**	**-**	**(87,278)**
Total investment liabilities	**(87,278)**	**-**	**-**	**(87,278)**
Net investment assets	**5,951,873**	**907,261**	**1,737,580**	**8,596,714**

	31 March 2020			
	Level 1	Level 2	Level 3	Total
Investment assets at fair value through fund account	**£000**	**£000**	**£000**	**£000**
Bonds	-	605,954	-	605,954
Equities	4,197,089	-	-	4,197,089
Pooled investment vehicles	25,949	40,427	1,441,719	1,508,095
Derivatives	15,228	-	-	15,228
Cash deposits	681,472	-	-	681,472
Investment income due	69,304	-	-	69,304
Non-financial assets at fair value through profit and loss				
Property	-	-	367,494	367,494
Total investment assets	**4,989,042**	**646,381**	**1,809,213**	**7,444,636**
Investment liabilities at fair value through fund account	**(1,927)**	**(22)**	**-**	**(1,949)**
Total investment liabilities	**(1,927)**	**(22)**	**-**	**(1,949)**
Net investment assets	**4,987,115**	**646,359**	**1,809,213**	**7,442,687**

LOTHIAN PENSION FUND
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20 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.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

20 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:

Asset type	Potential price movement (+ or -)
Equities - Developed Markets	20.5%
Equities - Emerging Markets	28.0%
Private Equity	30.0%
Timber and Gold	18.0%
Secured Loans	10.5%
Fixed Interest Gilts	8.1%
Index-Linked Gilts	11.5%
Infrastructure	12.0%
Property	13.0%
Cash	1.0%

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.

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NOTES TO THE FINANCIAL STATEMENTS

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

	Value at 31 March 2021	% of fund	Potential Change +/-	Value on increase	Value on decrease
	£m	%	%	£m	£m
Equities - Developed Markets	4,606	53.6	20.5%	5,550.2	3,661.8
Equities - Emerging Markets	406	4.7	28.0%	519.7	292.3
Private Equity	148	1.7	30.0%	192.4	103.6
Timber and Gold	119	1.4	18.0%	140.4	97.6
Secured Loan	470	5.5	10.5	519.4	420.7
Fixed Interest Gilts	93	1.1	8.1	100.5	85.5
Index-Linked Gilts	613	7.1	11.5	683.5	542.5
Infrastructure	892	10.4	12.0%	999.0	785.0
Property	551	6.4	13.0%	622.6	479.4
Cash and forward foreign exchange	699	8.1	1.0	706.0	692.0
Total [1]	**8,597**	**100.0**	**16.7%**	**10,033.8**	**7,160.2**
Total [2]			**13.0%**	**9,716.3**	**7,477.7**
Total [3]			**13.7%**	**9,776.5**	**n/a**

[1] No allowance for correlations between assets
[2] Including allowance for correlations between assets
[3] Including allowance for correlation between assets and liabilities.

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

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

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

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

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

20 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 2021, cash deposits represented £1009m, 11.60% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2021	Balances at 31 March 2020	Balances at 31 March 2021
Held for investment purposes		**£000**	**£000**
Northern Trust Global Investment Limited - liquidity funds	Aaa-mf	88,569	180,045
Northern Trust Company - cash deposits	Aa3	238,706	612,447
UK Short-Term Bills and Notes	Aa3	218,968	-
The City of Edinburgh Council - treasury management	See below	135,229	135,111
Total investment cash		**681,472**	**927,603**
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	38,168	80,021
JLL in-house property cash (Barclays)	A1	-	5,847
Total cash - parent		**719,640**	**1,007,624**
Cash held by LPFE/LPFI Limited			
Royal Bank of Scotland	A1	870	901
Total cash - group		**720,510**	**1,008,525**

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.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

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

	Moody's Credit Rating at 31 March 2021	Balances at 31 March 2020	Balances at 31 March 2021
Money market funds		**£000**	**£000**
Deutsche Bank AG, London	Aaa-mf	20,825	27,910
Goldman Sachs	Aaa-mf	12,444	2
Aberdeen Standard Sterling Liquidity Fund	Aaa-mf	23,005	32,601
Bank call accounts			
Bank of Scotland	A1	4,795	21,592
Royal Bank of Scotland	A1	9,634	16,576
Santander UK	A1	-	21,596
Barclays Bank	A1	12	11
Svenska Handelsbanken		6	-
HSBC Bank PLC	Aa3	4	3
Notice accounts			
HSBC Bank PLC	Aa3	9,044	19,464
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa3	93,628	75,377
		173,397	**215,132**

[1] Very few Local Authorities have their own credit rating, but they're generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2021 was 'Aa3').

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.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

20 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 2021, the Fund was owed £625k 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's 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 80% (2020 76%)) of the Fund's investments could be converted to cash within three months in a normal trading environment.

21 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.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

22 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 £10,374m (2020 £8,774m). 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.

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

	31 March 2020	31 March 2021
	% p.a.	% p.a.
Inflation / pensions increase rate	1.9	2.9
Salary increase rate	3.5	3.4
Discount rate	2.3	2.0

Longevity assumptions

Life expectancy is based on the Fund's VitaCurves with improvements in line with the CMI 2020 model, with a 0% weighting of 2020 data, standard smoothing (Sk7), initial adjustment of 0.5% and a long term rate of improvement of 1.5% per annum. Based on these assumptions, the average future life expectancies at age 65 are summarised below:

	31 March 2020		31 March 2021	
	Male	Female	Male	Female
Current pensioners	21.7 years	24.3 years	20.5 years	23.3 years
Future pensioners (assumed to be currently 45)	24.7 years	27.5 years	21.9 years	25.2 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.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

23 Non-current Debtors

	LPF Parent 31 March 2020	LPF Group 31 March 2020	LPF Parent 31 March 2021	LPF Group 31 March 2021
	£000	£000	£000	£000
Contributions due - employers' cessation	5,256	5,256	5,587	5,587
	5,256	**5,256**	**5,587**	**5,587**

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.

24 Debtors

	LPF Parent 31 March 2020	LPF Group 31 March 2020	LPF Parent 31 March 2021	LPF Group 31 March 2021
	£000	£000	£000	£000
Contributions due - employers	13,680	13,680	15,402	15,402
Contributions due - members	3,808	3,807	3,945	3,945
Benefits paid in advance or recoverable	49	49	53	53
Sundry debtors	195	525	12,778	13,214
Prepayments	386	386	355	362
LPFE & LPFI Limited Loan facility - see note 28	-	-	-	-
	18,118	**18,447**	**32,533**	**32,976**

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

25 Creditors

	LPF Parent 31 March 2020	LPF Group 31 March 2020	LPF Parent 31 March 2021	LPF Group 31 March 2021
	£000	£000	£000	£000
Benefits payable	6,622	6,622	7,639	7,828
VAT, PAYE and State Scheme premiums	4,402	4,863	724	1,266
Contributions in advance	16,742	16,742	12,250	12,250
Miscellaneous creditors and accrued expenses	1,791	2,004	1,211	1,286
Office - operating lease	197	197	174	174
Corporation tax	-	13	-	-
Corporation tax losses utilised from CEC group	-	2	-	5
Intra group creditor - see note 28	329	-	462	-
	30,083	**30,443**	**22,460**	**22,809**

26 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.

	2019/20	2020/21
Total contributions during year for Lothian Pension fund	£000	£000
Standard Life	323	365
Prudential	2,037	1,223
	2,360	**1,588**

	31 March 2020	31 March 2021
Total value at year end for Lothian Pension Fund	£000	£000
Standard Life	4,102	4,890
Prudential*	7,515	8,700
	11,617	**13,590**

**Figures provided are unaudited*

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

27 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's 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 2020	31 March 2021
	£000	£000
Year-end balance of holding account	4,924	4,152
	4,924	**4,152**

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 2021, the fund had an average investment balance of £166.6m (2019/20 £144.7m). Interest earned was £428k (2019/20 £1135k).

Year end balance on treasury management account

	31 March 2020	31 March 2021
	£000	£000
Held for investment purposes	135,229	140,958
Held for other purposes	38,168	80,021
	173,397	**220,979**

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

27 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 2020	31 March 2021
	£000	£000
City of Edinburgh Council	64,051	68,087
West Lothian Council	26,458	28,462
Scottish Water	16,504	16,775
East Lothian Council	15,799	16,612
Midlothian Council	14,927	15,472
Edinburgh Napier University	5,521	5,844
Lothian Buses	6,565	5,834
Heriot-Watt University	3,205	3,446
Scottish Police Authority	2,802	3,395
Edinburgh College	2,621	2,694

Governance

As at 31 March 2021, all members of the Pensions Committee, with the exception of Richard Lamont, and all members of the Pension Board were members of the Lothian Pension Fund. One member of both the Pensions Committee and the Pension Board are in receipt of pension benefits from Lothian Pension Fund.

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

During the period from 1 April 2020 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 2020	31 March 2021
	£000	£000
Short-term employee benefits	757	864
Post-employment benefits - employer pension contributions	140	189

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

27 Related parties (cont)

Key management personnel employed by LPFE had accrued pensions totalling £119,873 (1 April 2020: £106,596 and lump sums totalling £126,989 (1 April 2020: £121,925) at the end of the period. Further details on senior management remuneration can be found within the remuneration report on page XXX.

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 and 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 2023 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 £1882 of which £747 was due at the year end and for LPFI Limited there was minimal interest payable for the year. At 31 March 2021, 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 2021, the Fund was invoiced £5,031k (2020 £4,239k) for the services of LPFE Limited staff.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

28a Consolidated Lothian Pension Fund Group - LPFE Limited & LPFI Limited - deferred tax

Movement in deferred tax asset (Non-current asset)

	LPF Group 2019/20	LPF Group 2020/21
	£000	£000
Opening balance	393	424
Credit for year to Fund Account	31	623
Closing balance	**424**	**1,047**

Elements of closing deferred tax asset

	LPF Group 31 March 2020	LPF Group 31 March 2021
	£000	£000
Pension liability	424	1,047
	424	**1,047**

28b Shares in group companies - LPFE Limited & LPFI Limited

	31 March 2020	31 March 2021
	£	£
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	590,378	590,378
	590,379	**590,379**

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.

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.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

29 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 Financial Statements of the Council.

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:

		Fair value at 31 March 2020	% of total 31 March 2020	Fair value at 31 March 2021	% of total 31 March 2021
Asset		**£000**	**%**	**£000**	**%**
Equity securities:	Consumer	1,036	10.0	1,730	13.0
	Manufacturing	1,568	14.0	2,022	15.0
	Energy & utilities	693	7.0	746	5.0
	Financial institutions	707	7.0	944	7.0
	Health & care	752	7.0	944	7.0
	Information Technology	470	4.0	662	5.0
	Other	794	7.0	1,112	8.0
Debt securities:	Corporate Bonds	582	5.0	470	3.0
	UK Government	669	6.0	835	6.0
Private equity:	All	95	1.0	84	1.0
Real property:	UK property	712	7.0	728	5.0
	Overseas property	10	0.0	2	0.0
Investment funds and unit trusts:	Equities	133	1.0	199	1.0
	Bonds	46	0.0	307	2.0
	Infrastructure	1,529	14.0	1,640	12.0
Derivatives:	Foreign Exchange	22	0.0	(2)	0.0
Cash and cash equivalents	All	1,053	10.0	1,425	10.0
		10,871	**100.0**	**13,848**	**100.0**

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

29 Retirement benefits obligation - group (cont)

Amounts recognised in the Net Assets Statement

	LPF Group 31 March 2020	LPF Group 31 March 2021
	£000	£000
Fair value of Fund assets	10,871	13,848
Present value of Fund liabilities	(13,103)	(19,361)
	(2,232)	**(5,513)**

Movement in the defined benefit obligation during the period

	LPF Group 31 March 2019/20	LPF Group 31 March 2020/21
	£000	£000
Brought forward	12,594	13,103
Current service cost	1,144	1,165
Past service cost	307	42
Interest cost on obligation	332	317
Fund participants contributions	233	257
Benefits paid	(11)	(56)
Actuarial losses arising from changes in financial assumptions	(1,496)	4,213
Actuarial losses arising from changes in demographic assumptions	-	(953)
Other actuarial losses	-	1,273
Balance at year end	**13,103**	**19,361**

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

29 Retirement benefits obligation - group (cont)

Movement in the fair value of Fund assets during the period

	LPF Group 31 March 2019/20	LPF Group 31 March 2020/21
	£000	£000
Brought forward	10,285	10,871
Benefits paid	(11)	(56)
Interest income on Fund assets	270	265
Contributions by employer	792	1,086
Contributions by member	233	257
Contributions in respect of unfunded benefits	-	-
Unfunded benefits paid	-	-
Other gains / (losses)	-	(172)
Return on assets excluding amounts included in net interest	(698)	1,597
Balance at year end	**10,871**	**13,848**

Amounts recognised in the Fund Account

	LPF Group 31 March 2019/20	LPF Group 31 March 2020/21
	£000	£000
Interest received on Fund assets	(270)	(265)
Interest cost on Fund liabilities	332	317
Current service costs	1,144	1,165
Past service costs	307	42
Employer contributions	(792)	(1,086)
Actuarial gain/(loss) due to re-measurement of defined benefit obligation	(1,496)	4,213
Return on Fund assets (excluding interest above)	698	1,425
Net cost recognised in Fund account	**(77)**	**5,811**

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

29 Retirement benefits obligation - group (cont)

Principal actuarial assumptions used in this valuation	31 March 2020	31 March 2021
	% p.a.	% p.a.
Inflation / pensions increase rate	1.8	2.8
Salary increase rate	3.4	3.3
Discount rate	**2.3**	**2.1**

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 the Fund's VitaCurves with improvements in line with the CMI 2020 model, with a 0% weighting of 2020 data, standard smoothing (Sk7), initial adjustment of 0.5% and a long-term rate of improvement of 1.5% p.a.

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

	31 March 2020		31 March 2021	
	Male	Female	Male	Female
Current pensioners	21.7 years	24.3 years	20.5 years	23.3 years
Future pensioners	24.7 years	27.5 years	21.9 years	25.2 years

Expected employer contributions to the defined benefit plan for the year ended 31 March 2021 are £616k, based on a pensionable payroll cost of £3,406k.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

30 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 2020	31 March 2021
	£000	£000
Outstanding investment commitment	301,002	264,448
	301,002	**264,448**

Office accommodation - 144 Morrison Street, Edinburgh

The Fund is committed to making the following future payments.

	31 March 2020	31 March 2021
	£000	£000
Within one year	124	118
Between one and five years	373	355
After five years	566	429
	1,063	**902**
Recognised as an expense during the year	**105**	**88**

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 £86k.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

31 Contingent assets and liabilities

Contribution refunds

At 31st March 2021, Lothian Pension Fund had £1,484k (2020: £914k) in unclaimed refunds due to members.

Co-investment deal abort costs

At 31 March 2021 the Fund had entered into negotiations for a timber co-investment in which it is exposed to the potential risk of investment abort costs. Lothian Pension Fund's exposure to this is approximately £375.3k.

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 2021, such contingent assets of the Fund totalled £2,386k and the Fund has secured second ranking security over two employer property assets.

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 £12.5m. 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.

LOTHIAN PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

31 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 eligible 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 January to 31 December 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 2020/21 year, payment two for the 2019/20 year and payment three for the 2018/19 year were made in January 2021. A liability has been raised at 31 March 2021 for the 2 months of service for the second and third instalment of 2020/21 and third instalment of 2019/20 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 December 2020 remain in the company's employment there is a contingent liability of £408,036 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.

Rectification of age discrimination - McCloud and Sargeant judgements

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.

On 4 August 2020, the Scottish Public Pensions Agency (SPPA) issued a statutory consultation on the proposed remedy, with this closing in October 2020. As anticipated, it is proposed that a comparison will be made between the benefits payable under the current rules with the entitlements which would have been paid if the Scheme had not changed in 2015, and with any higher sum being paid to the member. This protection will apply automatically and members who meet the qualifying criteria won't need to take any action. Many members benefits won't change or will only see a small increase because of low salary growth since the new scheme was introduced. As the changes will be backdated to April 2015 and apply to qualifying members who left the LGPS after that date, implementation of the remedy is expected to be extremely challenging from both administration and communications perspectives. SPPA has not yet published its formal response to its consultation.

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

31 Contingent assets and liabilities (cont)

In March 2021, SPPA advised administering authorities that rectification regulations should come into force in April 2023 (one year later than anticipated).

The Fund's IAS26 reporting from its actuary, as disclosed in Note 14, takes into account the appeal decision and the proposed remedy.

GMP Equalisation - Lloyds ruling on historic transfers
On 20 November the High Court ruled on the equalisation for GMPs of historic transfers out of the three largest Lloyds Banking Group pension schemes. The judgement requires all transfers with 17 May 1990 - 5 April 1997 GMPs to be equalised, even if they were taken as long ago as 1990. Schemes will be expected to pay a top-up to receiving scheme with interest at Bank base rate +1%. There are limited exceptions that do not require a top-up, but it is not obvious within the judgement that there is to be any blanket exception on the application of this ruling to public sector schemes.

It is not yet clear what impact this will have for the LGPS and the Fund is awaiting further guidance before taking any further action.

Weslo Housing Management ("Weslo") Transfer of engagements to Link Group Limited ("Link")
Link Housing Association has advised the Fund that the formation of Weslo Housing Management arose partially from a stock transfer, in 1994, from the then Scottish Homes governmental agency. Its interpretation of relevant Weslo archives is that there is potential that a guarantee or indemnity for the pension liabilities of transferred employees may pertain from the Scottish Government. Accordingly, it has approached the Scottish Government and a definitive legal opinion is awaited as to whether a proportion of the pension liabilities of Weslo Housing Management should be transferred from Lothian Pension Fund and be met by Scottish Homes Pension Fund. Lothian Pension Fund has no evidence within its own records to support such transfer. Should, the Scottish Government accept such historic guarantee, however, then the contributions payable by Link to Lothian Pension Fund would be reduced proportionately and transfer to Scottish Homes Pension Fund effected.

32 Impairment losses

	2019/20	2020/21
	£000	£000
Bad Debt provision	166	54

During the year the Fund recognised an decrease in impairment losses in respect of specific benefit over payments for which reimbursement has been requested of £112k. This decreased the impairment to £54k at the year end.

LOTHIAN PENSION FUND ("THE FUND") ACTUARIAL STATEMENT FOR 2020/21

This statement has been prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2018. 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 Statement (FSS), dated March 2021. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the overall Fund
- to ensure the solvency of each individual employers' share of the Fund based on their expected term of participation in the Fund
- to minimise the degree of short-term change in employer contribution rates
- maximise the returns from investments within reasonable and considered risk parameters, and hence minimise the cost to the employer
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment
- to help employers manage their pension liabilities
- 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 balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable. For employers whose covenant was considered by the Administering Authority to be sufficiently strong, contributions have been stabilised to have a sufficiently high likelihood of achieving the funding target over 20 years. Asset-liability modelling has been carried out which demonstrates that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is at least a 67% chance that the Fund will be fully funded after 20 years.

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 2018 was as at 31 March 2020. This valuation revealed that the Fund's assets, which at 31 March 2020 were valued at £7,479 million, were sufficient to meet 106% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2020 valuation was £408 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 time horizon and probability measure as per the FSS. Individual employers' contributions for the period 1 April 2021 to 31 March 2024 were set in accordance with the Fund's funding policy as outlined in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the 2020 valuation report.

LOTHIAN PENSION FUND ("THE FUND") ACTUARIAL STATEMENT FOR 2020/21

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 2020 valuation were as follows:

	31 March 2020
Financial assumptions	**% p.a.**
Discount rate	3.00%
Salary increase assumption	2.45%
Benefit increase assumption (CPI)	1.95%

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 2019 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.5% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Male	Female
Current Pensioners	20.5 years	23.3 years
Future Pensioners *	22.0 years	25.2 years

**Currently aged 45*

Copies of the 2020 valuation report and Funding Strategy Statement are available on the Fund's website.

Experience over the period since 31 March 2020

Markets were severely disrupted by COVID-19 at the 31 March 2020 funding valuation date, resulting in depressed asset values but have recovered strongly in 2020/21. Although the value placed on the liabiliities will also have increased due to changes in underlying market conditions, the funding level of the Fund as at 31 March 2021 is likely to be significantly improved compared to that reported as at 31 March 2020.

The next actuarial valuation will be carried out as at 31 March 2023. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden FFA
For and on behalf of Hymans Robertson LLP
7 May 2021:

LOTHIAN PENSION FUND
LIST OF ACTIVE EMPLOYERS AT 31 MARCH 2021

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	
Audit Scotland	Improvement Service (The)
Baxter Storey	ISS UK Ltd
BEAR Scotland	LPFE Ltd
Bellrock Property and Facilities Management	Melville Housing Association
Canongate Youth Project	Mitie PFI
Capital City Partnership	Morrison Facilities Services Ltd
CGI UK Ltd	Museums Galleries Scotland
Children's Hearing Scotland	Newbattle Abbey College
Children's Hospice Association Scotland	North Edinburgh Dementia Care
Citadel Youth Centre	NSL Services Ltd
Compass Chartwell	Penumbra
Convention of Scottish Local Authorities	

LOTHIAN PENSION FUND
LIST OF ACTIVE EMPLOYERS AT 31 MARCH 2021

Admitted Bodies	
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
Heriot Watt University Students Association	West Lothian Leisure
Homes for Life Housing Partnership	Young Scot
HWU Students Association	

SCOTTISH HOMES PENSION FUND INVESTMENT STRATEGY

SCOTTISH HOMES PENSION FUND ACCOUNTS

	Active	Deferred	Pensioners	Dependants	Total
31 March 2017	-	478	919	289	1,686
31 March 2018	-	433	908	269	1,610
31 March 2019	-	416	893	264	1,573
31 March 2020	-	368	905	260	1,533

** 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:

(a) 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

(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

(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.

SCOTTISH HOMES PENSION FUND INVESTMENT STRATEGY

Investment strategy

The Fund's actuary completed his triennial valuation during the year with a reassessment of financial and demographic estimates based on the latest three years of experience. He estimated that the funding level of the Scottish Homes Pension Fund was 117.7% at 31 March 2020, an improvement from the prior estimate of 104.7% at 31 March 2017. The fund has, therefore, maintained its full funding objective ahead of the target originally agreed by the Scottish Government and the City of Edinburgh Council.

The fund is closed to new entrants and relatively mature, and given the actuary's estimate of full funding, it is able to minimise investment shortfall risk of assets relative to liabilities as guided by the Scottish Government. There has, therefore, been no change to the objective approved by the Pensions Committee 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."

There was no change to the fund's strategic allocation of 100% to bonds in the year to 31 March 2021, and the fund invests solely in cash and bonds, specifically UK gilts, which move proportionately with liability values. The strategic and actual asset allocations for the fund at the end of the 2020 and 2021 financial years are shown in the table below.

Asset Class	Strategic Allocation 31 March 2020 %	Actual Allocation 31 March 2020 %	Strategic Allocation 31 March 2021 %	Actual Allocation 31 March 2021 %
Equities	-	-	-	-
Bonds	100	99	100	90
Property	-	-	-	-
Cash	-	1	-	10
Total	**100**	**100**	**100**	**100**

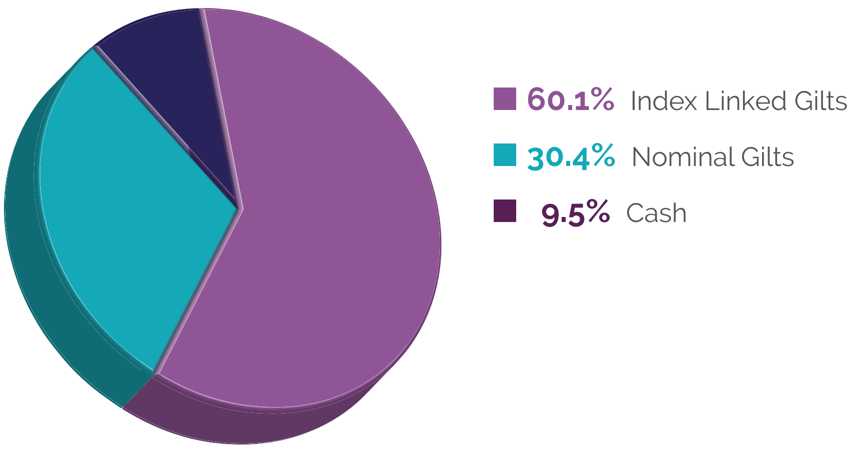
To ensure that invested assets are as closely matched with the liability profile as possible, the investment manager takes into consideration the expected duration of liabilities and whether they're fixed or index-linked in nature. The fund's strategy is to match the cash flows of liabilities one year beyond the date of the next valuation and to match the duration of liabilities beyond that. This is because of the greater visibility of pension payments in the near term.

SCOTTISH HOMES PENSION FUND INVESTMENT STRATEGY

Over the longer term, funding levels are subject to the actuary's financial and demographic assumptions of future experience, which are re-examined every three years. Some rebalancing of the fund's assets will be undertaken early in the new financial year to ensure that liabilities are cash flow matched until 2024.

The actual asset allocation of the fund is shown in the pie chart below:

ACTUAL ASSET ALLOCATION 31 MARCH 2021



Investment movements

As the Scottish Homes Pension Fund is relatively 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. Being fully funded, the fund typically invests excess cash in short-dated bills and gilts. To avoid paying interest or taking undue interest rate risk on negative yielding assets, the fund increased the proportion of cash over the year. The cash balance at end March 2021 was equivalent to approximately two years' pension payments.

The fund's assets have decreased in value by 2.0% over the year, adjusted for cash flow movements to pay pensions, as gilt prices fell in anticipation of higher economic growth and rising inflationary pressures.

SCOTTISH HOMES PENSION FUND ACCOUNT FOR YEAR ENDED 31 MARCH 2021

This statement shows a summary of the income and expenditure that the 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.

2019/20 £000		Note	2020/21 £000
	Income		
-	Contributions from the Scottish Government	3	-
-	Transfers from other schemes	4	-
-			**-**
	Less: expenditure		
6,653	Pension payments including increases		6,619
621	Lump sum retirement payments		727
4	Lump sum death benefits		7
-	Transfers to other schemes	5	-
(25)	Administrative expenses	6b	(6)
7,253			**7,347**
(7,253)	**Net withdrawals from dealing with members**		**(7,347)**
	Returns on investments		
2,466	Investment income	7	2,028
4,473	Change in market value of investments	8, 11b	(3,097)
(104)	Investment management expenses	6c	(112)
6,835	**Net returns on investments**		**1,181**
(418)	**Net increase/(decrease) in the Fund during the year**		**(8,528)**
166,488	Net assets of the Fund at 1 April 2020		166,070
166,070	**Net assets of the Fund at 31 March 2021**	**11**	**157,542**

SCOTTISH HOMES PENSION FUND
NET ASSETS STATEMENT AS AT 31 MARCH 2021

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

31 March 2020			31 March 2021
£000		Note	£000
	Investment Assets		
159,933	Bonds - UK		140,723
3,824	Cash Deposits		14,906
615	Other investment assets		461
164,372			**156,090**
	Investment Liabilities		
-	Other investment liabilities		-
-			-
164,372	**Net investment assets**	**9**	**156,090**
	Current assets		
130	The City of Edinburgh Council	17	141
1,599	Cash balances	12, 17	1,357
2	Debtors	15	-
1,731			**1,498**
	Current liabilities		
(33)	Creditors	16	(46)
(33)			**(46)**
1,698	**Net current assets**		**1,452**
166,070	**Net assets of the Fund**	**11**	**157,542**

The unaudited accounts were issued on 23 June 2021 and the audited accounts were authorised for issue on XX September 2021.

John Burns FCMA CGMA, PgC
Chief Finance Officer, Lothian Pension Fund
23 June 2021

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 don't 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.

SCOTTISH HOMES PENSION FUND 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 XXX.

2 Events after the Reporting Date

There have been no events since 31 March 2021, and up to the date when these Financial Statements were authorised, that require any adjustments to these Financial Statements.

SCOTTISH HOMES PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

3 Contributions from the Scottish Government

The Scottish Homes Pension Fund (SHPF) is an employer pension fund for former employees of Scottish Homes (subsequently Communities Scotland), Scottish Special Housing Association and 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 Regulations). 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. The fund has no contributions paid into it by active members, but consists only of deferred and pensioner members and therefore only pays money out to the pensioners.

Section 2 (1C) of the 2005 Regulations 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 2020, SHPF showed a funding surplus of £24.9 million with a funding level of 117.7%, derived from a market valuation of assets of £166.1million and liabilities of £141.1million.

In accordance with the provisions of the Funding Agreement, the assets of SHPF are now invested entirely on a low risk basis. With a funding surplus, the Scottish Government isn't required to provide any contribution, but as Guarantor has the responsibility to pay towards the administration expenses of the fund. This amounted to £70,000 per annum for years 2018 to 31 March 2021, with this rising to £90,000 per annum for the three years starting 1st April 2021 following the most recent actuarial valuation. Investment expenses are being met directly from the fund's surplus..

SCOTTISH HOMES PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

4 Transfers from other pension schemes

	2019/20 £000	2020/21 £000
Group transfers	1,726	-
Individual transfers	-	-
	1,726	**-**

5 Transfers out to other pension schemes

	2019/20 £000	2020/21 £000
Group transfers	-	-
Individual transfers	129	-
	129	**-**

6a Total Management expenses

	2019/20 £000	2020/21 £000
Administrative costs	(30)	(17)
Investment management expenses	62	60
Oversight and governance costs	47	63
	79	**106**

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

SCOTTISH HOMES PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

6b Administrative expenses

	2019/20 £000	2020/21 £000
Employee costs	26	31
System costs	9	19
Actuarial fees	2	3
External audit fees	1	1
Printing and postage	3	4
Depreciation	1	1
Office costs	2	2
Sundry costs less sundry income	1	3
	45	**64**
Administration fee received	(70)	(70)
	(25)	**(6)**

LPFE, which is a wholly owned subsidiary of the Council, is responsible for providing the staffing resource to administer the pension funds. Lothian Pension Fund (inclusive of Scottish Homes Pension 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, and costs that are common to the two funds are allocated on a defined basis.

6c Investment management expenses

	2019/20 £000	2020/21 £000
External management fees - deducted from capital (direct)	-	-
Transaction costs	-	-
Employee costs	56	57
Custody fees	8	5
Engagement and voting fees	3	2
Performance measurement fees	-	-
Consultancy fees	1	13
System costs	12	13
Legal fees	3	1
Office costs	3	3
Sundry costs less sundry income	18	18
	104	**112**

The fund has not incurred any performance-related investment management fees in 2020/21 or 2019/20.

SCOTTISH HOMES PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

7 Investment income

	2019/20 £000	2020/21 £000
Income from fixed interest securities	2,437	2,024
Interest on cash deposits and sundries	29	4
	2,466	**2,028**
Irrecoverable withholding tax	-	-
	2,466	**2,028**

8 Reconciliation of movement in investments

	Market value at 31 March 2020 £000	Purchases at cost £000	Sales & proceeds £000	Change in market value £000	Market value at 31 March 2021 £000
Bonds	159,933	-	(16,111)	(3,099)	140,723
Equities	-	-	-	-	-
Pooled investment vehicles	-	-	-	-	-
	159,933	**-**	**(16,111)**	**(3,099)**	**140,723**
Other financial assets / (liabilities)					
Cash deposits*	3,824			2	14,906
Investment income due/ amounts payable*	615			-	461
	4,439			**2**	**15,367**
Net financial assets	**164,372**			**(3,097)**	**156,090**

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.

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

8 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 on the previous page.

	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	-	-	-	-	-
	160,542	**-**	**(5,015)**	**4,406**	**159,933**
Other financial assets / (liabilities)					
Cash deposits*	3,650			12	3,824
Investment income due/ amounts payable*	618			-	615
	4,268			**12**	**4,439**
Net financial assets	**164,810**			**4,418**	**164,372**

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

SCOTTISH HOMES PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

9 Investment managers and mandates

		Market value at 31 March 2020	% of total 31 March 2020	Market value at 31 March 2021	% of total 31 March 2021
Manager	**Mandate**	**£000**	**%**	**£000**	**%**
In-house	Ex-Equity	27	0.0	12	0.0
Total UK equities		**27**	**0.0**	**12**	**0.0**
In-house	UK Index linked gilts	163,021	99.2	156,078	100.0
Total fixed interest and inflation linked bonds		**163,021**	**99.2**	**156,078**	**100.0**
In-house	Cash	1,324	0.8	-	-
Total cash		**1,324**	**0.8**	**-**	**-**
Net financial assets		**164,372**	**100.00**	**156,090**	**100.0**

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

	Market value at 31 March 2020	% of total 31 March 2020	Market value at 31 March 2021	% of total 31 March 2021
	£000	**%**	**£000**	**%**
UK Gov 4.25% 07/06/32	9,880	6.0	9,234	5.9
UK Gov 4.125% Index Linked 22/07/30	9,258	5.6	9,013	5.7
UK Gov 1.25% Index Linked 22/11/27	9,033	5.4	8,974	5.7
UK Gov 2.5% Index Linked 17/07/24	8,913	5.4	8,831	5.6
UK Gov 1.875% Index Linked 22/11/21	8,049	4.8	7,973	5.1
UK Gov 2.5% Index Linked 16/04/20	11,411	6.9	-	-

SCOTTISH HOMES PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

11 Financial Instruments

11a Classification of financial instruments

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

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

	31 March 2020			31 March 2021		
Financial assets	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	159,933	-	-	140,723	-	-
Cash	-	3,824	-	-	14,906	-
Other balances	-	615	-	-	461	-
	159,933	**4,439**	**-**	**140,723**	**15,367**	**-**
Other assets						
City of Edinburgh Council	-	130	-	-	141	-
Cash	-	1,599	-	-	1,357	-
Debtors	-	2	-	-	-	-
	-	**1,731**	**-**	**-**	**1,498**	**-**
Assets total	**159,933**	**6,170**	**-**	**140,723**	**16,865**	**-**
Financial liabilities						
Other liabilities						
Creditors	-	-	(33)	-	-	(46)
Liabilities total	**-**	**-**	**(33)**	**-**	**-**	**(46)**
Total net assets	**159,933**	**6,170**	**(33)**	**140,723**	**16,865**	**(46)**

Total net financial instruments	**166,070**	**157,542**

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

11b Net gains and losses on financial instruments

	2019/20	2019/20
	£000	£000
Designated as fair value through fund account	4,406	(3,099)
Loans and receivables	12	2
Financial liabilities at amortised cost	-	-
Total	**4,418**	**(3,097)**

11c Valuation of financial instruments carried at fair value

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

Level 1

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

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

Level 2

Financial instruments at Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that isn't 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.

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

11c 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 isn't 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 2021
	Level 1	Level 2	Level 3	Total
Investment assets	**£000**	**£000**	**£000**	**£000**
Bonds	-	140,723	-	140,723
Cash deposits	14,906	-	-	14,906
Investment income due/amounts payable	461	-	-	461
Total financial assets	**15,367**	**140,723**	**-**	**156,090**
Investment liabilities				
Payable for investment purchases	-	-	-	-
Total investment liabilities	**-**	**-**	**-**	**-**
Net investment assets	**15,367**	**140,723**	**-**	**156,090**

				31 March 2020
	Level 1	Level 2	Level 3	Total
Investment assets	**£000**	**£000**	**£000**	**£000**
Bonds	-	159,933	-	159,933
Cash deposits	3,824	-	-	3,824
Investment income due/amounts payable	651	-	-	651
Total financial assets	**4,475**	**159,933**	**-**	**164,408**
Investment liabilities				
Payable for investment purchases	-	-	-	-
Total investment liabilities	**-**	**-**	**-**	**-**
Net investment assets	**4,475**	**159,933**	**-**	**164,408**

SCOTTISH HOMES PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

12 Nature and extent of risk arising from financial instruments

Risk and risk management

The fund's primary aim is to ensure that all members and their dependents receive their benefits when they become payable. As directed by Scottish Government, with the 31 March 2020 actuarial valuation showing a funding level of 117.7%, the fund is invested entirely in low risk assets. In addition, the fund ensures that sufficient cash is available to meet all liabilities when they fall due.

Responsibility for the fund's overall investment strategy 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.

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 the Scottish Homes Pension Fund has to some extent been mitigated, as the fund holds only gilts. Most of the reduction in market risk is relative to the liabilities, and not outright. The fund's assets have been matched to its liabilities as at the 31 March 2017 triennial valuation so that 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 takes place following the publication of each triennial valuation, which is typically a year after the valuation point. Following the results of the 31 March 2020 triennial valuation, rebalancing is scheduled to take place early in the new financial year.
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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	10.8%
Fixed Interest Gilts	3.8%
Cash	0.2%

SCOTTISH HOMES PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

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

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

Asset classes don't always move in line with each other. The extent to which assets move together is known as their "correlation". A lower correlation means that there's 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 2021	% of fund	Potential Change +/-	Value on increase	Value on decrease
	£000	%	%	£000	£000
Index-Linked Gilts	94	59.9	10.8	104	84
Fixed Interest Gilts	47	30.2	3.8	49	45
Cash	15	9.9	0.2	15	15
Total [1]	**156**	**100.0**	**14.7**	**168**	**144**
Total [2]			**13.5**	**177**	**135**
Total [3]			**1.9**	**159**	**n/a**

[1] No allowance for correlations between assets
[2] Including allowance for correlations between assets
[3] Including allowance for correlation between assets and liabilities.

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

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

However, because the purpose of a pension scheme is to make payments to scheme beneficiaries, the true risk of a pension scheme isn't 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.

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

12 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 isn't reflected in market prices.

Cash deposits

At 31 March 2021, cash deposits represented £16m, 10% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2021	Balances at 31 March 2020	Balances at 31 March 2021
Held for investment purposes		**£000**	**£000**
Northern Trust Company - cash deposits	A2	1,324	14,906
The City of Edinburgh Council - treasury management	See below	-	-
		1,324	**14,906**
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	1,599	1,357
Total cash		**2,923**	**16,263**

SCOTTISH HOMES PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

12 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 2021	Balances at 31 March 2020	Balances at 31 March 2021
Money market funds	**£000**	**£000**	**£000**
Deutsche Bank AG, London	Aaa-mf	192	176
Aberdeen Standard Sterling Liquidity Fund	Aaa-mf	212	206
Goldman Sachs	Aaa-mf	115	-
Bank call accounts			
Bank of Scotland	A1	44	136
Royal Bank of Scotland	A1	89	105
Royal Bank of Scotland	A1	90	136
Notice accounts			
HSBC Bank PLC	Aa3	83	123
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa3	864	475
		1,689	**1,357**

[1] Very few Local Authorities have their own credit rating but they're generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2021 was 'Aa3').

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

12 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 doesn't 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 isn't 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 won't be able to meet its financial obligations as they fall due. The fund therefore ensures that there's adequate cash and liquid resources to meet its commitments. Cash flow projections are prepared on a regular basis to understand and manage the timing of the fund's cash flows.

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

13 Actuarial statement

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

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

14 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £125m (2020 £122m). 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 2020	31 March 2021
	% p.a.	% p.a.
Inflation/pensions increase rate	1.90%	2.85%
Discount rate	2.30%	2.00%

Longevity assumptions

The life expectancy assumption is based on fund specific statistical analysis with improvements in line with the CMI 2020 model, with a 0% weighting of 2020 data, standard smoothing (Sk7), initial adjustment of 0.5% and a long term rate of improvement of 1.5% p.a. Based on these assumptions, the average future life expectancies at age 65 are summarised below:

	31 March 2020		31 March 2021	
	Male	Female	Male	Female
Current pensioners	22.4 years	24.8 years	20.8 years	23.2 years
Future pensioners (assumed to be currently 45)	24.8 years	27.8 years	21.0 years	26.0 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.

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

15 Debtors

	31 March 2020	31 March 2021
	£000	£000
Sundry debtors	2	0
	2	**0**

16 Creditors

	31 March 2020	31 March 2021
	£000	£000
Benefits payable	31	45
Miscellaneous creditors and accrued expenses	2	1
	33	**46**

17 Related party transactions

The City of Edinburgh Council

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

LPFE, which is a wholly owned subsidiary of the Council, is responsible for providing the staffing resource to administer the pension funds. Lothian PensionThe Fund (inclusive of Scottish Homes Pension 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 2020	31 March 2021
	£000	£000
Year end balance of holding account	130	141
	130	**141**

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).

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

	31 March 2020	31 March 2021
Year end balance on treasury management account	**£000**	**£000**
Held for investment purposes	-	-
Held for other purposes	1,599	1,357
	1,599	**1,357**

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 XX) 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 2021, the fund was recharged £88k (2020 £81k) for the services of LPFE Limited staff.

Governance

As at 31 March 2021, all members of the Pensions Committee, with the exception of Richard Lamont, and all members of the Pension Board, were members of the Lothian Pension Fund. One member of both the Pensions Committee and the Pension Board are in receipt of pension benefits from Lothian Pension Fund

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

SCOTTISH HOMES PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

During the period from 1 April 2020 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 2020	31 March 2021
	£000	£000
Short-term employee benefits	757	864
Post-employment benefits - employer pension contributions	140	189

Key management personnel employed by LPFE had accrued pensions totalling £119,873 (1 April 2020: £106,596 and lump sums totalling £126,989 (1 April 2020: £121,925) 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.

WHAT OUR MEMBERS SAY:

'Very happy with the website. It's easy to get around and I particularly like seeing my payslip and p60 online as it saves on my filing at home. Thank you.'

SCOTTISH HOMES PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

18 Contingent assets/liabilities

Rectification of age discrimination - McCloud and Sargeant judgements

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.

On 4 August 2020, the Scottish Public Pensions Agency (SPPA) issued a statutory consultation on the proposed remedy, with this closing in October 2020. As anticipated, it's proposed that a comparison will be made between the benefits payable under the current rules with the entitlements which would have been paid if the Scheme had not changed in 2015, and with any higher sum being paid to the member. This protection will apply automatically and members who meet the qualifying criteria won't need to take any action. Many members' benefits won't change or will only see a small increase because of low salary growth since the new scheme was introduced. As the changes will be backdated to April 2015 and apply to qualifying members who left the LGPS after that date, implementation of the remedy is expected to be extremely challenging from both administration and communications perspectives. SPPA has not yet published its formal response to its consultation.

In March 2021, SPPA advised administering authorities that rectification regulations should come into force in April 2023 (one year later than anticipated).

The Fund's IAS26 reporting from its actuary, as disclosed in Note 14, takes into account the appeal decision and the proposed remedy.

GMP Equalisation - Lloyds ruling on historic transfers

On 20 November the High Court ruled on the equalisation for GMPs of historic transfers out of the three largest Lloyds Banking Group pension schemes. The judgement requires all transfers with 17 May 1990 - 5 April 1997 GMPs to be equalised, even if they were taken as long ago as 1990. Schemes will be expected to pay a top-up to receiving scheme with interest at Bank base rate +1%. There are limited exceptions that don't require a top-up, but it's not obvious within the judgement that there's to be any blanket exception on the application of this ruling to public sector schemes.

It's not yet clear what impact this will have for the LGPS and we're awaiting further guidance before taking any further action.

SCOTTISH HOMES PENSION FUND ("THE FUND") ACTUARIAL STATEMENT FOR 2020/21

Weslo Housing Management ("Weslo") Transfer of engagements to Link Group Limited ("Link")

Link Housing Association has advised Lothian Pension Fund that the formation of Weslo Housing Management arose partially from a stock transfer in 1994, from the then Scottish Homes governmental agency. Its interpretation of relevant Weslo archives is that there's potential that a guarantee or indemnity for the pension liabilities of transferred employees may pertain from the Scottish Government. Accordingly, it has approached the Scottish Government and a definitive legal opinion is awaited as to whether a proportion of the pension liabilities of Weslo Housing Management should be transferred from Lothian Pension Fund and be met by Scottish Homes Pension Fund. Lothian Pension Fund has no evidence within its own records to support such transfer. Should the Scottish Government accept such historic guarantee, then the contributions payable by Link to Lothian Pension Fund would be reduced proportionately and transfer to Scottish Homes Pension Fund effected.

19 Contractual commitments

The Fund had no contractual commitments at the year end.

20 Impairment losses

No impairment losses have been identified during the year.

SCOTTISH HOMES PENSION FUND ("THE FUND") ACTUARIAL STATEMENT FOR 2020/21

This statement has been prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2018. 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 2021, 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.

The fund's assets are invested wholly 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 2018 was as at 31 March 2020. This valuation revealed that the fund's assets, which at 31 March 2020 were valued at £166.1 million, were sufficient to meet 117.7% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2020 valuation was £24.9 million.

The Guarantor's contributions for the period 1 April 2021 to 31 March 2024 were set in accordance with the fund's funding policy as outlined in its FSS

SCOTTISH HOMES PENSION FUND ("THE FUND") ACTUARIAL STATEMENT FOR 2020/21

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the 2020 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 assets at their market value.

The key financial assumptions adopted for the 2020 valuation were as follows:.

Financial assumptions	31 March 2020
Discount Rate	Bank of England nominal yield curve
Benefit increase assumption (CPI)	Bank of England implied (RPI) curve less 0.9% p.a.

SCOTTISH HOMES PENSION FUND ("THE FUND") ACTUARIAL STATEMENT FOR 2020/21

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 2019 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 2.0% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows

	Male	Female
Current Pensioners	20.8 years	23.3 years
Future Pensioners *	21.1 years	26.0 years

**Currently aged 45*

Copies of the 2020 valuation report and Funding Strategy Statement are available on the LPF website.

Experience over the period since 31 March 2020

Since the last formal valuation, real bond yields have fallen placing a higher value on the liabilities and asset values have fallen over the last year. As a result, the funding level of the fund as at 31 March 2021 is likely to be lower than that reported at the previous formal valuation.

The next actuarial valuation will be carried out as at 31 March 2023. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden FFA
For and on behalf of Hymans Robertson LLP
11 May 2021:

ACCOUNTING POLICIES AND GENERAL NOTES

1. Basis of preparation

The Financial Statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2020/21 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 2020/21 financial year and report on the net assets available to pay pension benefits as at 31 March 2021. 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 LPF 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 POLICIES AND GENERAL NOTES

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 POLICIES AND GENERAL NOTES

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 POLICIES AND GENERAL NOTES

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 POLICIES AND GENERAL NOTES

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. LPF 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 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

ACCOUNTING POLICIES AND GENERAL NOTES

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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262 FACILITIES MANAGERS AND ASSISTANTS

LOTHIAN PENSION FUND

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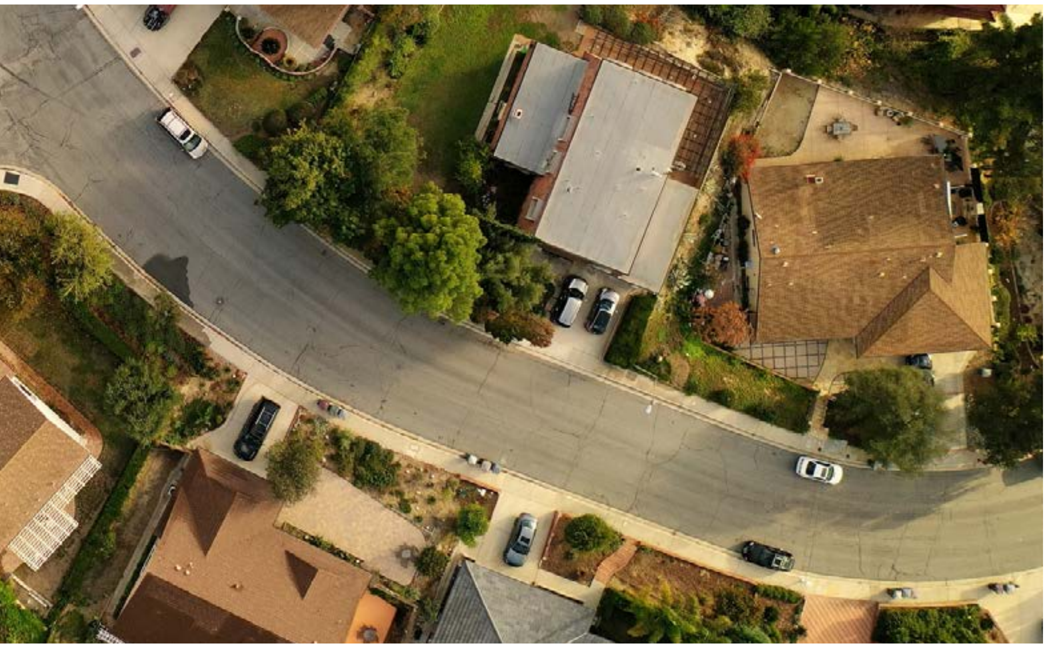
ACCOUNTING POLICIES AND GENERAL NOTES

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.



ACCOUNTING POLICIES AND GENERAL NOTES

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 Red Book Global Valuation Standards (introduced with effect from 31 January 2020).	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 and the IPEV Board's Special Valuation Guidance (March 2020).	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.

ACCOUNTING POLICIES AND GENERAL NOTES

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 2021.

Lothian Pension Fund	Assessed Valuation range (+ or -)	Value at 31 March 2021	Value on increase	Value on decrease
Unquoted		£m	£m	£m
Private Equity	30%	53	69	37
Infrastructure	12%	865	969	761
Timber	18%	119	140	98
Private Secured Loans	7.5%	293	315	271
Property	13%	377	426	328
		1,707	**1,919**	**1,495**

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.

ACCOUNTING POLICIES AND GENERAL NOTES

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

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

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

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

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

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

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

q) Employee benefits
The employees of LPFE are eligible to participate in Lothian Pension Fund.

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

ACCOUNTING POLICIES AND GENERAL NOTES

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

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

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

Past-service costs are recognised immediately in the Fund Account, unless the changes to the pension plan are conditional on the employees remaining in service for a specified 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 2021/22 Code:

The Code requires implementation from 1 April 2021 and there's therefore no impact on the 2020/21 financial statements.

- Definition of a Business: Amendments to IFRS 3 Business Combinations
- Interest Rate Benchmark Reform: Amendments to IFRS 9, IAS 39 and IFRS 7
- Interest Rate Benchmark Reform: Phase 2: Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16.

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.

ACCOUNTING POLICIES AND GENERAL NOTES

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 2021 was £1,629m (2020 £1,395m).

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:

ACCOUNTING POLICIES AND GENERAL NOTES

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

Change in assumptions - year ended 31 March 2021	Approx Increase in liabilities %	Approx monetary amount £m
0.5% decrease in the real discount rate	10	1,042
1 year increase in member life expectancy	4	417
0.5% increase in salary increase rate	1	111
0.5% increase in pensions increase rate	9	909

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

Change in assumptions – year ended 31 March 2021	Approx Increase in liabilities %	Approx monetary amount £m
0.5% decrease in the real discount rate	5	6
1 year increase in member life expectancy	4	5
0.5% increase in pensions increase rate	5	6

ACCOUNTING POLICIES AND GENERAL NOTES

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

Mark Smith, Employers and Members Quality Assurance Manager

Mark joined Lothian Pension Fund in July 2000 as our Employer and Members Quality Assurance Manager. Mark's responsible for ensuring that our members and employers receive a quality, professional service. Mark says:

"From the very first day I started with LPF, every day has been busy, varied, challenging and rewarding. No day is ever is the same and there's a lot of opportunity to develop my skills and knowledge."

ACCOUNTING POLICIES AND GENERAL NOTES

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 11th March 2020, continues to impact many aspects of daily life and the global economy - with some real estate markets having experienced lower levels of transactional activity and liquidity. Travel, movement and operational restrictions have been implemented by many countries. In some cases, "lockdowns" have been applied - in varying degrees - to reflect further 'waves' of COVID-19. While these may imply a new stage of the crisis, they're not unprecedented in the same way as the initial impact.

The pandemic and the measures taken to tackle COVID-19 continue to affect economies and real estate markets globally. Nevertheless, as at the valuation date, property markets are mostly functioning again, with transaction volumes and other relevant evidence at levels where enough market evidence exists upon which to base opinions of value. Accordingly - and for the avoidance of doubt - our valuation is not reported as being subject to 'material valuation uncertainty', as defined by VPS 3 and VPGA 10 of the RICS Valuation - Global Standards.

For the avoidance of doubt, this explanatory note has been included to ensure transparency and to provide further insight as to the market context under which the valuation opinion was prepared. In recognition of the potential for market conditions to move rapidly in response to changes in the control or future spread of COVID-19, we highlight the importance of the valuation date.

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

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
23 June 2021

STATEMENT OF RESPONSIBILITIES FOR THE ANNUAL ACCOUNTS

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 2020/21 (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 2021.

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.

John Burns, FCMA CGMA PgC
Chief Finance Officer
Lothian Pension Fund
23 June 2021

ANNUAL GOVERNANCE STATEMENT

Roles and responsibilities

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

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

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

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

Scope of responsibility

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

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

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 Operating 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.
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ANNUAL GOVERNANCE STATEMENT

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:

ANNUAL GOVERNANCE STATEMENT

- 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
- An Elected Members remuneration and expenses scheme is in place and is consistent with the Scottish Government's 'Councillors Remuneration: allowances and expenses – Guidance'. Information on the amounts and composition of elected members salaries, allowances and expenses is published on the Council's website
- The Council's Democracy, Governance and Resilience Senior Manager ensures that induction training on roles and responsibilities, and ongoing development opportunities, are provided for Elected Members. A separate policy on Pensions Committee and Pension Board member training has been adopted and is overseen by the LPF Group's officers
- Mandatory training for Councillors newly appointed to the Pensions Committee is programmed within the Induction and training programme for Elected Members. This focuses on governance, investment management and strategy and how the LPF Group and Fund work. Committee members are reminded of the requirement to undertake a minimum of 21 hours of training per financial year to fulfil their role on the Pensions Committee
- 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
- 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
- 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

A significant element of the governance framework is the system of internal controls, which is based on an ongoing process to identify and prioritise risks to the achievement of the Council's objectives, including those relevant to the LPG Group and Fund. Following the establishment of the wholly-owned subsidiary companies, LPFE and LPFI, the Council continues to have appropriate assurance processes and procedures in relation to the responsible officers involved in the administration of those companies and so the wider LPF Group administering the Fund.

Review of Effectiveness

[The Local Code of Governance details the Council's arrangements for monitoring each element of the framework and providing evidence of compliance. The Council's Governance and Democratic Services Manager has reviewed the effectiveness of the Code.

The Chief Internal Auditor has also provided an assurance statement on the effectiveness of the system of internal control. The opinion in the assurance statement states: "Internal Audit considers that 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 2021. 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 2020 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."]

To be updated following confirmation of IA opinion.]

ANNUAL GOVERNANCE STATEMENT

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 2020 to 31 March 2021 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 human resources strategy and Governance specific to LPF Group's requirements, prioritising 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 embed the 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

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
23 June 2021

Dr Stephen S Moir
Executive Director of Resources
The City of Edinburgh Council
23 June 2021

Doug Heron
Chief Executive Officer
Lothian Pension Fund
23 June 2021

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 2021 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.	✔	The City of Edinburgh Council acts as administering authority and delegates all pension scheme matters to a committee of seven members (Pensions Committee) made up as follows: Five City of Edinburgh Council elected members Two external members, one drawn from the membership of the Fund and one drawn from the employers that participate in the Fund.
	That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	✔	The Pensions Committee includes two external places for pension fund stakeholders i.e. one each from the employer and member representatives. Fund members and employers are also represented within the Fund's Pension Board. Membership includes five employer representatives and five member representatives, although this is currently under review. All members of the Pension Board are invited to attend the meeting of the Pensions Committee and receive the relevant papers prior to those meetings. Two members of the Pension Board are invited to attend the Pensions Audit Sub-Committee.

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.	✔	The Pensions Audit Sub-Committee, consisting of three members of the Pensions Committee, report to the Pensions Committee on their findings and recommendations. Two members of the Pension Board attend the Pensions Audit Sub-Committee in a non-voting capacity. The Pension Board attends the Pensions Committee meetings and takes part in training events. Implementation of investment strategy is delegated to the Executive Director of Resources who then delegates to the Head of Finance, who takes advice from the Joint Investment Strategy Panel. The Panel meets quarterly and reports to the Pensions Committee annually. The advisers on the Joint Investment Strategy Panel consists of the Chief Investment Officer and on other portfolio manager of LPFI plus two experienced independent external industry advisers. The Pensions Committee receives annual updates from LPFE and LPFI.
Representation	That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include employing authorities (including non-scheme employers, e.g. admitted bodies) and scheme members (including deferred and pensioner scheme members).	✔	The Pension Board consists of a mix of representatives: • Five employer representatives from non-administering authority employers • Five member representatives appointed by the Trade Unions in accordance with the approach required under Scottish statute. •
	Where appropriate, independent professional observers, and expert advisers (on an ad-hoc basis).	✔	An Independent Professional Observer was appointed in March 2013 to help Committee scrutinize advice. This contract expired in February 2018 and a new Observer was appointed in August 2018.

GOVERNANCE COMPLIANCE STATEMENT

Principle		Full Compliance	Comments
Representation	Where appropriate, independent professional observers, and expert advisers (on an ad-hoc basis).	✔	As mentioned previously, external investment advisers sit on the Joint Investment Strategy Panel. A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the funds. A non-executive director was appointed to the board of LPFI on 7 February 2017 and LPFE on 19 March 2018. A further non-executive director is expected to be appointed to both boards in Q3 2020. An external compliance consultant supports the LPF Group on its ongoing compliance with the Financial Conduct Authority rules, regulations and guidance.
	That where lay members sit on a main or secondary committee, they'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.	✔	The Pension Board attends the Pensions Committee meetings to help ensure that the operation of the pension funds is in accordance with the applicable law and regulation. The Pension Board takes part in all Committee training events. The Pensions Committee takes account of the views of the Pension Board when making decisions.
Selection and Role of Lay Members	That committee or board members are made fully aware of the status, role and function that they're required to perform on either a main or secondary committee.	✔	A comprehensive training programme including induction is in place. Members of the Pensions Committee and Pension Board are expected to attend no less than three days of training (21 hours) per year. The elected members are required to read, sign and abide by the Councillors' Code of Conduct. 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.

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.	✔	The declaration of members' interests is a standard item on the agenda for meetings of the Pensions Committee, Pensions Audit Sub-Committee and Pension Board. A Code of Conduct also applies to all members of the Pensions Committee and the Pension Board. The declaration of board members interest is a standard item on the agenda for the meetings for the LPFE and LPFI board meetings.
Voting	The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	✔	Five of the seven places of the Pensions Committee are held by elected members of the City of Edinburgh Council, which is required to retain a 2/3 majority in line with the Local Government (Scotland) Act 1973. The LPF Group's Nomination and Appointments Policy clearly documents how employer and member representatives will be elected to the Pensions Committee and Pension Board. LPFI and LPFE board members conduct meetings and other matters in accordance with their respective articles of association and shareholders' agreements.
Training/ Facility Time/ Expenses	a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	✔	A Training and Attendance Policy is in place covering training requirements and reimbursement of expenses. The policy is available on the LPF Group's website www.lpf.org.uk. Board members and staff working for LPFI and LPFE also attend separate training for the purposes of their knowledge, understanding and (where appropriate) compliance with Financial Conduct Authority regulations.
	b) That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	✔	The Training and Attendance Policy applies to both the Pensions Committee and the Pension Board. Advisers have their own professional development obligations.

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 urgent business, the Pension Committee met two additional times during the year on 26 January 2021 and 24 March 2021.
	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.	✔	The Pensions Audit Sub-Committee is held before the Pensions Committee at least three times a year with further meetings held if necessary. The Joint Investment Strategy Panel meets quarterly or more frequently as required. The Pension Board attends all the Pensions Committee meetings and separately meets in advance of such meetings. Further meetings are held if necessary. The LPFE board now meet five times a year (in February, May, June, August, October and December) and the LPFI board at least quarterly.
	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 provides quarterly updates and attends all Pension Committee, Audit Sub Committee and Pension Board 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.	✔	The Pensions Committee deals with all matters relating to both the administration and investment of the Fund and the LPF Group. A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the Fund.
Publicity	That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	✔	Governance documents, policies and details of Pension Board membership are on the LPF Group's website. The LPF Group also communicates regularly with employers and scheme members.

Andrew Kerr
Chief Executive Officer
The City of Edinburgh Council
23 June 2021

Dr Stephen S Moir
Executive Director of Resources
The City of Edinburgh Council
23 June 2021

Doug Heron
Chief Executive Officer
Lothian Pension Fund
23 June 2021

REMUNERATION REPORT

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 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 us. 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 January to 31 December 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.

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.

In accordance with IAS 19, therefore, a liability has been raised as at 31 March 2021 for the two months of service which the employees have delivered with regards to the remaining vested payments in the scheme.

REMUNERATION REPORT

This obligation of LPF to make payments as a result of colleague service delivered up to 31 March 2021 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	2019/20	2020/21	Remuneration Bands	2018/19	2019/20
£50,000 - £54,999	1	-	£110,000 - £114,999	1	-
£55,000 - £59,999	1	-	£115,000 - £119,999	4	-
£60,000 - £64,999	1	4	£120,000 - £124,999	-	-
£65,000 - £69,999	1	-	£125,000 - £129,999	-	1
£70,000 - £74,999	1	2	£130,000 - £134,999	-	3
£75,000 - £79,999	-	-	£135,000 - £139,999	1	1
£80,000 - £84,999	-	1	£140,000 - £144,999	-	1
£85,000 - £89,999	1	-	£145,000 - £149,999	-	-
£90,000 - £94,999	-	-	£150,000 - £154,999	-	-
£95,000 - £99,999	-	-	£155,000 - £159,999	5	1
£100,000 - £104,999	-	2	£160,000 - £164,999	-	-
£105,000 - £109,999	2	-	£165,000 - £169,999	-	4
			Total No. of Employees	**19**	**20**

REMUNERATION REPORT

EMPLOYEES REMUNERATION

The remuneration paid to LPF's senior employees is as follows:

	Total Remuneration 2019/20	Salary, Fees and Allowances	Variable Remuneration	Total Remuneration 2020/21
Name and Post Title	**£000**	**£000**	**£000**	**£000**
Doug Heron, Chief Executive Officer (from February 2019)	136	121	36	157
Bruce Miller, Chief Investment Officer	149	116	53	169
Struan Fairbairn, Chief Risk Officer (Head of Legal, Risk and Compliance)	100	91	41	132
John Burns, Chief Finance Officer	115	87	39	126
Helen Honeyman, Head of People and Communications (from January 2020)	14	80	18	98
Total	**352**	**495**	**187**	**682**

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.

REMUNERATION REPORT

The variable remuneration shown above includes the Company variable remuneration for 2020/21 along with the Senior Management variable remuneration for 2020/21 and vested payment for the previous two assessment years. This is split as follows:

	Company Variable Remuneration 2020/21	Senior Management Variable Remuneration			Total Variable Remuneration 2020/21
		2019 Payment 3	2020 Payment 2	2021 Payment 1	
Name and Post Title	**£000**	**£000**	**£000**	**£000**	**£000**
Doug Heron, Chief Executive Officer	11	-	10	15	36
Bruce Miller, Chief Investment Officer	11	13	15	14	53
Struan Fairbairn, Chief Risk Officer (Head of Legal, Risk and Compliance)	9	10	11	11	41
John Burns, Chief Finance Officer	8	10	10	11	39
Helen Honeyman, Head of People and Communications	7	-	-	11	18
Total	**46**	**33**	**46**	**62**	**187**

The remuneration paid to our employees whose remuneration during the year exceeded £150,000 is as follows:

	Total Remuneration 2019/20	Salary, Fees and Allowances	Variable Remuneration	Total Remuneration 2020/21
Name and Post Title	**£000**	**£000**	**£000**	**£000**
Andrew Imrie, Portfolio Manager	154	110	57	167
Stewart Piotrowicz, Portfolio Manager	152	109	57	166
Ian Wagstaff, Portfolio Manager	152	109	57	166
Total	**458**	**328**	**171**	**499**

REMUNERATION REPORT

The variable remuneration shown on the previous page includes the Company variable remuneration for 2020/21 along with the Portfolio Manager variable remuneration for 2020/21 and vested payment for the previous two assessment years. This is split as follows:

	Company Variable Remuneration 2020/21	Portfolio Manager Variable Remuneration			Total Variable Remuneration 2020/21
		2019 Payment 3	2020 Payment 2	2021 Payment 1	
Name and Post Title	£000	£000	£000	£000	£000
Andrew Imrie, Portfolio Manager	11	20	13	13	57
Stewart Piotrowicz, Portfolio Manager	11	20	13	13	57
Ian Wagstaff, Portfolio Manager	11	20	13	13	57
Total	**33**	**60**	**39**	**39**	**171**

Senior officers of the City of Edinburgh Council are also fully remunerated via the Council and no additional remuneration is paid by LPF. 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 2021 remain in the company's employment is as follows:

	Payable January 2022		Payable January 2023
	2020 Payment 3	2021 Payment 2	2021 Payment 3
	£000	£000	£000
Senior Employee Variable Remuneration	36	45	45
Portfolio Manager Variable Remuneration	99	95	95
Employer National Insurance Contribution	18	19	19
Total	**153**	**159**	**159**

The amounts payable for senior employee variable remuneration over the next two years exclude amounts previously calculated for Doug Heron in respect of performance in 2019/20 and 2020/21 following his resignation from LPFE in March 2021, and subsequent foregoing of vested variable pay.

LOTHIAN PENSION FUND

REMUNERATION REPORT

Colleague Pension Entitlement

Pension benefits for colleagues are provided through the Local Government Pension Scheme.

The Local Government Pension Scheme became a career average pay scheme for colleagues 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).

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 2020/21 were as follows:

Pensionable Pay (2020/2021)	Rate (%)
On earnings up to and including £22,200 (2019/2020 £21,800)	5.5%
On earnings above £22,201 and up to 27,100 (2019/2020 £21,800 to £26,700)	7.25%
On earnings above £27,101 and up to £37,200 (2019/2020 £26,700 to £36,600)	8.5%
On earnings above £37,201 and up to £49,600 (2019/2020 £36,600 to £48,800)	9.5%
On earnings of £49,601 and above (2019/2020 £48,800)	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 a 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:

	In-year Pension Contributions			Accrued Pension Benefits	
	2019/20	2020/21		As at 31 March 2021	Increase from 31 March 2020
Name and Post Title	£000	£000		£000	£000
Doug Heron, Chief Executive Officer	32	40	Pension	5	5
			Lump Sum	-	-
Bruce Miller, Chief Investment Officer	32	39	Pension	35	3
			Lump Sum	32	2
Struan Fairbairn, Chief Risk Officer (Head of Legal, Risk and Compliance)	25	30	Pension	14	2
			Lump Sum	-	-
John Burns, Chief Finance Officer	25	28	Pension	44	1
			Lump Sum	82	3
Helen Honeyman, Head of People and Communications	4	26	Pension	-	-
			Lump Sum	-	-
Total	118	163			

The pension entitlement of the LPF Group's colleagues whose remuneration during the year exceeded £150,000 is as follows:

	In-year Pension Contributions			Accrued Pension Benefits	
	2019/20	2020/21		As at 31 March 2021	Increase from 31 March 2020
Name and Post Title	£000	£000		£000	£000
Andrew Imrie, Portfolio Manager	31	36	Pension	27	-
			Lump Sum	17	-
Stewart Piotrowicz, Portfolio Manager	31	36	Pension	22	2
			Lump Sum	-	-
Ian Wagstaff, Portfolio Manager	31	36	Pension	20	2
			Lump Sum	-	-
Total	93	108			

REMUNERATION REPORT

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 2020/21 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.

ADDITIONAL INFORMATION

Key documents online

You can find further information on what we do and how we do it, on our website at www.lpf.org.uk. To view individual policy documents, click on the links below if viewing online or visit www.lpf.org.uk/publications.

- Actuarial Valuation reports
- Pension Board constitution
- Annual Report and Accounts
- Statement of Investment Principles
- Pension Administration Strategy
- Communications Strategy
- Funding Strategy Statement
- Service Plan
- Training and Attendance policy

Fund advisers

Actuaries:	Hymans Robertson LLP, Exchange Place One, 1 Semple Street, Edinburgh, EH3 8BL
Bankers:	Royal Bank of Scotland, 36 St Andrew Square, Edinburgh, EH2 2YB
Strategic advisers:	Scott Jamieson, Kirstie MacGillvray and Stan Pearson
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

Comments and suggestions

We appreciate your comments and suggestions on this report. Please let us know which sections you found useful and if you have any suggestions for items to be included in the future. Please email your comments to pensions@lpf.org.uk.

Accessibility

You can get this document on tape, in Braille, large print and various computer formats on request. Please contact the Interpretation and Translation Service (ITS) on 0131 242 8181 and quote reference number 00819. The ITS can also give information on community language translations.

Contact details

If you would like further information about Lothian Pension Fund and Scottish Home Pension Fund, please contact us using the details on the back page of this report.

LOTHIAN PENSION FUND

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Edinburgh, EH3 1GY

Phone: 0131 529 4638
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Appendix 2

The City of Edinburgh Council

Statement on the system of internal financial control

1. This statement is provided 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 is 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 financial 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 (where the majority of finance-related controls lie), 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 November 2020 (as part of the Council's Annual Audit). This assessment did not result in the identification of any significant weaknesses in these systems.

5. As with other systems across the Council, some aspects of the financial control framework have had to be adapted to a home-working environment following the COVID-19 pandemic but with the emphasis consistently being on obtaining assurance in a different way rather than compromising or relaxing existing controls. Specific contingency plans had been developed in areas where service continuity is most crucial, including Financial Systems, Procurement, Treasury Management, Council Tax collection, Benefits Processing, Payroll and Supplier Payments. These plans have worked effectively following enforced offsite working and performance against a range of key targets in these areas has largely been maintained.

6. A number of specific finance- and procurement-related risks and corresponding mitigating actions linked to the COVID-19 emergency were identified for inclusion in the Council Incident Management Team (CIMT) Risk Management Plan and have been actively monitored during 2020/21. While the financial and economic risk category was assigned "critical" status in the period to December 2020, following confirmation that pressures had been appropriately reflected and managed and offsetting sources of funding identified, this was revised to "high" and then subsequently to "medium" later in the year, albeit with continuing implications for the Council's medium- to longer-term sustainability. Further commentary on this aspect is included later in this statement.

7. The Finance Division has also taken forward a number of specific audit actions during the year, including:

   (i) working with Digital Services, creating a Shadow ICT Register and producing associated guidance on expected content of contracts for shadow IT/cloud-based systems;

   (ii) identifying critical suppliers and supply chain-associated risks in connection with the UK's exit from the European Union;

   (iii) improving contract management arrangements for high-risk contracts;

   (iv) reconciling the NSL Apply system and CEC ledger to confirm on-going accuracy of parking fee income received;

   (v) reviewing the Council's budget-setting process, including conducting an annual "lessons learned" exercise and better aligning project management and savings template documentation; and

   (vi) improving oversight and consistency of a range of financial models.

   Progress in implementing the resulting actions is regularly considered by the Finance Management Team. As of the time of writing, there are no Finance-led actions where relevant work is not underway, with improved arrangements to track progress also now in place.

8. 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 was 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

9. 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 2020/21, 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.

10. 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 2021. Given the equivalent assessments in recent 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 necessary actions as they relate to financial systems implemented as a matter of urgency.

Elements of system of internal financial control

11. 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. This system of control has been modified, where appropriate, to take account of the impacts of the pandemic, although as noted above this has been with a view to obtaining equivalent assurance in a modified way. 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**. Given the unprecedented nature and scale of the financial challenges facing the Council in 2020/21, the frequency of reporting to the Corporate Leadership Team and elected members (through the Leadership and Advisory Panel, Policy and Sustainability Committee and Finance and Resources Committee) was greatly increased, with a focus not only on the immediate in-year position but estimated implications for the budget framework in future years. A revenue budget-setting and management internal audit undertaken in 2020 identified a number of areas of good practice but with some opportunities for improvement highlighted through the adoption of standardised documentation and procedures and regularising formal “lessons learned” exercises after each year’s process, with a corresponding action plan agreed and relevant actions currently being taken forward.
- **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. While an unprecedented level of overspend had been forecast early in the year, through a combination of savings in corporate budgets and the receipt of additional grant funding late in the year, a provisional in-year underspend of £7.9m was achieved. This sum, alongside additional carried-forward COVID-related funding and a COVID contingency created through re-alignment of the Council’s reserves, has been used to increase the budget framework’s provision for the pandemic’s on-going impacts. Despite the impacts of the pandemic, it was also encouraging to note that the proportion of approved savings delivered, at 82%, continued the improving trend from 2019/20;

- **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 August 2020;
- a **five-year revenue budget framework and ten-year capital strategy** approved by Council in February 2021. The Council's Best Value Assurance Review encouraged the Council, once the recurring impacts of the pandemic become clearer, to continue to look at opportunities to adopt medium- to longer-term financial planning and the budget revision approved by Council on 27 May 2021 marked an important first step in this process;
- **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. In recognising the scale of the pandemic's operational and financial impacts on their activities, I have also met with representatives of the Council's main Arm's-Length External Organisations (ALEOs) on a monthly basis during 2020/21, as well as regularly reporting these impacts to the Finance and Resources Committee, including two dedicated sessions to explore the issues concerned in greater depth.

12. 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.

13. 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 some embedding of actions taken in response to previous recommendations, are still required**.

14. 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 a number of actions additionally

currently 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 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 COVID pandemic and, across the piece, have performed well.

CIPFA Financial Management Code

15. An additional requirement of this year's statement is undertaking a preliminary assessment of the extent to which the Council's financial management arrangements comply with the principles set out within the CIPFA Financial Management (FM) Code. The Code is designed to support good practice and assist councils in demonstrating their financial sustainability and resilience by setting out expected standards of financial management. While 2020/21 is only a "shadow" year for implementation of the Code, all councils are encouraged to undertake an early assessment in preparation for full adoption during 2021/22.

16. This assessment, carried out with reference to the 2021/22 budget process and involving interviews with a range of key stakeholders including service directors, elected members and colleagues within partner services, has highlighted a number of recent improvements contributing positively to the Council's financial resilience and stability, including:

    (i) realigning and reprioritising the Council's reserves to enable the creation of a £16m COVID-specific contingency whilst also increasing the level of the unallocated general reserve to £25m;

    (ii) incorporating within the budget framework explicit provision for underlying service pressures and anticipated shortfalls in savings delivery, all based on detailed discussion with members of the Corporate Leadership Team;

    (iii) reflecting within the budget framework, insofar as is practicable at this stage given the on-going nature of the pandemic, increased provision for its continuing impacts, particularly for losses of income; and

    (iv) dedicated investment in prevention-related resource which, if used effectively, should make a contribution towards future years' savings requirements, as well as improving outcomes for service users.

17. These steps build on a number of aspects already in place that are conducive to enhancing the Council's longer-term financial sustainability including (i) regular reviews, reported to both CLT and elected members, of revenue and capital budget planning assumptions, (ii) close working between the CLT and the Coalition Budget Core Group and (iii) development of updated, detailed and consistently-applied guidance for Finance staff used to assess savings implementation plans and mitigation of service budget pressures.

18. While the above position reflects a number of positive aspects, I have continued to impress upon all elected members the need for additional savings proposals to be brought forward if the Council's financial sustainability is to be maintained. With this in mind, the revenue budget update report considered by Council on 27 May 2021 pointed to an anticipated incremental savings requirement of more than £50m in 2023/24 with, at this stage, no specific proposals as to how this gap will be bridged. My report therefore specifically recommended the initiation of a detailed Council-wide savings programme by Autumn 2021. As with the capital programme, where a funding shortfall of around £172m is projected over the next ten years, I will also continue to make the case for greater use of service prioritisation aligned to the three principles within the Business Plan.

19. In addition to the Council's own activities, I have also considered the immediate and potential on-going impacts of the pandemic on major projects within the city, including the St James Centre Growth Accelerator Model (GAM), Tram Extension and Edinburgh International and Conference Centre (EICC) Hotel project. There has, and continues to be, a need to revisit relevant business cases in light of these significant changes in the external environment and I will therefore keep all under active review in the coming months.

20. Consideration of the FM Code has also highlighted a number of areas where I assess further actions are potentially required going forward, including a need, in some cases, for more systematic options appraisal to be undertaken. In addition, improvements could be made to the effectiveness of current service arrangements in demonstrating value for money, including their contribution to broader Council objectives. Relevant actions will be taken forward with CLT colleagues.

21. As noted in previous sections, opportunities to adopt longer-term planning timescales will also be considered, although the extent to which this is possible may be somewhat compromised by a succession of one-year financial settlements and, at least in the short term, continuing uncertainty over the lasting impacts of the pandemic.

Hugh Dunn
Head of Finance
1 June 2021

Appendix 3

Annual Report 2021
of
Lothian Pension Fund
and
Scottish Homes Pension Fund

"Statement on the system of internal financial control for the year ended 31 March 2021"

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 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 Officer with a statement of the effectiveness of the internal financial control system of the Funds for the year ended 31 March 2021.

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 1 June 2021, 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 internal audit function for Lothian Pension Fund and Scottish Homes Pension Fund is provided by the City of Edinburgh's Chief Internal Auditor and forms part of our assurance framework. During the past year the demands for thematic assurance relating to the pandemic have caused some disruption to our audit plan and, at the time of writing, the reviews have not yet been concluded. However, we (the Funds) have been in close dialogue with our other assurance providers, who have successful concluded reviews during the year, and no material concerns have been raised in relation to our controls. On this basis and in the absence of any concerns having been raised with us by Internal Audit, suitable reliance can continue to be placed upon the LPF control environment and governance and risk management frameworks.

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

07 June 2021

Pensions Committee

2.00pm, Wednesday, 23 June 2021

Joint Investment Strategy Panel Activity

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the activities of the Joint Investment Strategy Panel during the financial year 2020/21.

Doug Heron
Chief Executive Officer, Lothian Pension Fund

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

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

Joint Investment Strategy Panel Activity

2. Executive Summary

2.1 The purpose of this report is to provide an update on the activity of the Joint Investment Strategy Panel (JISP) for the year to 31 March 2021, with a focus on the Lothian Pension Fund and the Scottish Homes Pension Fund.

2.2 To enable efficient collaboration, the three Chief Financial Officers of the Lothian, Falkirk and Fife Pension Funds established the JISP which is designed to align governance for the investment of funds. It advises the appointed officers with responsibility for oversight of the assets of the Lothian, Falkirk and Fife pension funds, currently being the Heads of Finance/CFO for the respective administering authorities.

2.3 Each Fund's Committee agreed its own bespoke investment strategy in 2018. During 2020/21, JISP has continued to advise and assist in the oversight of the three Funds' investment strategies, focusing on asset allocation, risk and performance. This includes the oversight of Lothian Pension Fund and Scottish Homes Pension Fund.

2.4 The JISP monitored and advised on the implementation of investment strategy by officers and the internal investment management team focusing on achieving targeted allocations within the constraints defined by Committee. For Lothian Pension Fund, the JISP advised in several areas, including equity manager structure and strategies, allocations to private market investments, including infrastructure and corporate loans, and potential triggers for changes to asset allocation in the light of funding level. For the fully funded Scottish Homes Pension Fund, the JISP advised on the appropriate approach to asset-liability matching.

3. Background

3.1 Over the year to 31 March 2021, the composition of the JISP changed. On the retiral of one independent adviser (Gordon Bagot), the Lothian, Falkirk and Fife funds agreed to appoint three independent advisers. Following an open selection process, Scott Jamieson was reappointed for a further term and two new independent advisers were appointed (Kirstie MacGillivray and Stan Pearson).

3.2 The JISP advisors now comprise:

- three independent advisers;
- the Chief Investment Officer of LPFI Limited (LPFI); and
- a second senior investment officer of LPFI.

3.3 The JISP provides strategic advice on the implementation of the investment strategies approved by the Committee for the two pension funds for which it is responsible – Lothian and Scottish Homes.

3.4 The JISP also provides strategic advice on the implementation of strategy for the Fife and Falkirk pension funds.

3.5 The external independent advisers on the JISP represent an important element of the governance framework, overseeing and scrutinising the investment strategies and implementation activity of the three collaborating funds.

4. Main Report

4.1 The JISP meets quarterly and provides strategic advice on all aspects of the investments of the pension funds. Regular activities include reporting to and making recommendations about investment strategy to the Committee, monitoring and advising on strategy implementation and risk and advising on the types of investment manager to utilise. The JISP ensures that important issues are reviewed on a regular basis and the agenda planning document is attached as Appendix 1.

4.2 The JISP advises on the appropriate investment management structure required to implement the Fund's investment strategy, and on the objectives and constraints appropriate to the various mandates that make up the Fund. It monitors the risk and performance of all portfolios. The JISP and the internal investment team monitor all managers on a regular basis using a traffic light system to ensure that scrutiny of portfolios is consistent and robust. Continuity of investment process, philosophy, people and ownership and performance are considered in the monitoring process. Where there are concerns over a manager, more regular and in-depth monitoring is undertaken.

4.3 The primary focus for the JISP during 2020/21 has been implementation of the investment strategies for Lothian Pension Fund and Scottish Homes Pension Fund, previously agreed by Committee, as well as implementation of the strategies of the collaborative partner funds. Each partner fund has its own bespoke investment strategy, but they are all defined in common terms, and have broadly similar objectives and strategies.

4.4 Special items addressed by Panel over 2020/21 have included:

- Review of Actuarial Valuations (2020), Funding Strategy Statements and Investment Strategy
- A fund strategy focus review of Scottish Homes Pension Fund

- Annual policy group focus reviews for Equity Assets (including carbon tracking), Real Assets (including property, infrastructure and timber), Debt Assets (including gilts, non-gilt debt and cash) and Currency Exposures and Hedging
- Annual reviews of all policy group and individual investment mandates
- Triennial reviews of internal mandates: Debt Assets, Property and Global Equity
- Annual review of all internally managed portfolios by external advisers
- Amendment of securities lending policies
- Investment cost benchmarking
- Statement of Responsible Investment Principles
- Additional voluntary contribution (AVC) provision
- JISP Terms of Reference and Effectiveness
- Stewardship and engagement activities, including ESG analysis and carbon monitoring
- Investment Controls & Compliance
- Presentation from Portfolio Evaluation

4.5 The JISP's self-assessment of its effectiveness is regarded as an important element of good governance. This is a formal review, undertaken every year using qualitative output from a survey questionnaire and quantitative output from independent sources of data. Qualitative output from the survey indicates that the JISP is operating effectively. With a slightly changed composition over the year, the survey generated fresh ideas / areas for improvement. The Committee will be asked later in the year to comment on the JISP's effectiveness to ensure all key stakeholders are satisfied with the way it is operating.

4.6 After a year of wild swings in stock market prices and valuations, the quantitative output is mixed. As described in more detail in the annual review of the Lothian Pension Fund, the returns of the fund have been very strong in absolute terms both over the year and over several years, but they now lag the benchmark returns. On the other hand, they remain above the proxy for the liabilities of the fund over the long term and the independent performance measurer demonstrates that the fund is achieving lower risk exposure than the benchmark.

4.7 Over the year, JISP's activity has resulted in:

- Continued implementation of the investment strategies of:
    - Lothian Pension Fund – activity across all policy groups, including investments in infrastructure, corporate debt and US inflation protected sovereign bonds as well as rebalancing activity in global equity portfolios
    - Scottish Homes Pension Fund - transfer of employer assets from MEG (Mature Employers Group – a Gilts-based Strategy) and increase in cash.

- Updated mandate objectives and controls for each investment portfolio and each policy group, including:
  - changes to constraints within Real Assets mandate
  - amendment to Real Assets benchmark
  - new property investment guidelines
- Introduction of the Statement of Responsible Investment Principles to improve clarity of approach and communicate more widely
- A change to agenda plans for investment strategy implementation reporting (to improve efficiency and tie in with the current investment strategy review)
- Oversight of investment activity across all policy groups
- A joint procurement process for a voting and engagement provider
- Preparatory work for the current investment strategy review
- An amended Securities Lending Policy
- Adjustments to employer strategies

4.8 Importantly, the focus of the JISP is the long-term superior risk-adjusted asset returns for the Funds. The short-term volatility of asset prices is less important given that the fund remains open to new entrants and cash flow is stable. The JISP continues to focus on deploying each fund's long-term capital at an appropriate level of risk.

4.9 Members of JISP, including external advisers, will be presenting at training events and Committee meetings over the year ahead when they will provide further detail on its activities over the year, including the 2021 review of investment strategy.

5. Financial impact

5.1 Investment strategy is a key determinant of asset returns and risk, funding level and volatility of employer contribution rates. The strategic advice of JISP influences investment strategy and implementation with the aim of achieving required risk-adjusted returns.

6. Stakeholder/Regulatory Impact

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 governance, compliance or regulatory implications as a result of this report.

7. Background reading/external references

7.1 None.

8. Appendices

Appendix 1 – Agenda Planning for Joint Investment Strategy Panel

Joint Investment Strategy Panel – Agenda Planning

This document provides an overview of the proposed agendas for future meetings of the Joint Investment Strategy Panel. It also provides a more general overview of the current cycle of Panel papers. An agenda planning document will be provided each quarter.

Some agenda items refer to Committee reports. These are generally Lothian reports, but Falkirk and Fife reports may also be presented. There will, of course, be other matters and papers that need to be brought to the attention of the Panel on an ad hoc basis.

Since September 2019, investment mandates are reviewed annually at the same time as the relevant asset class focus.

The proposed agendas for the next two meetings are set out below.

September 2021

Special Items

- Policy Group Focus, Annual Review, incl. Investment and Policy Group Mandates – Real Assets (property, infra & timber)
- Policy Group Focus, Annual Review, incl. Investment and Policy Group Mandates – Currency Exposures/Hedging
- Audit of Foreign Exchange Transaction Costs

Quarterly Items

- Investment Strategy Implementation / Funding Updates
- Investment Portfolio Monitoring (Traffic Lights)
- Asset/Liability Context – Investment Markets

December 2021

Special Items

- Policy Group Focus, Annual Review, incl. Investment and Policy Group Mandates – Debt Assets (Gilts, Non-Gilts, Cash)
- Review of Governance of Internal Portfolios by external JISP members
- Stewardship
- Pension Fund Cost Benchmarking
- AVC Monitoring – Lothian, Falkirk & Fife

Quarterly Items

- Investment Strategy Implementation/ Funding Updates
- Investment Portfolio Monitoring (Traffic Lights)
- Asset/Liability Context – Investment Markets

Future Joint Investment Strategy Panel Dates

- Monday 6 September 2021, 10.30am, TEAMS meeting or Atria One Boardroom
- Wednesday 1 December 2021, 12.30am, TEAMS meeting or Atria One Boardroom

Frequency			Month
Annually	**Fund Strategy Focus – Annual Review (to end March)**		
	Lothian Pension Fund		June
	Falkirk Council Pension Fund		June
	Fife Pension Fund		June
	Scottish Homes Pension Fund		June
	Policy Group Focus – Annual Reviews, incl. Investment & Policy Group Mandates		
	Equities (listed & unlisted), incl. Carbon Assessment		June
	Real Assets (property, infra & timber)		September
	Currency Exposures/Hedging		September
	Debt Assets (Gilts, Non-Gilts, Cash)		December
	Securities Lending Policy Review		March
	Investment Controls & Compliance (incl. custodian)	Committee Report	June
	Statement of Investment Principles & Responsible Investment Policy	Committee Reports	June
	Investment Strategy Panel – Terms of Reference & Effectiveness		June
	Audit of Foreign Exchange Transaction Costs		September
	Review of Governance of Internal Portfolios by external JISP members		December
	Stewardship	Committee Report	December
	Pension Fund Cost Benchmarking	Committee Report	December or March
	AVC Monitoring – Lothian, Falkirk & Fife		December

Appendix 1

Frequency				Month
Quarterly	Investment Strategy Implementation/Funding Updates Investment Portfolio Monitoring (traffic lights) Asset/Liability Context – Investment Markets (incl. Adviser Ideas/Recommendations)			March, June, September, December
Every 3 Years (minimum)	Investment Strategy Reviews (at least every 3 years)		Due 2024	Typically December or March
	Actuarial Valuations		Due 2023/24	
	Funding Strategy Statements		Due 2023/24	
	Internal Mandate Reviews	**Most recent review**	**Review due**	
	UK All Cap	June 2021	June 2024	March, June, September and December
	UK Mid Cap	June 2021	June 2024	
	Europe ex-UK	June 2016	December 2022	
	US	March 2019	March 2022	
	GLOVE	March 2021	March 2024	
	GHDY	March 2021	March 2024	
	SMuRV	March 2021	March 2024	
	Debt Assets	December 2020	December 2023	
	Property	June 2020	September 2023	
As required	Development Work Transitions			

Pensions Committee

2.00pm, Wednesday, 23 June 2021

Annual Investment Update – Lothian Pension Fund

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the asset allocation, investment performance and funding update of the Lothian Pension Fund.

Bruce Miller
Chief Investment Officer, Lothian Pension Fund

Contact: Stewart Piotrowicz, Portfolio Manager, Lothian Pension Fund

E-mail: stewart.piotrowicz@edinburgh.gov.uk | Tel: 0131 469 3843

Annual Investment Update – Lothian Pension Fund

2. Executive Summary

2.1 This report provides an update on the investments and funding position of the Lothian Pension Fund to 31 March 2021.

2.2 Over the twelve months to 31 March 2021, investment market returns were dominated by the rebound in equities following the pandemic-induced market decline in the first quarter of 2020. Global listed equities, as measured by MSCI ACWI (in GBP) rose by an unusually large 38.9% over the twelve months to March 2021, more than recovering the unusually large losses in Q1 2020. Lothian's predominantly lower risk equities unsurprisingly lagged this measure but still gained an impressive 26.8%. The Fund's other asset classes were lacklustre by comparison with real assets (mainly infrastructure and property) broadly flat (-0.6%), non-gilt debt gaining a modest 1.7%, and gilts – a good proxy for Fund liabilities - rising by 3.9%. As a result, while overall Fund returns were strong at +15.5%, this notably lagged the more volatile benchmark gain of 24.0%.

2.3 The Fund aims to achieve a return in line with its strategic benchmark, over the long term, with a lower-than-benchmark level of risk. The extremes of the last twelve months have impacted longer-term figures. Over five years, the Fund has delivered returns below the benchmark, but with lower risk, having returned +8.5% per annum compared with the benchmark +11.8% per annum (with ex-post risk of 7.7% for the Fund vs. benchmark risk of 8.8%). Over ten years, the Fund has gained 8.8% p.a., lagging the benchmark gain of 9.4% p.a., but with lower risk (ex-post risk of 7.2% vs. 8.0%).

2.4 Lothian Pension Fund's funding level (the ratio of assets to liabilities) was 106% at the March 2020 valuation, an improvement from the 98% as at 31 March 2017. Following receipt of these results and discussions with employers, work is now underway to determine potential changes to investment strategy.

3. Background

3.1 The purpose of the report is to provide an update on the investments and funding position of the Lothian Pension Fund to 31 March 2021.

3.2 The investment performance of the Fund has a significant impact on the funding level and potentially on the contributions required by employers.

3.3 The objective of the Fund's overall investment strategy is the achievement of the return assumed by the Actuary in excess of the gilt return that is consistent with acceptable and stable contribution rates. With such a return, it is expected that the Fund will be able to pay pensions as they fall due.

3.4 For reporting purposes, Fund assets are divided into five Policy Groups, which are broad asset classes that reflect the nature of the investments. Although individual investments within each group will have different risk and return characteristics, each Policy Group targets a long-term return in relation to the return from UK gilts. The return target provides perspective on the expected risk of each group in relation to Fund liabilities. These are detailed in the Statement of Investment Principles.

3.5 In order to provide suitable investment strategies for the differing requirements of employers, the Fund now operates four investment strategies. The assets in each strategy are shown in the table below. Employers fund their liabilities with the strategy that reflects their ability to tolerate risk.

Investment Strategy	Assets (£m)	Weight
Main Strategy	7,887	91%
Mature Employer Strategy	80	1%
50/50 Strategy	75	1%
Buses Strategy	578	7%
Total	8,619	100%

At end March 2021

3.6 Most employer liabilities are funded under the Main strategy, which adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer. The strategy retains significant exposure to real investments, such as Equities and Infrastructure, which have a history of protecting or enhancing purchasing power over the long term.

3.7 A small number of employers are funded in the Mature Employer strategy (MEG), which invests in a portfolio of UK index-linked gilts and cash to reduce funding level and contribution rate risk as these employers approach exit from the Fund.

3.8 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 Employer strategy.

3.9 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 and reflects the specific circumstances and increasing maturity of liabilities for this employer.

3.10 The four investment strategy allocations to the five Policy Groups at 31 March 2021 are presented in the table below.

Policy Group	Main Strategy	Mature Employer Strategy	50/50 Strategy	Buses Strategy
Equities	65%	0%	33%	35%
Real Assets	18%	0%	9%	18%
Non-Gilt Debt	10%	0%	5%	20%
Gilts	7%	100%	54%	28%
Cash	0%	0%	0%	0%
Total	**100%**	**100%**	**100%**	**100%**

Totals may not sum due to rounding

3.11 Implementation of the investment strategy is delegated to the Executive Director of Resources, who in turn delegates to the Head of Finance, who takes advice from the Joint Investment Strategy Panel (JISP), comprising independent advisers and senior officers from LPFI Limited, the Fund's FCA authorised investment vehicle. The JISP assesses the underlying risks and the long-term objectives of the Fund.

3.12 The Fund has expanded its internal team over recent years and over 2020/21 added an experienced portfolio manager within the real assets team and two graduate trainees to increase depth and breadth to the existing structure and develop increased capabilities for the long term.

4. Main Report

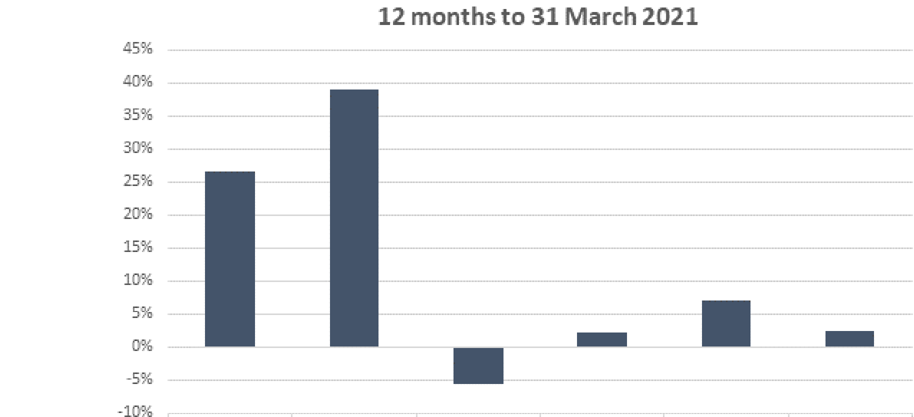
Market background to 31 March 2021

4.1 For the 12 months to 31 March 2021, UK equities (FTSE All Share) returned +27%, while global equities (MSCI ACWI, in GBP) returned +39%. The rise in global equities for sterling-based investors was offset by a stronger pound (global equities returned +51% in local currency terms). Sterling had weakened sharply alongside equity markets in March 2020 in response to the widening COVID-19 (coronavirus) pandemic, before stabilising and then strengthening over the period as risk assets recovered.

4.2 Credit spreads, which had spiked higher when equity markets sold off in March 2020, recovered strongly ending the period close to their pre-crisis lows. Government bond yields re-tested lows in May 2020 before rising gradually over much of the year, spiking higher on vaccine developments in November then accelerating further on fiscal stimulus expectations with the confirmation of Democratic candidate Joe Biden as US president-elect in December.

4.3 As vaccine roll-outs gained momentum, with the UK to the fore, rising economic optimism supported risk assets, such as equities. Commodity prices also rose as manufacturing activity continued to recover and investor attention, in the latter part of the period, turned increasingly towards recovery sectors such as retail, property, travel and leisure, which had been most negatively impacted by lockdowns. Inflation expectations moved sharply higher in the first quarter of 2021, which caused bond yields to rise and prices to fall.

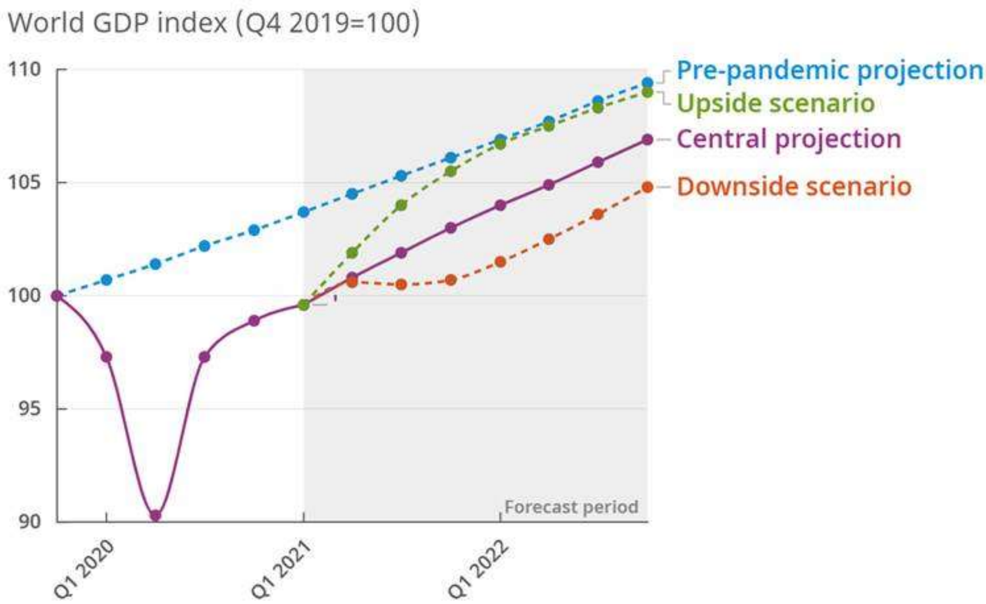
4.4 The graph below shows index returns over 12 months to 31 March 2021 for a range of asset classes.



	UK equities	Global equities	Gilts	Index-linked Gilts	Investment Grade Bonds	UK Property
12 month return (£)	26.7%	38.9%	-5.5%	2.3%	7.0%	2.5%

Source: FTSE, Bloomberg, MSCI, Portfolio Evaluation

4.5 The speed with which economies have recovered from the COVID-19 downturn is shown in the World GDP index chart below, alongside the most recent March 2021 forecasts by the OECD. The latest projections provide a much more optimistic outlook than most would have envisaged 12 months ago during the depths of the downturn. The recovery was aided by unprecedented levels of monetary and fiscal support, which cannot be sustained indefinitely; market participants will need to deal, at some point, with the prospect of that support tapering off.



Source: OECD Interim Economic Outlook, March 2021

Asset Allocation and Strategy Implementation

4.6 As described above, the overall Fund strategy is made up of four investment strategies. The strategic allocations, which are the weighted average of the four employer strategies, are shown in the table below along with the actual allocations.

Policy Group	Actual Allocation 31 March 2020	Actual Allocation 31 March 2021	Strategic Allocation 31 March 2020	Strategic Allocation 31 March 2021
Equities	58.3%	60.0%	62.0%	62.1%
Real Assets	22.0%	18.2%	17.7%	17.7%
Non-Gilt Debt	7.8%	9.2%	10.5%	10.5%
Gilts	6.9%	5.6%	9.8%	9.6%
Cash	4.9%	7.1%	0.0%	0.0%
Total	100%	100%	100%	100%

Note: numbers may not sum due to rounding

4.7 Over the year, the actual allocation to Equities has risen modestly. We took the opportunity to add to equities in mid-March 2020. Modest profit-taking and ongoing income withdrawal from the three internal global portfolios since then has not fully offset equity strength, resulting in a modestly increased weighting and a marginally below strategy allocation as the funding level has improved. Exposure to Real Assets has reduced in weight over the year predominantly as a result of the exceptional 27% gain in equities over the last twelve months against broadly flat performance from real assets. The Non-Gilt Debt allocation has increased as the Fund strives to improve diversification and secure returns in excess of gilt yields. The actual allocation increased from 7.8% to 9.1% with additional investment in investment grade corporate bonds and a new allocation to US TIPS, which are designed to provide some protection against unexpected inflation. Gilt yields remain unattractive and the Fund remains underweight. The Cash weighting is available to invest when attractive investments become available in the other Policy Groups. The actual allocations lie within the permitted ranges defined in the Statement of Investment Principles (SIP).

4.8 The Fund implements strategy by allocating to several investment mandates across the five Policy Groups. Most assets are managed by Lothian's internal investment team, but external mandates are awarded where access to investments is not available to the internal team, for example in private markets where the Fund achieves investment exposure to assets such as infrastructure and timber through externally managed investment vehicles. The table below details the actual allocations to Policy Groups and investment mandates.

Policy Groups and Investment Mandates – 31 March 2020 and 31 March 2021

Policy Groups & Mandates	Manager	Actual Allocation 31 March 2020	Actual Allocation 31 March 2021
EQUITIES		**58.3%**	**60.0%**
Global Low Volatility	Internal	**13.2%**	**13.1%**
Global High Dividend Yield	Internal	**13.7%**	**13.4%**
Global Stable Multi-factor	Internal	**12.1%**	**13.7%**
Global Stable Equities	Nordea	**3.9%**	**3.5%**
Global Value	Harris	**2.4%**	**1.4%**
Global Alpha	Baillie Gifford	**1.6%**	**2.2%**
UK All Cap	Internal	**2.9%**	**3.1%**
UK Mid Cap	Internal	**1.2%**	**1.6%**
Europe (ex UK) Quality	Internal	**2.7%**	**2.7%**
US Value	Internal	**2.7%**	**3.4%**
Private Equity	Various	**1.7%**	**1.7%**
Currency Hedge	Internal	**0.2%**	**0.0%**
REAL ASSETS		**22.0%**	**18.2%**
Property	Various	**7.4%**	**6.4%**
Other Real Assets	Various	**14.7%**	**11.8%**
NON-GILT DEBT		**7.8%**	**9.2%**
Other Bonds	Various	**7.8%**	**9.2%**
GILTS		**6.9%**	**5.6%**
Index-linked Gilts	Internal	**6.9%**	**5.6%**
CASH		**4.9%**	**7.1%**
TOTAL FUND		**100.0%**	**100.0%**

Note: numbers may not sum due to rounding

Equities

4.9 The current equity investment strategy has remained broadly unchanged for several years now. While there were no new or complete sale of existing mandates, there were more allocation changes over 2020/21 than would be typical. This was as a result of extreme market movements.

4.10 Approximately £62m was added to the SMuRV portfolio in Q3'20 and a further £73m in Q4'20 as we re-invested some of the dividends from the global portfolios. Additionally, having added in excess of £120m in total to the UK All Cap & European portfolios in the middle of March 2020, near the market bottom, we took advantage of the subsequent extreme rally to take profits both here and elsewhere. The Europe ex-UK portfolio was reduced in Q4'20 (~£63m) alongside a reduction in Harris (~£50m). During Q1'21 we also took the opportunity to further reduce equities on strength (Harris ~£110m, Nordea £60m, UK All Cap £60m).

4.11 The Equity policy group is expected to perform relatively well when equity markets are weak and produce good positive absolute returns in rising equity markets, whilst providing attractive levels of income.

4.12 None of the Fund's equity portfolios are constrained by market capitalisation indices, or the tracking error measurement of risk, which is regarded as a suboptimal approach to portfolio construction. Instead, the focus is on capital preservation and the sustainability of income generation. The Fund's independent performance measurer, Portfolio Evaluation, reports that the Fund's equity risk over the last 1, 3 and 5 years was between 90% and 92% of benchmark risk.

4.13 As of 31 March 2021, approximately 88% of the Fund's listed equities are managed internally with the majorityof these in low cost, low turnover strategies, which are expected to enhance the Fund's risk-adjusted returns over the long term.

4.14 The Fund also hedges exposures to the currencies of overseas listed equities with the explicit aim of reducing volatility rather than seeking to generate improved returns. The Fund therefore maintains exposure to currencies that are expected to reduce volatility, such as the US Dollar and Japanese Yen which tend to fall as equities rise, and hedges exposure to currencies that are expected to increase volatility, such as the Australian Dollar which tends to rise as equities rise

4.15 Given the focus on risk reduction, new commitments to private equity investments were discontinued as they tend to be more volatile investments involving greater financial leverage. As historic investments mature, cash is being returned though strength in listed private equity over the last 12 months (+44.3%) has resulted in allocation remaining unchanged over the year at 1.7%.

Real Assets

4.16 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 whilst providing diversification. 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 Asset investments.

4.17 The Fund's actual allocation has decreased this year from 22% to 18%, which, in a reversal from last year, is predominantly attributable to the performance relative to equities rather than a net decrease in investments. Property, infrastructure and timber asset values were broadly unchanged over 12 months versus notable gains for the Fund's equities (+27%).

4.18 During 2020/21, several investment opportunities were appraised, resulting in approximately £86m being invested in UK, European and global infrastructure assets. Investments were made to five secondary fund / co-invest interests and one co-investment. Proceeds of £168m were distributed to the Fund over the year, including two very successful realisations. The exposure to infrastructure decreased to 10.4% from 12.9% of the Fund's investment value.

4.19 Likewise, the actual allocation to Property decreased from 7.4% to 6.4% almost entirely due to relative movements in asset prices (equity strength). Several investment opportunities were appraised although the impact of the pandemic on the property investment market was profound. The restrictions on travel made carrying out due diligence very difficult and near impossible during lockdowns. This caused many investors to pause activity and, with the exception of industrials and distribution, there was a marked decrease in activity across the main sectors. Transactions activity fell c20% year on year in 2020 although, for context, this was no worse than the declines in both 2016 and 2019, when Brexit uncertainty hit transactions. The Fund made one new commercial real estate purchase – a prime distribution unit let to the Scottish government. There were no sales in the period.

4.20 Despite the small change in the portfolio, there has been considerable activity relating to this asset class:

- as many tenant's revenue streams disappeared overnight as a result of the COVID-19 lockdown, an unexpected challenge arose to determine the best long-term approach to managing the situation. Through direct engagement with tenants a number of agreements were reached to extend leases and remove break options in return for rent deferments and other concessions. This assisted tenants through the most vulnerable period and maximised tenant retention for the longer term. This also supported valuations. The impact of non-payment and rent concessions on fund cash flows has been reflected to a degree in valuations since March 2020. There were a number of tenant failures, most notably in the leisure sector.
- the small team of property professionals has improved working practices and quality of service provision with key suppliers remotely.
- many asset management initiatives were undertaken to reduce void exposure and secure income returns; and
- 100 St John St, the fund's flagship development and largest asset, is now 65% let having been 100% vacant at the point of handover from ASI. The biggest letting accounts for 50% of take-up and completed in August.

4.21 The smallest sub-category in the Real Assets policy group is timber. Valuations were relatively resilient. One new commitment was made during the year; funding is due to complete in Jun/Jul 2021. The investment weighting decreased from 1.7% to 1.4%.

Non-Gilt Debt

4.22 The Non-Gilt Debt allocation has been increasing modestly 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 2020/21 from 7.8% to 9.2% with additional investment in investment grade corporate bonds and a new allocation to US TIPS to provide additional diversification and an element of inflation protection. Given very low sovereign bond yields and historically low spreads in credit markets, the Fund remains below the long-term strategic allocation.

Gilts

4.23 The Fund's allocation to Gilts declined over the year, from 5% to 4.2%, which in common with the Non-Gilt Debt allocation remains below the long-term strategy target of 10%. There were no significant changes over 2020/21. The UK government confirmed plans to align the RPI with the CPI from 2030, following a consultation with bondholders in which we took part. The Fund retains exposure, as index-linked gilts provide some insurance against an unexpected rise in inflation and a return broadly in line with the Fund's liabilities. However, having benefitted from uncertainty following the EU referendum and subsequent Brexit, real yields and inflation expectations are comparatively low and high respectively in an international context. As a result, the Fund added to diversification within the Non-Gilt Debt allocation instead.

Unfunded Commitments

4.24 Across a number of policy groups, the Fund makes commitments to unlisted investments and the timing of these can be uncertain as it depends on the manager being able to purchase assets. Details of outstanding commitments at 31 March 2021 are shown in the table below. Unfunded commitments of £220m compares with £255m at 31 March 2020.

Unlisted Unfunded Commitments	£m	% of Fund assets
Private Equity	33	0.4%
Infrastructure	87	1.0%
Timber & Agriculture	54	0.6%
Real Estate	2	0.0%
Private Debt	45	0.5%
Total Commitments	**220**	**2.6%**

Investment performance to 31 March 2021

4.25 The Fund's performance over the last year and over longer-term timeframes is presented in the table below, both relative to benchmark and with other relevant long-term measures - a liability proxy (over 15-year gilts index) and two inflation measures, the consumer price index (CPI) and average weekly earnings (AWE)

	1 Year	5 Years	10 Years
Lothian Pension Fund	15.5%	8.5%	8.1%
Benchmark	24.0%	11.8%	9.4%
Relative	*-8.5%*	*-3.3%*	*-1.3%*
Liability proxy	-10.4%	4.8%	7.9%
Consumer price index (CPI)	0.7%	1.8%	1.7%
Average Earnings (AWE)	4.1%	2.7%	2.2%

4.26 The Fund return over the twelve months to March 2021 was very strong in absolute terms though notably weak relative to benchmark. This was broadly driven by equities where the global index (MSCI ACWI in GBP) gained 38.9% over the period. In-line with strategy, the Fund's broadly lower risk equities lagged this market strength, gaining a still respectable 26.8% over the period. This has significantly impacted the five-year figures. The Fund's objective is to meet the strategic benchmark return over five and ten-year periods with lower risk. Given the recent negative relative returns, the Fund is now 3.2% p.a. behind benchmark over five years (+8.5% vs. +11.8%) and a more modest 0.6% p.a. behind over ten years. It is important to highlight that absolute returns are strong. These returns have been achieved with lower levels of volatility (approximately 90% of benchmark risk). In contrast, UK CPI and AWE have grown at low and relatively stable rates for many years and the Fund has continued to perform ahead of the proxy for liabilities.

4.27 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. Over the period since the change in structure, the Fund's returns have been delivered with lower volatility than the benchmark.

4.28 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. While historically this evidence has shown a pattern very much in-line with expectations, the impact of the pandemic, lockdowns and associated market action (where work-from-home stocks thrived) over the last 12 to 18 months has impacted the numbers significantly. From March 2016 to March 2021, the Fund performed:

- better than the strategic allocation when markets fell (18 out of 60 months) with average performance of 0.1% better than the strategic benchmark and,

- worse than the strategic allocation when markets were rising (42 out of 60 months) with average performance 0.4% behind the strategic benchmark, demonstrating that the Fund is positioned relatively defensively, in line with strategy, and is generally expected to deliver outperformance when equity market returns are poor.

4.29 The returns from the Fund's broad asset class benchmarks over 1 and 5 years are as follows:

Policy Group	1 Year (%)		5 Year (% pa)	
	Fund	**Benchmark**	**Fund**	**Benchmark**
Equities	26.8	38.9	9.5	14.1
Real Assets	-0.6	-1.9	7.5	7.3
Non-Gilt Debt	1.7	7.2	5.2	4.5
Gilts	3.9	3.6	7.4	7.3
Total Fund Return	15.5	24	8.5	11.8
Total Fund Risk	10.1	11.4	7.7	8.8

4.30 In the table above, it is the equity returns that really catch the eye. While the Fund's equities produced a very respectable 26.8% gain over the last 12 months and 9.5% p.a. over the last 5 years, these returns are notably behind benchmark. With such exceptional gains, well above long-term history or long-term expectations for equity returns, it should be unsurprising that Lothian's lower risk equities have lagged. It is absolute returns that help to pay pensions and by focusing on lower risk equities, the Fund has been able to have greater exposure to this asset class than might otherwise be the case. Over the last 5 years, and over the long-term, equities tend to produce superior returns to the alternative assets.

4.31 Other asset classes returns were modest over 12 months with good mid to high single-digit gains evident over the last 5 years.

4.32 Over the year to 31 March 2021, notable performance within each policy group was as follows:

- The Fund's equity investments all produced very strong gains, rising from the pandemic-induced lows back in March 2020. While the strategic, lower volatility portfolios performed well, they notably lagged returns delivered elsewhere. Standouts were Harris global equity (+67.8%) and Baillie Gifford Global Alpha (+56.8%) but also the internally managed UK Mid Cap (+58.3%), Europe ex-UK (+54.1%), UK All Cap (+53.5%) and US (+45.6%) equity portfolios.
- The Fund's Real Assets allocation returned -0.6% over the year. Returns from listed infrastructure (+7.0%) were reasonable with more muted results

elsewhere - infrastructure limited partnerships (-0.7%), timber & agriculture (-5.9%) and property returns (+0.3%).

- The Fund's Non-Gilt Debt exposure produced a return of +1.7% over the year, with underlying mandates performing in line or above expectations, but the allocations to more defensive credit (Legal & General AAA-AA-A Fund, +4.2%), US TIPS (internal, -2.0%) and Private Debt (+1.9%), lagged the returns of the policy group benchmark (Non-Gilts £ Index + 0.2%, +7.2%).
- The Fund's Index-Linked investments delivered a return of +3.9% over the year, broadly in line with benchmark as expected, with the holdings managed on a passive basis.

4.33 Returns relative to the benchmark over a one-year period need to be placed in the context that there are no ideal benchmarks for many of the assets held in the Fund, especially within the Real Assets policy group and more broadly across the various unlisted investments. The true value and returns on unlisted investments will not be known until assets are realised, perhaps not for several years.

Scrutiny & Transparency of Investments

4.34 Details of the Lothian Pension Fund's investments are reported regularly, both in Committee reports and in the Annual Report & Accounts, both of which are publicly available. The Fund is also subject to regular Freedom of Information requests to which it responds promptly. A complete list of holdings is also made available on the Fund's website.

Funding Level Update

4.35 The funding level is the ratio of the pension scheme's assets to liabilities. The most recent triennial actuarial valuation estimated the funding level at 31 March 2020 to be 106%, a notable improvement from the 98% reported at the 31 March 2017 valuation.

4.36 Following the results of the 2020 valuation, officers and advisers have been assessing whether changes to investment strategy are required and this is the subject of another paper on the agenda.

Conclusions

4.37 Over the year, the Fund's strategic allocation to the different policy groups are broadly unchanged. The actual allocation to Equities has risen following notable equity market strength, while Non-Gilt Debt exposure has risen as a result of additional investment in investment grade corporate bonds and a new allocation to US TIPS. The weighting to Gilts and Real Assets has fallen due to relative market movements (aforementioned equity strength).

4.38 The equity allocation remains slightly below the strategic target at 31 March 2021 (-2.1%), with further underweight exposures to non-gilt debt (-1.3%) and gilts (-4.0%). Real assets (+0.5%) and cash (7.1%) were above strategic target. The allocations are all comfortably within permitted ranges.

4.39 The most significant investment activity during the year were the ~£230m equity reduction in Q1 2021 following notable strength; continuing purchases of infrastructure assets and purchases of non-gilt debt assets to further diversify the portfolio; and the sale of gilts reflecting the long term valuation impact of government plans to align RPI with CPI.

4.40 The absolute performance of Lothian Pension Fund over the twelve-month period was +15.5%. Five-year performance is +8.5% per annum. Over ten years, the Fund returned +8.1% per annum.

4.41 While the returns for the 12-month to end March 2021 are strong in absolute terms, they are notably behind benchmark (+15.5% vs. +24.0%). This is mainly as a result of the Fund's lower risk equity exposure lagging a very strong market (+26.8% vs. +38.9%). This has impacted longer term returns with both five and ten-year figures behind benchmark, though strong in absolute terms. These returns have been achieved at lower than benchmark risk, broadly in-line with strategy.

4.42 The most recent triennial actuarial valuation estimated the funding level at 31 March 2020 to be 106%, an improvement from the 98% reported at the 31 March 2017 valuation.

5. Financial impact

5.1 The report details the investment performance and funding position of Lothian Pension Fund. The investment performance has a significant impact on the funding levels and potentially on the contributions required from employers.

6. Stakeholder/Regulatory Impact

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 governance, compliance or regulatory implications as a result of this report.

7. Background reading/external references

7.1 None.

8. Appendices

None.

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Pensions Committee

2.00pm, Wednesday, 23 June 2021

Annual Investment Update – Scottish Homes Pension Fund

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the asset allocation, investment performance and funding update of the Scottish Homes Pension Fund.

Bruce Miller
Chief Investment Officer, Lothian Pension Fund

Contact: Ross Crawford, Portfolio Manager, Lothian Pension Fund

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Annual Investment Update – Scottish Homes Pension Fund

2. Executive Summary

2.1 This report provides an update for the year to end March 2021 on the strategic allocation and the invested assets of the Scottish Homes Pension Fund (the Fund).

2.2 As reported at the March 2021 Pensions Committee meeting, the funding level of the Scottish Homes Pension Fund at 31 March 2020 was 117.7%, an increase from 104.7% at the 2017 valuation.

2.3 In line with the Scottish Government's guidance, the Fund's objective is to minimise the investment shortfall risk of assets relative to liabilities. Accordingly, the Fund's assets comprise UK gilts and cash as closely matched to the estimated liability payments as possible.

3. Background

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

3.2 The Guarantee and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilities are maturing over time.

3.3 The Target Funding Level (TFL), as set out in the Guarantee, was 94.5% at 31 March 2020, the date of the last formal actuarial valuation, with a target of being 100% in 2044. The Actual Funding Level (AFL) at 31 March 2020 was 117.7%.

3.4 As the AFL was above the TFL, no deficit contributions are required from the Scottish Government (as Guarantor) for the period April 2021 to March 2024. The Guarantor is, however, responsible for meeting the cost of administration and oversight and governance. Investment expenses will be met from the current funding surplus.

4. Main Report

Funding Level

4.1 As reported at the March 2021 Pensions Committee meeting, the funding level of the Scottish Homes Pension Fund at end March 2020 was 117.7%, an increase from 104.7% at the 2017 valuation. The increase in funding level reflects actuarial revisions to financial and demographic assumptions based on actual experience over the three years as well as changes to asset values, which are not a perfect match for liability values.

4.2 As full funding had been achieved faster than expected, the Scottish Government was consulted over future funding options. It decided not to change the Funding Agreement, and so the investment strategy to minimise investment risk is retained.

Investment Objective

4.3 Given achievement of full funding, the Committee approved the following 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.

There is no change to that objective.

Investment Strategy

4.4 The strategic allocation to bonds (UK gilts) is essentially 100%. The actual allocation is shown in the table below.

	Actual Allocation	
Asset Class	**31 March 2020**	**31 March 2021**
Gilts	**99.2%**	**90.5%**
Index-Linked Gilts	*63.6%*	*60.1%*
Nominal Gilts	*35.6%*	*30.4%*
Cash	**0.8%**	**9.5%**
TOTAL	**100%**	**100%**
Asset Value (£)	**£163m**	**£156m**

4.5 A detailed analysis of the Fund's liabilities was undertaken during 2018/19 to ensure that the invested assets were as closely matched with the liability profile as possible, taking into consideration the expected duration of liabilities and whether they are fixed or index-linked in nature. This resulted in an increase in holdings of nominal gilts and a decrease in index-linked gilts to achieve a closer asset-liability match.

4.6 At end March 2021, the fund's assets are matched with the duration of the liabilities. The fund's strategy is to match the cash flows of liabilities one year beyond the date of the next valuation and to match the duration of liabilities beyond that. This is because of the greater visibility of pension payments in the near term. Over the longer term, funding levels are subject to the actuary's financial and demographic assumptions of future experience, which are re-examined every three years. Some rebalancing of the fund's assets will be undertaken early in the new financial year to ensure that liabilities are cash flow matched until 2024.

4.7 At end March 2021, the funding level is estimated to be broadly similar to the position at the end March 2020 valuation.

4.8 As the Fund is mature, it must redeem maturing assets to pay pensions. Cash or cash equivalents are held to enable pensions to be paid in between the dates that gilts redeem. Over 2020/21, £7.2m was redeemed to pay pensions, which compares with the Fund value of £156m at the end of March 2021.

4.9 Being fully funded, the fund invests excess cash in short-dated bills and gilts. To avoid paying interest or taking undue interest rate risk on negative yielding assets, the fund increased the proportion of cash over the year. The cash balance at end March 2021 was equivalent to approximately two year's pension payments.

Transfer of employer - Homeless Action Scotland

4.10 The transfer of the assets and liabilities relating to former Lothian Pension Fund employer Homeless Action Scotland ("HAS") took place on 4 June 2020. At Scottish Ministers' direction, Scottish Homes Pension Fund was substituted as the appropriate fund for HAS. The actuary calculated the remaining liabilities that remained on cessation at £641,000.

5. Financial impact

5.1 The financial impact for the Scottish Government is described in paragraph 3.4. The funding level of the Scottish Homes Pension Fund, which depends on relative changes to asset and liability values, affects the contributions required from the Scottish Government. Lothian Pension Fund recovers expenses for administering and managing the Fund.

5.2 The Scottish Government's decision not to change the funding agreement provides greater certainty of the funding level, but at a potentially higher long-term cost.

6. Stakeholder/Regulatory Impact

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 governance, compliance or regulatory implications as a result of this report.

7. Background reading/external references

7.1 None.

8. Appendices

None.

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Pensions Committee

2.00pm, Wednesday, 23 June 2021

Investment Strategy Review

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 Approve (amendments to) the investment strategy as outlined in paragraphs 4.32 to 4.34

Doug Heron
Chief Executive Officer, Lothian Pension Fund

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

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

Investment Strategy Review

2. Executive Summary

2.1 The purpose of this report is to provide the conclusions of the review of investment strategy of the Lothian Pension Fund (the Fund) and to ask Committee to approve the long-term investment strategy.

2.2 The proposed strategy makes minor amendments to the current strategy, including a name change for one Policy Group (paragraph 4.7) and changes to the Policy Group weightings and permitted ranges (paragraph 4.32), including a 5% reduction in Equities.

2.3 The review of strategy has been undertaken in cooperation with the Falkirk and Fife Pension Funds, taking advice from the Joint Investment Strategy Panel (JISP) and Hymans Robertson.

2.4 The proposed strategy aims to balance this Committee's assumed aim for contribution stability (which is affected by the actuarial assessment of funding level every three years), against the need to generate positive real returns from invested assets to pay pensions over a long time horizon. Stability in the actuarial assessment of the funding level is achieved by owning assets that match the discount rate that the actuaries use to calculate the current value of liabilities – essentially UK gilts. The strategy, therefore, balances the fact that gilts are currently priced to produce negative real returns, which will act as a drag on future returns, with the assumption that other financial assets will generate positive long-term returns.

2.5 The JISP advisers note that the central scenario of the asset liability model (ALM) provided by our investment consultant, Hymans Robertson, assumes a significant rise in gilt yields (involving a corresponding fall in capital value). They believe that it would be most appropriate to consider buying into gilts as this is realised rather than to anticipate the rise.

3. Background

3.1 The Fund undertakes an in-depth review of its investment strategy following the completion of its triennial actuarial valuations. This enables consideration of the actuary's updated assumptions. The Committee reviewed the recently completed actuarial valuation dated 31 March 2020 at its meeting in March 2021. The investment strategy review described in this report was able to consider developments in the funding level and financial market developments to end March 2021.

3.2 The investment strategy of a pension fund has a significant impact on its investment performance, funding level and employer contribution rates. Setting strategy is therefore a major decision for the Pensions Committee.

3.3 The review has been undertaken in collaboration with Falkirk and Fife Pension Funds, working with the JISP and Hymans Robertson. A joint event was held for the Committees and Boards of the three funds on 11 June to provide background information, and to discuss, this review.

3.4 The Pensions Committee of each fund is responsible for determining its own investment strategy and monitoring implementation of that strategy and its success. Given that the funding position and cash flow outlook of each fund is different, the investment strategy of each fund may be different.

3.5 LPF's Committee delegates implementation of investment strategy to the Executive Director of Resources and in turn the Head of Finance taking advice from the JISP. The Head of Finance works with the officers to implement and monitor strategy, which includes the regular quarterly meeting of the JISP advisers.

3.6 The Fund constituted the JISP to provide strategic advice. Its three external independent advisers, Scott Jamieson, Kirstie MacGillivray and Stan Pearson, have been supported by Lothian's internal investment team and Hymans Robertson in this investment strategy review. Hymans Robertson undertook asset liability modelling (ALM), which tests potential investment strategies, and quantifies the probabilities of achieving objectives. JISP advisers will attend this meeting and will be available to comment further on the proposed strategy.

3.7 In order to provide suitable investment programmes for the differing requirements of employers, the Fund currently operates four investment strategies.

Table 1

Investment Strategy	Assets (£m)	Weight
Main Strategy	7,887	91%
Mature Employer Strategy	80	1%
50/50 Strategy	75	1%
Buses Strategy	578	7%
Total	8,619	100%

At end March 2021

3.8 Most employer liabilities are funded under the Main Strategy, which maintains a significant exposure to real investments, such as equities, which have a history of protecting and enhancing real purchasing power. This reflects the fact that the fund is open to new entrants, so these employers have long duration liabilities that continue to grow. Indeed, without real growth in the investments, contributions would need to be significantly higher to meet these new liabilities. Volatility of returns associated with these real investments is less important when liabilities are long in duration and so funding level variability is less important though not unimportant.

3.9 The other three employer strategies are maintained because the duration of liabilities of some employers are relatively short. The Buses company has closed to new entrants and so the fund is maturing and a more appropriate asset strategy to fund liabilities is in place. The Mature Employers Group (MEG) is invested entirely in index-linked gilts and cash to match assets and liabilities and eliminate funding level variability as much as possible. The 50:50 strategy combines the Main and MEG Strategies in 50:50 proportion, reflecting the relative maturity of those employers and the duration of their liabilities.

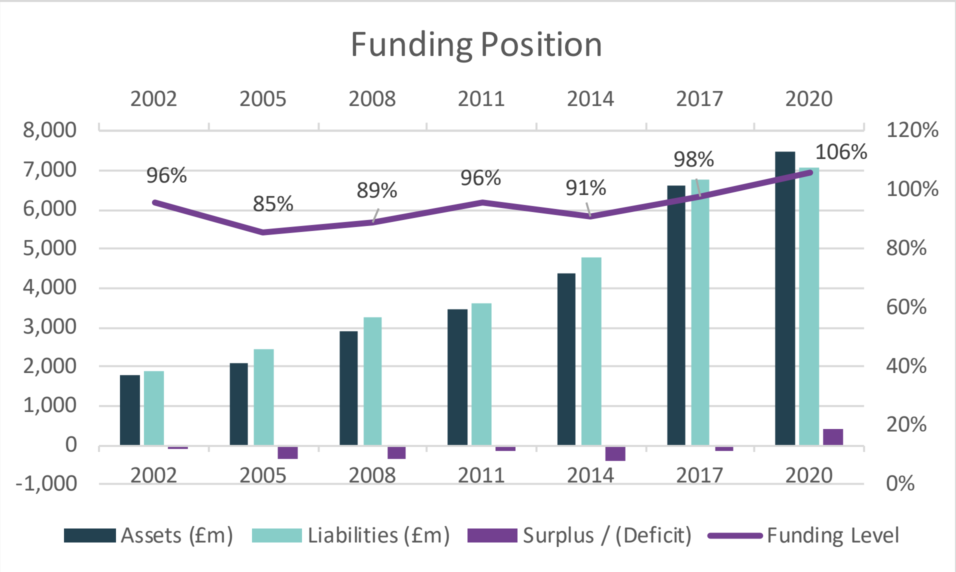
4. Main Report

Funding Position

4.1 The investment strategy of a pension fund has a significant impact on its investment performance, funding level and employer contribution rates. Setting strategy is therefore the major decision for the overall pension fund.

4.2 The graph below shows the actuary's assessment of the funding position over the last several actuarial valuations. This investment strategy review is based on the results of the 2020 actuarial valuation adjusted for estimated market movements over the year to 31 March 2021.

Graph 1



4.3 At 31 March 2020, the actuary estimated that the funding level was 106%. As noted in Appendix 1 (slide 17), that is the actuarial *reporting basis*. For the investment strategy review, the investment consultant has used the *long-term funding basis* to provide consistency with the approach used to set employer contributions. This basis more clearly illustrates that the Fund must invest in assets with returns above those of UK gilts to achieve its objectives. It was estimated to be 89% at 31 March 2021.

4.4 Committee will recall that, for the most financially secure employers, a Contribution Stability Mechanism has been applied over the last three actuarial valuations. Under this mechanism, employers are currently paying lower than the rate which would be based on the theoretical position based on markets. This is largely due to low yields.

4.5 The table below shows the cashflows into and out of the Fund. It illustrates that net cashflow from dealing with members is broadly neutral. Income from investments has averaged £217m over the last three years, which means that Fund is overall cash flow positive.

Table 2

Cash Flow (net additions / withdrawals from dealing with members)

	2011/12	2013/14	2017/18	2018/19	2019/20	2020/21*
Income	188	186	196	227	240	305
Expenditure	151	173	214	241	279	247
Net Cash Flow	37	13	(18)	(15)	(39)	58

* A one-off transfer in of assets by Visit Scotland amounted to £58.3m in 2020/21

Policy Groups

4.6 To support effective strategy determination, the JISP continues to recommend that the Committee defines the Fund's high-level investment strategy in terms of five Policy Groups. These classify assets into categories with similar risk and return characteristics, which are not completely correlated with one another. The weighting of these groups in a portfolio is the key determinant of risk and return. Appendix 1 contains asset return and volatility assumptions used in the modelling and the strategy. Table 3 below shows the Policy Groups in descending order of return and risk. (Note that the real returns on both gilts and cash are negative, and which is lower broadly depends on how much they each lag inflation).

4.7 The JISP has recommended minor amendments to the existing five Policy Groups which condense the vast array of investment choices into a manageable number of investment groups. The proposed Policy Groups are shown in the table below. The name of the Gilts Policy Group has been changed to LDI (liability driven investment) to reflect the fact that the main reasons for investing in gilts is to reduce the variability of the funding level because they are a good match for liabilities. It should be noted that Gilts are currently expensive, with a guaranteed negative real return to maturity.

Table 3

Policy Group	Objective	Permitted Assets
Equities	The principal driver of the Fund's growth and. In the long term, expected to outperform liabilities, albeit with periods of volatility	Listed equity; private equity; forward currency contracts; equity futures
Real Assets	Positive real returns with an income stream, in some way, linked to inflation. Likely to deliver some diversification from equity returns.	Property; infrastructure; timberlands; agriculture; commodites
Non-Gilt Debt	Assets offering strategic funding level protection and / or delivering a superior yield to that available from gilts (and where returns may have a positive correlation with bonds).	Investment grade bonds; high yield bonds; loans; private credit; emerging market debt; overseas sovereign bonds
LDI (formerly Gilts)	Assets offering strategic funding level protection by virtue of being the asset that most closely matches the liabilities and so reduces funding level variability. This currently comes at a cost because gilts guarantee a negative real return if held to maturity.	Index-linked gilts; nominal gilts; gilt futures
Cash	Liquidity function avoiding (mostly) credit and duration risk premia.	UK Treasury assets; overseas Treasury assets; local authority loans; bank/building society deposits (all short term)

4.8 Under the governance structure of the Fund, the implementation of the investment strategy within these Policy Groups is delegated by the Pensions Committee to nominated officers with advice from the JISP.

4.9 The modelling results below and in Appendix 1 indicate that the level of equities is by far the key determinant of investment risk and return. Variation in the types of investment managers within each Policy Group is typically less significant to the overall risk and return than strategic Policy Group allocations over the long term.

Asset Liability Modelling

4.10 An Asset Liability Model (ALM) is a tool which projects how the Fund's assets and liabilities might perform in the long-term. The primary aim is to indicate the degree of uncertainty associated with a particular strategy; the ALM is not a forecasting tool. It describes how likely different investment strategies are to deliver returns that achieve the Fund's objectives – paying pensions as they fall due. Investment strategies with higher expected returns are likely to require lower employer contributions. However, such strategies will be accompanied by more variability in funding level and the risk that employers will be required to make larger contributions if the investments do not perform as expected.

4.11 Asset Liability Models include many assumptions about how the economy and investment markets might change in the future, highlighting the uncertainty in projecting future outcomes. The assumptions in such models should be considered as well as the results. Hymans Robertson has tested the current investment strategy and potential investment strategies, which are expected to deliver sufficient returns with a high probability of success over a 20-year timeframe. There are, however, a wide range of possible outcomes, which reflects the need to generate returns in excess of the return generated by gilts, the matching asset for a pension fund. There is less certainty associated with the future returns from other financial assets.

4.12 The assumption for future gilt yields is one of the most critical inputs to the model. The level of gilt yields does not impact the actual pensions which will fall due. But it greatly affects the current value of these liabilities calculated by the actuary – as discounted by this rate. The higher the assumed discount rate (level of gilt yields), the lower the current value of liabilities, as calculated by the actuary's model.

4.13 Hymans Robertson's asset liability model assumes, on average, that nominal gilts return c. 1.5% p.a. over the next 20 years, with nominal yields increasing to +3.5% pa. This is a major assumption because nominal 20-year gilt yields are 1.3% pa (27/5/2021), and they are currently expected by the market to fall. Nominal 40-year gilt yields are currently 1.2% pa, which is consistent with 20-year gilt yields in 20 years' time falling to 1.1% pa.

Table 4

UK Gilts

Maturity	Years to Maturity	Yield
2071	50	1.122%
2061	40	1.216%
2055	30	1.316%
2035	15	1.163%
2030	10	0.808%
2028	7	0.582%
2026	5	0.344%
2024	3	0.153%
2023	2	0.043%

Source: Bloomberg

4.14 The ALM helps to demonstrate, on its assumptions, whether the investment strategy is likely to deliver the funding objectives, the associated risks and the impact of changing investment strategy. However, model assumptions need to be considered when interpreting the results, particularly the gilt yield and equity assumptions.

The Results

4.15 The results of the Asset Liability Modelling are attached as Appendix 1. The modelling shows that:

4.15.1 future funding levels are significantly reliant on the assumption of future gilt yields; and

4.15.2 the risk associated with the investment strategy is largely determined by the amount invested in equities, typically the most volatile asset class over shorter term time periods.

4.16 The modelling has generated estimated probabilities of the Fund being at least 100% funded by 2040 (20 years after the 2020 actuarial valuation) based on several different investment strategies.

4.17 The Appendix shows 'Current' investment strategy is 65% invested in equities. The ALM calculates that:

4.17.1 The probability of reaching 100% funding by 2040 (20 years after the 2020 actuarial valuation) is 82% (slide 24); and

4.17.2 There is a "very low" 4% probability that the funding level will be below 65% in 2023, which would be a deficit of approximately £3.3billion or more (slide 30). In comparison, the total payroll for members of the Fund as at March 2020 was £789million. Hence recovering such a deficit from employers over 20 years would equate to approximately 21% of payroll per annum.

4.18 As noted earlier, the anticipated increases in gilt yields are a critical assumption in the ALM model. Recall that the financial markets expect yields to fall slightly. Slide 28 illustrates the potential impact on the Fund if yields do not increase to the full extent assumed by the model. This has a meaningful impact (slide 29), reducing the probability of achieving the target funding level by 2040 by 13 percentage points. Based on the current strategy, the probability of exceeding 100% funding by 2040 is 82% assuming the nominal gilt yield reverts to 3.5%, but only 69% with a low yield model assumption of 1.5%. This yield assumption looks more prudent based on current financial market pricing.

4.19 The ALM indicates that there is scope for the Fund to reduce equities (the most volatile assets) to lower the probability of its funding level calculation falling below 65% to 2-3% against 4% currently. However, this implies buying (matching LDI gilt) assets with a guaranteed negative real return. This would reduce probabilities of achieving funding targets. So, following the model would be acceptable if the assumptions are deemed acceptable. But the estimated 82% probability of success is significantly reliant on gilt yields increasing, when financial markets expect them to fall. On the "low yield reversion" assumption also tested by the ALM, the probability of success would be 69% on current strategy, dropping to 64% on "de-risking" (selling equities and buying gilts or debt assets).

4.20 The ALM does not incorporate climate scenario analysis, but Hymans Robertson and the JISP advisers believe that the existential threat of climate change should be taken seriously by pension funds with long duration liabilities. Hymans Robertson is actively developing a climate scenario model to integrate with its ALM. Currently, it provides standalone analysis, which was used for the purposes of this strategy review.

4.21 Three possible scenarios, which differ according to governments' policy responses to climate issues, were considered. The scenarios capture the high-level impact of government policies over 20 years and an impact on longevity. As bad outcomes are already incorporated into Hymans' ALM, the serious implications of climate change do not necessarily alter the ALM conclusions.

Adviser Commentary

4.22 Advisers have discussed the inputs and outputs of the ALM with Hymans Robertson to understand its strengths and its limitations. They note that it:

4.22.1 quantifies and frames the uncertainty inherent in forecasting 20-year risk and returns;

4.22.2 quantifies the shorter term, downside risks that could impact employer contributions at the next actuarial valuation in 2023;

4.22.3 highlights the critical role that gilt yields have in the funding level output and the probability of success.

4.23 The quantitative model cannot produce a right 'answer' for the Committee. It produces a range of possible outcomes and the central outcome is not more certain than any others. However, the central outcome of the model does rely on gilt yields rising. (Note that the model does incorporate potential, worse outcomes where yields do not rise.) The reality is that yields have continued to trend down over the last four decades along with a downshift in nominal economic growth. Obvious reasons for this include high and rising debt levels, demographic trends, globalisation and the substitution of capital for labour. It is not clear that these trends will reverse putting upward pressure on interest rates and inflation anytime soon. To sustain higher gilt yields, short term policy rates, such as the UK Base Rate, would need to rise to levels not seen for more than a decade. The Bank of England has cautioned against expecting such a move any year soon.

4.24 Perhaps the most insidious of these issues is the increasing global debt burden, which has been further exacerbated by the global pandemic. It was already very high by historical standards and yet fiscal policies have taken on a more expansionary flavour, financed by increased debt. Although the immediate future looks brighter as the world economy emerges from the COVID-19 trauma - interest rates and inflation expectations have already anticipated this to some degree - it is far from clear that the path of gilt yields is on the trajectory of the yield reversion in the model. Certainly, the model is at odds with the market's current expectations, which show yields falling to 1.1% per annum in 20 years, not 3.5% in the model.

4.25 The long-term implications of the current and expected economic policies - expansionary, debt-financed fiscal policy combined with easy, average inflation-targeting central bank monetary policy - will be a challenge for pension funds. There seems to be only one politically acceptable way to reduce debt levels and that is to inflate them away gradually. That would be to the detriment of savers and to the benefit of debtors; to the detriment of financial assets and the benefit of real assets. Levels of debt to GDP have continued to rise, not fall. It seems almost certain that major central banks around the world will be distorting price signals by buying government bonds to keep yields low and below inflation in order to deflate the real value of the debt. The existing policies have provided a tailwind to riskier assets, where valuations have expanded. Prospective policies may do the same, but real returns from financial assets are likely to be much lower in future than in the recent past given that starting valuations are higher.

4.26 The balance between minimising the probability that the ALM calculation of funding level will fall below 65% in 3 years, against maximising the probability that the fund will be able to pay (100% of) pensions as they fall due is the key strategic decision for the Committee.

4.27 Based on statistical modelling, our investment consultant judges that there is scope to reduce financial market risk within the pension fund without a material reduction in the probability of a successful outcome. This conclusion is informed by insight into thousands of possible economic and financial scenarios. An alternative to de-risking would be to plan for lower contribution rates.

4.28 Given that there is uncertainty about future outcomes, there are a range of views expressed by advisers, but the consensus view is that the most likely scenarios are those shaped by a continuation of expansive monetary and fiscal policies across the globe. Policymakers are explicitly targeting higher nominal economic growth and, by association, strong asset markets. To reduce risk would be to decide that these policy objectives will be missed. The advisers believe it is premature to come to that conclusion.

4.29 Accordingly, having reviewed the ALM results and considered the strengths and limitations of the model, the JISP advisers believe it is appropriate to wait for increased yields to arise, rather than to reduce the Fund's investment risk and return ahead of such time. As noted earlier, employer contributions being paid are lower than the theoretical rate based on current yields and this is, in effect, anticipating increases in yields.

4.30 Climate modelling is unavoidably fraught with uncertainty. Work done by the investment consultant highlights that, on balance, climate change would, in the longer term, weaken the financial position of the pension fund. This affects the probability of success and means that risk appetite should be maintained.

4.31 The JISP advisers conclude that the Fund should reduce its exposure to equities slightly to 60% invested in lower risk equities with small increases in LDI and Real Assets. They agree with Hymans Robertson that the Fund should consider further reductions of Equities should the funding position continue to improve, but that it is not prudent to anticipate a rise in gilt yields and funding level.

Recommended Strategy

4.32 The proposed investment strategy is presented in the table below. It is based on long term expectations (20+ years) that the asset mix will generate returns comfortably in excess of liabilities. The permitted ranges are the constraints within which nominated officers can implement strategy under delegated authority without referral to the Committee. They are wide enough to avoid unnecessary and potentially costly rebalancing under normal financial conditions, but to enable prompt action in fast moving markets.

Table 5

Policy Group	Current Strategy	Proposed Strategy	Current Permitted Range	Proposed Permitted Range
Equities	65%	60%	50% - 70%	50% - 70%
Real Assets	18%	20%	10% - 25%	10% - 30%
Non-Gilt Debt	10%	10%	0% - 20%	0% - 20%
LDI (formerly Gilts)	7%	10%	0% - 20%	0% - 20%
Cash	0%	0%	0% - 10%	0% - 15%
Total	**100%**	**100%**		

4.33 The strategy modifies the ALM output to reflect adviser consensus that the yield reversion is far from certain, given the policy backdrop that is likely to persist for a substantial portion of the 20-year period modelled. Climate change considerations too impact the outlook with the cost of transitioning being a potential drag on economic growth.

4.34 The investment team will continue to monitor the funding level with JISP advisers and adjust exposures of the Policy Groups within the constraints of the permitted ranges. They will provide regular reporting on strategy implementation and refer to Committee for direction should there be a recommendation to operate outwith the permitted ranges or to adjust the strategic weights.

5. Financial impact

5.1 The investment strategy has a significant impact on the investment returns of the pension fund and hence impacts on the funding level and employer contribution rates.

5.2 The extent of the financial implications is illustrated in the ALM results shown in the report.

6. Stakeholder/Regulatory Impact

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

None.

8. Appendices

Appendix 1 – Asset Liability Modelling results

Investment Strategy Review

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Falkirk, Fife and Lothian Pension Funds

John Dickson, Senior Partner
Jordan Irvine, Senior Investment Consultant
Mark Tighe, Investment Analyst

June 2021

Introduction

- This paper is addressed to the Pension Committees (“the Committees) of the Lothian Pension Fund, Falkirk Council Pension Fund and Fife Council Pension Fund (“the Funds”).
- The purpose of this paper is to present the results of the asset liability modelling (ALM) exercise and the potential implications for each Fund.
- We accept that the paper can be part of the Committees’ public papers. However, the results and conclusions are not addressed to any party other than the respective Pension Committees and no other party should rely on any of the content or advice contained in this paper. We accept no liability to any other party unless we have accepted such liability in writing.
- This paper has been prepared in accordance with the relevant professional standards (specifically the Technical Actuarial Standard, TAS 100: Principles for Technical Actuarial Work).
- Details of the Reliances & Limitations associated with this work and the assumptions made are set out as an Appendix.

Areas we'll explore today

- How likely is it that the current combination of funding and investment strategy delivers 100% funding over an acceptable period?
- Consider alternative investment strategies and their impact on achieving full funding – consider the suitability of the current strategic ranges.
- Assess whether a lower risk investment approach can be adopted given the current strong funding positions?
- Assess whether a lower level of contributions can be achieved in the future?
- Consider the impact of a downside risk event over the next couple of years, how big the deficit could become and any action that should be taken?
- Assess the strategies against different economic scenarios e.g. varying yield and inflation environments.

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High level overview

- All three Funds have seen an improvement in funding position since the 2020 actuarial valuation as a result of strong market returns over this period. Throughout this presentation we have focussed on the long-term funding position as this is most relevant when thinking about contributions and investment strategy.
- Under our central yield assumption, there is significant scope to reduce investment risk across the three Funds. Falkirk's starting funding position is lower than Lothian and Fife, which offers less scope to reduce investment risk. That said, the equity exposure can be reduced by 15% across all three Funds and still retain at least a 75% probability of being fully funded in 2040. In doing so, the downside risk measures reduce materially (c.10% for each Fund).
- There is also some scope to reduce contributions in the future under the central yield assumption; however, Falkirk is limited in its ability to reduce both investment risk and contributions. Any potential reductions in contributions would need to be tested by the Scheme Actuary at next actuarial valuation.
- Under a lower central assumption for long term yields, there is less scope to reduce investment risk. However, based on the current position, both Fife and Lothian could reduce the level of equity exposure by a modest amount.
- If the Funds continue to see an improvement in the funding position, then there will be significant scope to reduce the level of equity exposure whichever of the central yield assumptions are adopted. A sensible next step would be to consider potential de-risking triggers to capture future improvements in the funding position. At the same time, the Committee may need to consider amending the current strategic targets and tolerances.
- As part of this review, we also considered climate scenario analysis. Climate scenario analysis is in its infancy and will continue to improve. However, overall, the proposals to reduce investment risk are well aligned to the green revolution and should therefore encourage positive action to help address climate issues.

Summary of conclusions

Overall, the results on the central yield assumptions show significant scope for all Funds to be able to reduce equity exposure. However, it is prudent not to allow for the potential improvements to the funding position coming from increasing gilt yields, certainly in the near term. Focussing on the results from the lower yield model retains this element of prudence. Overall, this reduces the scope to reduce equity exposure at least until we see further improvements in the funding positions. On this basis, our conclusions from the modelling for each fund are as follows:

Lothian

- Although limited, there is scope to reduce equity exposure by 5-10% which would move it towards the centre of the current range. However, as the funding level improves, there will be scope for further reductions in equity exposure. This indicates that it would be useful to set funding level triggers at which the JISP could consider what, if any, action could be taken to reduce risk further.

Falkirk

- Due to a lower current funding level, there is less scope to reduce equity exposure immediately. However, the current position has an equity allocation above the strategic target of 60%. The results continue to support moving to the strategic target. As with Lothian, future funding improvements will give more scope to reduce equity exposure further; again, indicating that funding level triggers to consider what action to take would make sense.

Fife

- Like Lothian, even under a lower yield assumption there is scope to reduce equity exposure immediately. We understand the Committee has been reducing the equity exposure recently from 60% to 55%, but our analysis would support reducing this by a further 5%. Funding level improvements will give scope to move even further and, as above, setting funding level triggers to consider future actions makes sense.

We note that the focus is on reducing equity exposure, particularly as improving funding levels afford it. There are many ways of achieving this. We have considered two – switching into the debt or LDI policy groups. Both are broadly equally affordable. There are other approaches, including buying equity protection in the market. We would expect that when the opportunity to reduce equity exposure is triggered, the JISP would consider both whether and how that should be achieved.

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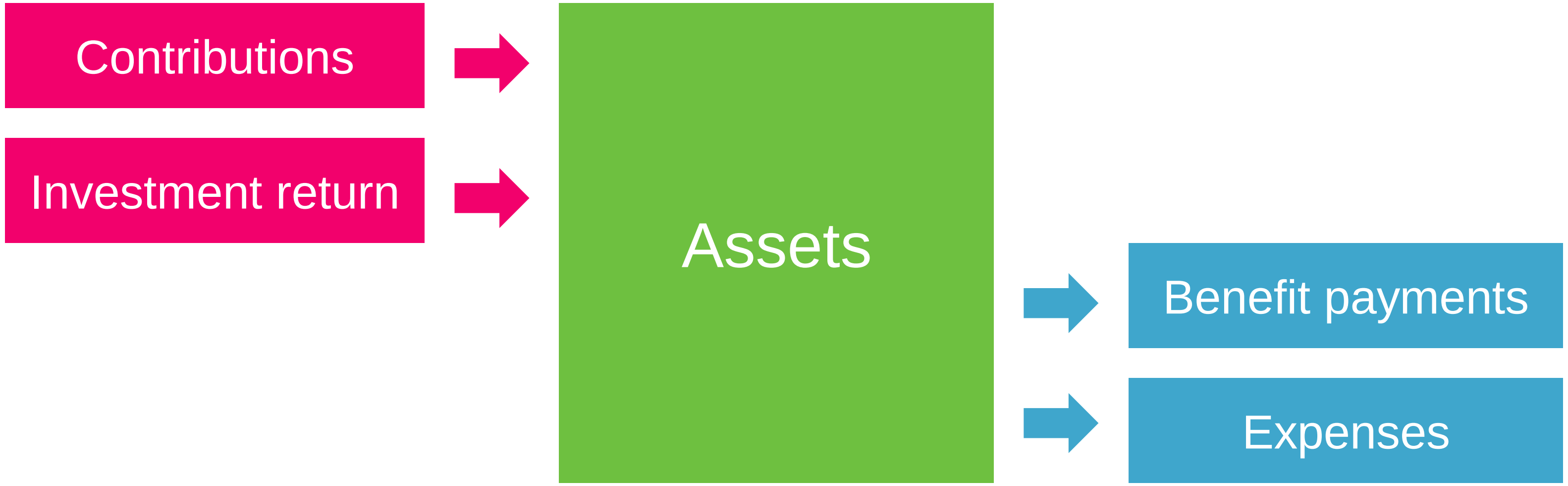
Strategic objectives

Funding pension benefits



- Only two sources of funding benefits
- Investing with a long-term investment horizon
- Requirement for “affordable and stable” contributions
- Want attractive <u>**real**</u> rate of return over the long term

Strategic priorities

Principal objectives

Pay benefits
Low, stable contributions

Requirement 1

Reduce risk of deficits emerging to protect against increase in secondary rates

- Minimise risk for particular target return
- Build buffer against risks

Requirement 2

Generate sufficient returns to keep the cost of new benefits accruing reasonable

- Affordable and stable contributions
- Returns beyond discount rate

Requirement 3

Identify sources of income in order to generate cash as the Fund requires

- Not immediate concern
- Strategic move to higher yielding assets supports this

Seeking long-term affordability and stability

Building towards a "steady state"

Principal objectives:

- Provide pensions for current and future generations
- Get funding to **a steady state**
  - affordable and stable contributions
  - an appropriate level of investment risk - "target returns"

Requirement 1

Reduce risk of deficits emerging to protect against increase in secondary rates

Requirement 2

Generate sufficient returns to keep the cost of new benefits accruing reasonable

Getting the balance right for now and the future

Approach to modelling

- Aim is to determine the optimum investment strategy by testing the current position against a range of alternatives.
- The key is finding a balance between having enough expected return (to ensure contributions remain affordable) and minimising the risk taken to generate this return (to maintain stability of contributions).
- To test different strategies, we use long-term projection models, projecting forward both liabilities and assets, and use a range of metrics to test the effectiveness of each strategy.
- The model is often referred to as an Asset Liability Model.

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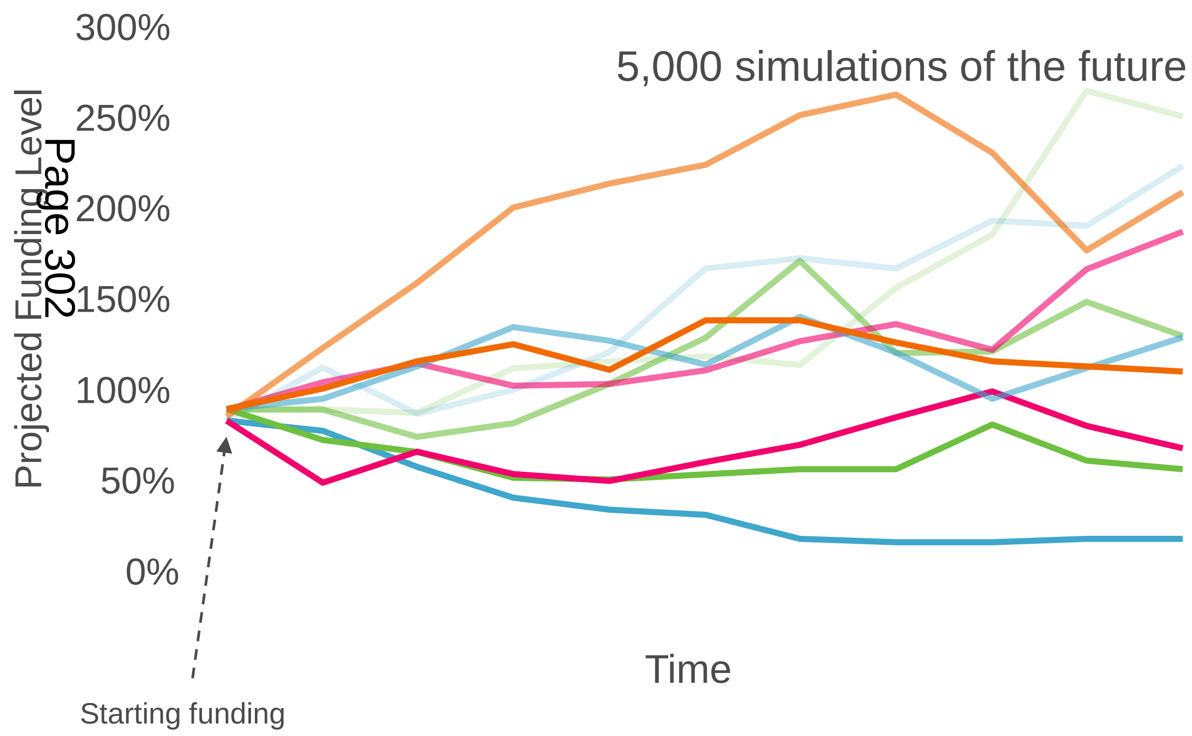
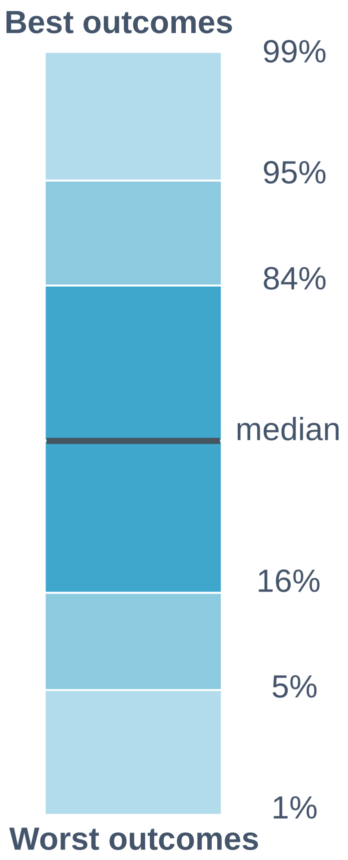
What we have modelled

Modelling process





- We run 5,000 simulations of the future for each strategy.
- The modelling uses market-consistent rates of return and volatilities and long-term characteristics of major asset classes.
- Current conditions are viewed as "unusual", particularly the low level of (real) interest rates. Our central assumption assumes higher long-term yields, but we have also tested the impact of lower levels of long-term yield.
- We rank the 5,000 simulations from best to worst to give a range of potential outcomes and focus on:
  - Probability of success – of achieving funding level of 100%
  - Downside risk – how bad could it get by next valuation. We consider the worst outcomes over 3 years.

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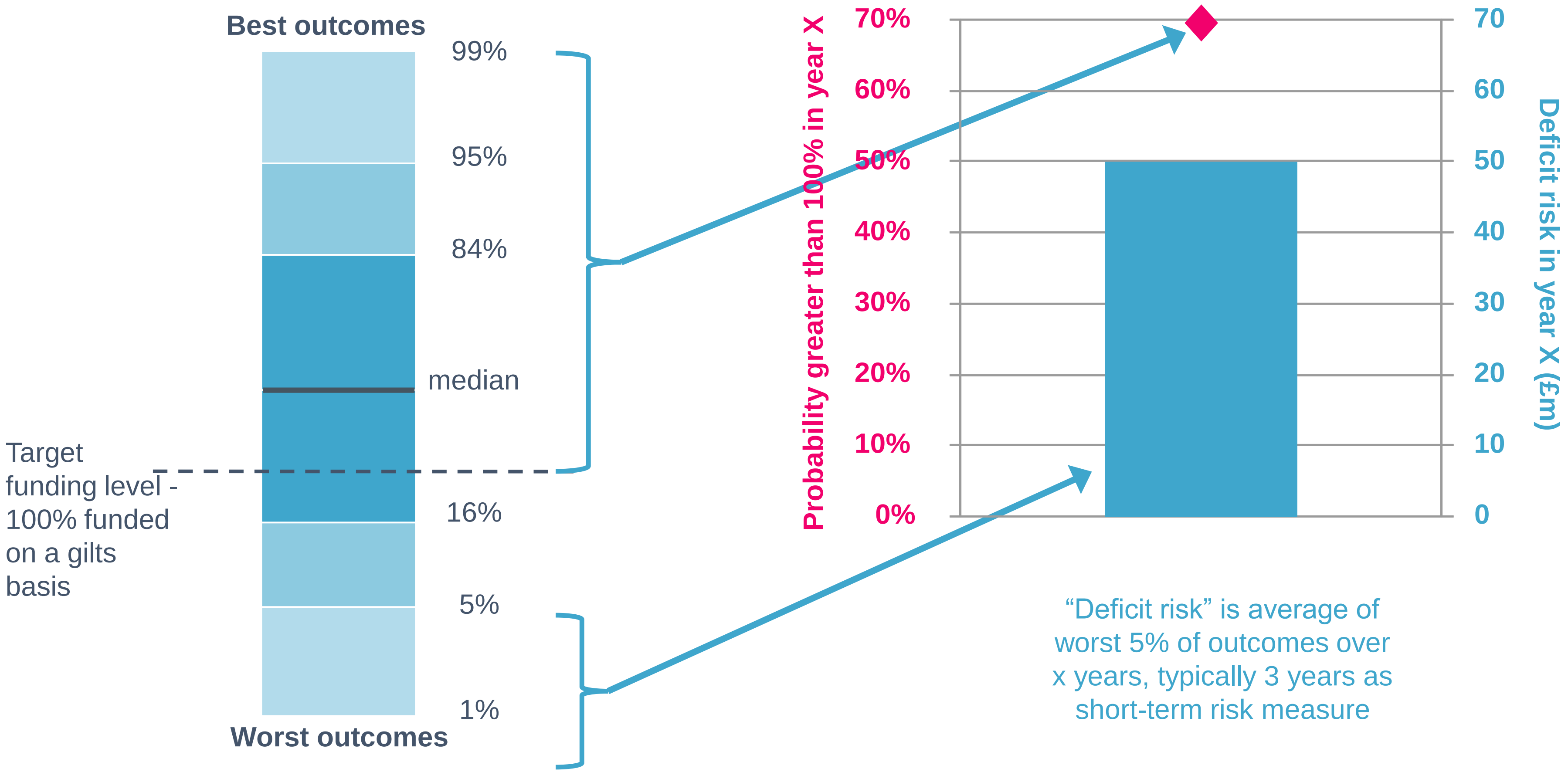
Understanding the output

Translating the output from the simulations into probabilities and a measure of risk.

"Probability of success", given 3,500 out of 5,000 simulations are above target funding level, is 70%



"Deficit risk" is average of worst 5% of outcomes over x years, typically 3 years as short-term risk measure

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Current strategy and ranges

	Lothian (Main) Allowable Range			Falkirk Allowable Range			Fife Allowable Range		
	Low	Target	High	Low	Target	High	Low	Target	High
Equities	50%	**65%**	70%	50%	**60%**	70%	45%	**50%**	65%
Real Assets	10%	**18%**	30%	10%	**20%**	30%	10%	**20%**	25%
Debt	0%	**10%**	20%	0%	**15%**	20%	5%	**15%**	25%
LDI	0%	**7%**	25%	0%	**5%**	20%	5%	**15%**	25%

- We have shown the proposed permitted ranges above, but understand that these are still being considered by the Committee.
- Reflecting the strong positions, we have focussed on lower risk investment strategies in this paper. If interested, we can follow up with results from the re-risked investment strategies.
- We have considered the current contribution schedule for each Fund and the impact of reducing the level of contributions.

Policy groups modelled

Policy group	Allocation
Equities (beta of 90% for Lothian)	**100%**
Overseas Equity	83%
UK Equity	8%
Emerging Markets Equity	6%
Private Equity	3%
Real Assets	**100%**
Infrastructure	55%
Property	40%
Timberland	5%
Debt	**100%**
Investment Grade Credit	60%
Private lending	20%
Cash	20%
LDI	**100%**
Index-linked	85%
Nominal	15%

- Note that this is not intended to exactly replicate the structure of the Funds, but gives a broad representation of the risk and return profile
- This provides a framework for comparing varying levels of risk and return
- The framework can be used to analyse the impact on the overall level of risk and return of changes to the strategies
- Structure modelling allows varying asset classes and proportions within each policy group to be investigated in more detail.

Risk and return assumptions (31 March 2021)

Asset class	Median return (%p.a. 20 year horizon)		1 year volatility (%)
	Nominal	Real (above RPI)	
Global equity (beta = 1)	5.8	3.0	17.4
Global equity (beta = 0.9)	5.8	3.0	15.7
Diversified growth	4.5	1.7	11.9
Property	4.2	1.4	14.2
Private equity	6.8	4.0	28.5
Infrastructure	5.9	3.1	21.0
Private debt	4.9	2.1	4.6
High yield bonds	3.8	1.0	5.9
Corporate bonds (A rated average)	1.6	-1.2	8.0
Cash	2.0	-0.8	0.3
Medium term gilts	1.0	-1.8	7.3
Medium term index-linked gilts	-0.3	-3.1	7.5

Difference in funding levels from valuation

	Lothian	Falkirk	Fife
31 March 2020 actuarial valuation (reporting basis)	106% (gilts + 2.23%)	94% (gilts + 2.4%)	97% (gilts + 2.3%)
31 March 2021 (long-term basis)	89% (gilts + 1.8%)	78% (gilts + 1.8%)	89% (gilts + 1.8%)

- Two separate funding level bases:
    - **Reporting basis** – shown historically and reported in the 2020 actuarial valuation.
    - **Long-term basis** – used by the actuary when considering funding position and contribution schedule.
- We have used the long-term basis in our modelling as this is most relevant to today's discussion when thinking about contributions and investment strategy.
- The initial funding levels used in the modelling are shown in the second row
- For illustration purposes, we have shown the funding levels on the reporting basis as at the 2020 actuarial valuation in the first row

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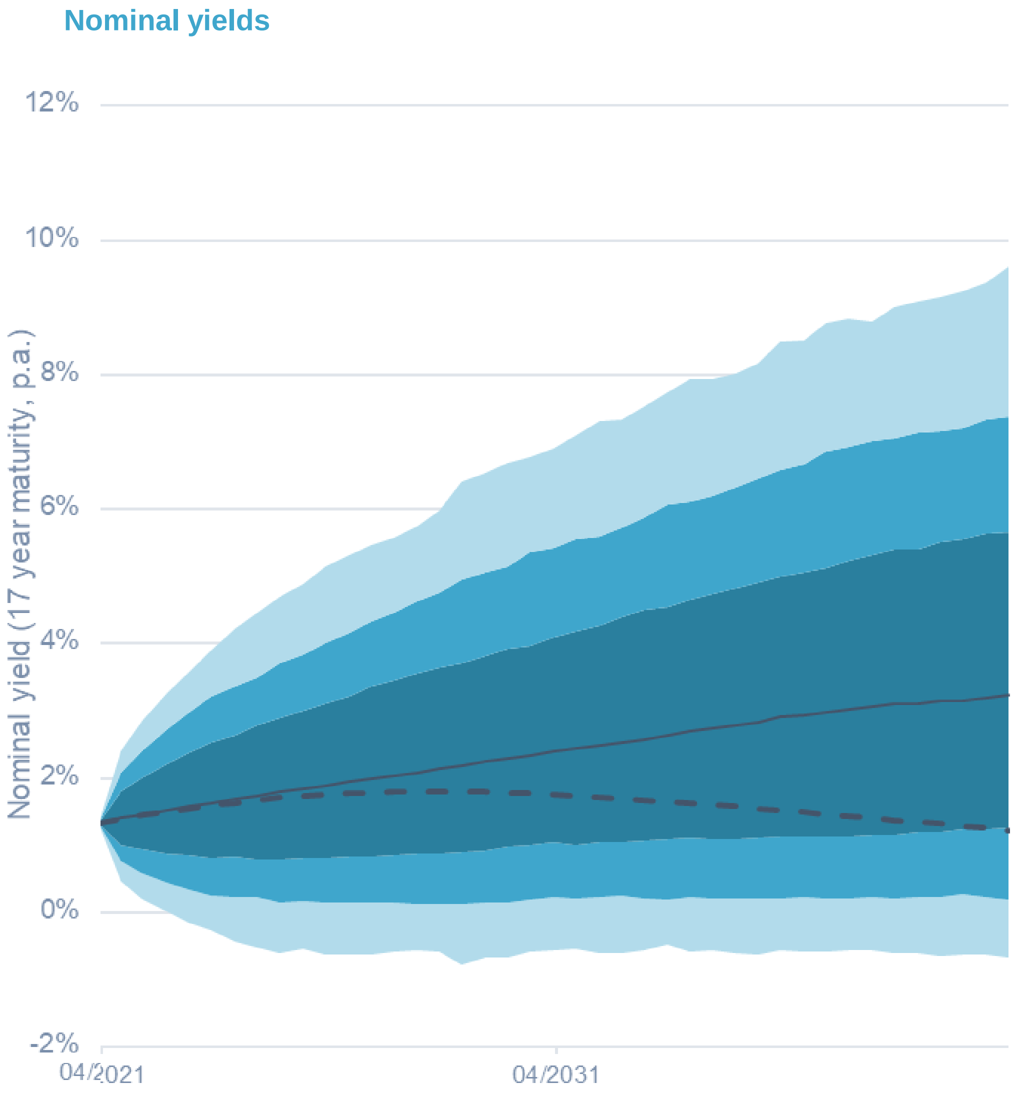
Yield assumptions



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- Due to the uncertainty around the appropriate level of yield normalisation, we assume short and long maturity nominal rates tend towards one of three distinct levels or regimes (on average), set at: the long-term historical average (4.5% p.a.); broadly in line with current levels (1.5% p.a.); and an intermediate level (3.0% p.a.).
- Our central assumption is a blend of the three regimes 60/20/20 and gives us a central long-term yield assumption of c3.5% p.a.
- Our yield assumption impacts the probability metrics as we assume that some of the improvements comes from liabilities being valued at a higher discount rate.
- However, we also show the analysis on the low yield regime, so that the impact of the assumption can be understood by the Committee.

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Key metrics in the output

Probability of success:

- Probability of reaching funding level of 100% over 20 years (i.e. reflecting the Fund’s long-term objective approach)
- We focus on strategies which deliver at least a 2/3rds probability of success.

Downside risk:

- We have measured the downside risk over a 3-year period (i.e. at the next valuation). This is calculated as the median deficit in 2023 less the average of the worst 5% of deficit outcomes in 2023.
- We have considered the probability that the funding level falls below 65% by 2023. Very broadly, this could be viewed as a level at which the Fund’s would start questioning whether further contributions are needed.

Climate scenarios

- Our three scenarios differ by the level of governments' policy responses, rather than CO_2 emissions or temperature rises
- We focus on the high-level economic impact of these policies over next twenty years
- We also make a simple allowance for the impact on longevity based on Club Vita analysis

Green revolution

- Concerted policy action before 2025
- Businesses forced to adjust quickly to greater regulation and higher standards
- Negative short-term impact on growth, inflation and equity returns
- Return to 'normality' in the long run
- 5% increase to liabilities after 20 years due to mortality impact

Delayed transition

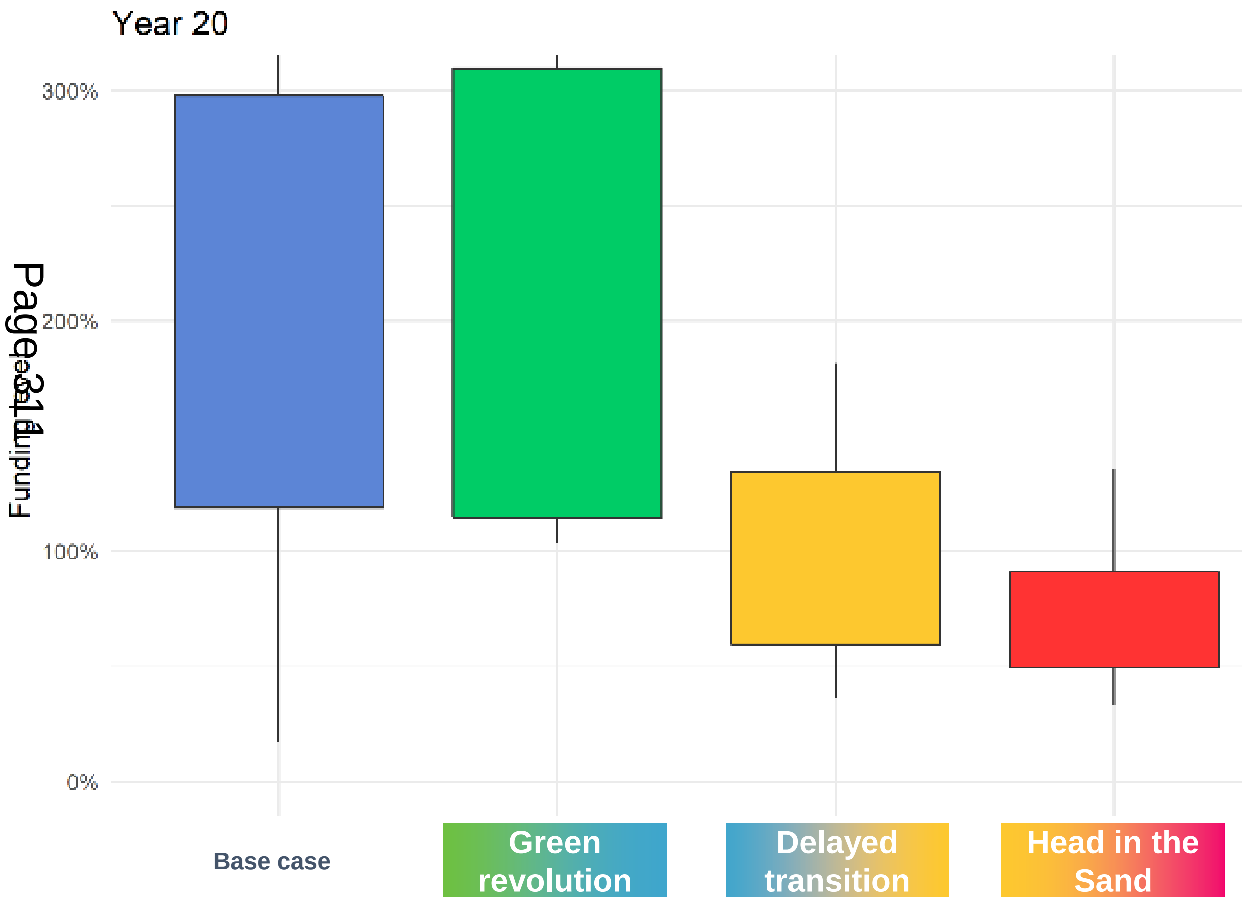
- No policy action for around 10 years
- Action is weaker and negative impact lasts longer as physical risks more damaging
- Greater impact on economies and businesses
- Return to 'normality' in the long run
- 4% decrease to liabilities after 20 years due to mortality impact

Head in the Sand

- No or minimal policy action
- Short term boost to returns and growth due to lower spending on investment
- Physical risks begin to take a toll in the medium term
- Sustained period of weaker performance in the medium-long term
- 12% decrease to liabilities after 20 years due to mortality impact

Club Vita Analysis: Hot and Bothered?

Comparison vs baseline at year 20 (Lothian)



Comments

- Wide range of outcomes under all climate scenarios – still very uncertain
- Similar expected funding level in year 20 between the Green Revolution and core output
- Delayed Transition and Head in the Sand results are materially worse. This is largely driven by the expected impact on equity returns. We therefore expect a strategy with lower investment risk (lower equity exposure) to fare marginally better in each of these scenarios. Based on this modelling, reducing the equity exposure would mitigate the more pessimistic climate scenarios.
- Ultimately the Funds will benefit most from a green revolution and should therefore actively encourage positive action to help address climate issues.

Results use current investment strategy and current contributions (21.6% of pay)

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Modelling results: Lothian

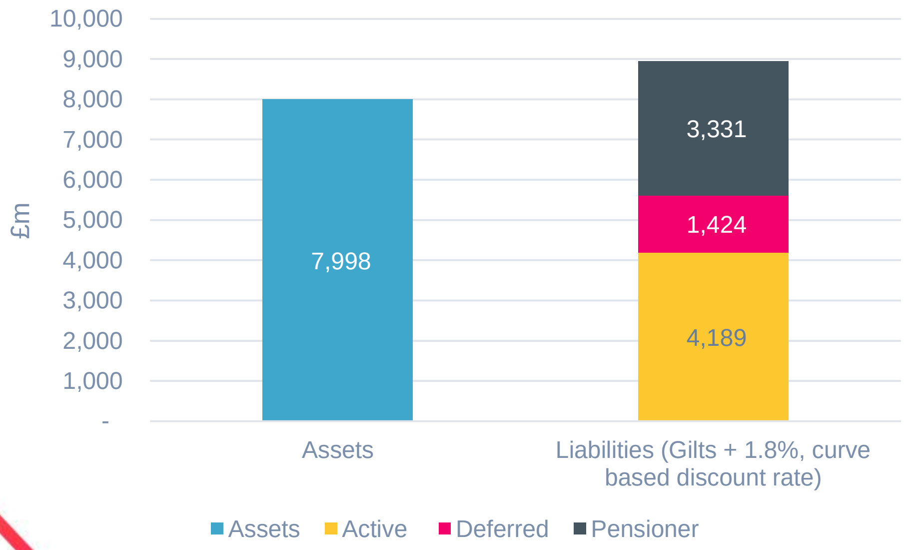
Current position

Key inputs to ALM

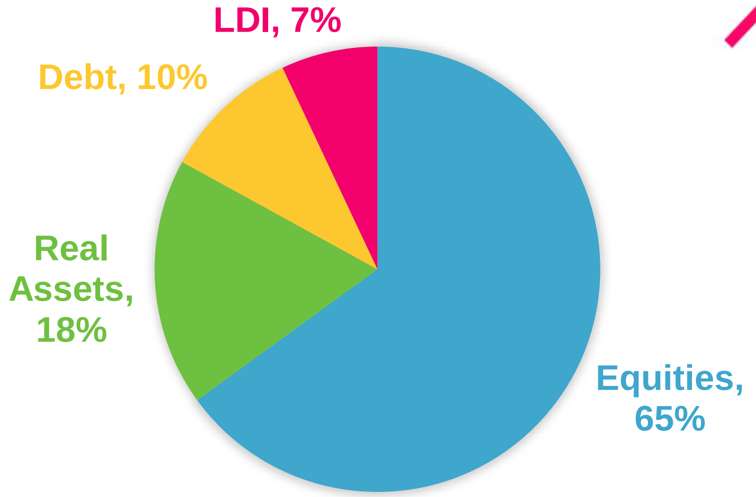
	31 March 2021
Assets	£7,998m
Liabilities (Gilts +1.8%)	£8,945m
Funding level	89%
Surplus / (Deficit)	(£947m)
Required investment income*	0.1% p.a.

Note that throughout the analysis, liabilities have been derived using gilt curves.
*Based on 3-year forecast benefit outgo and contribution income as at 2020 actuarial valuation

Funding position at 31 March 2021

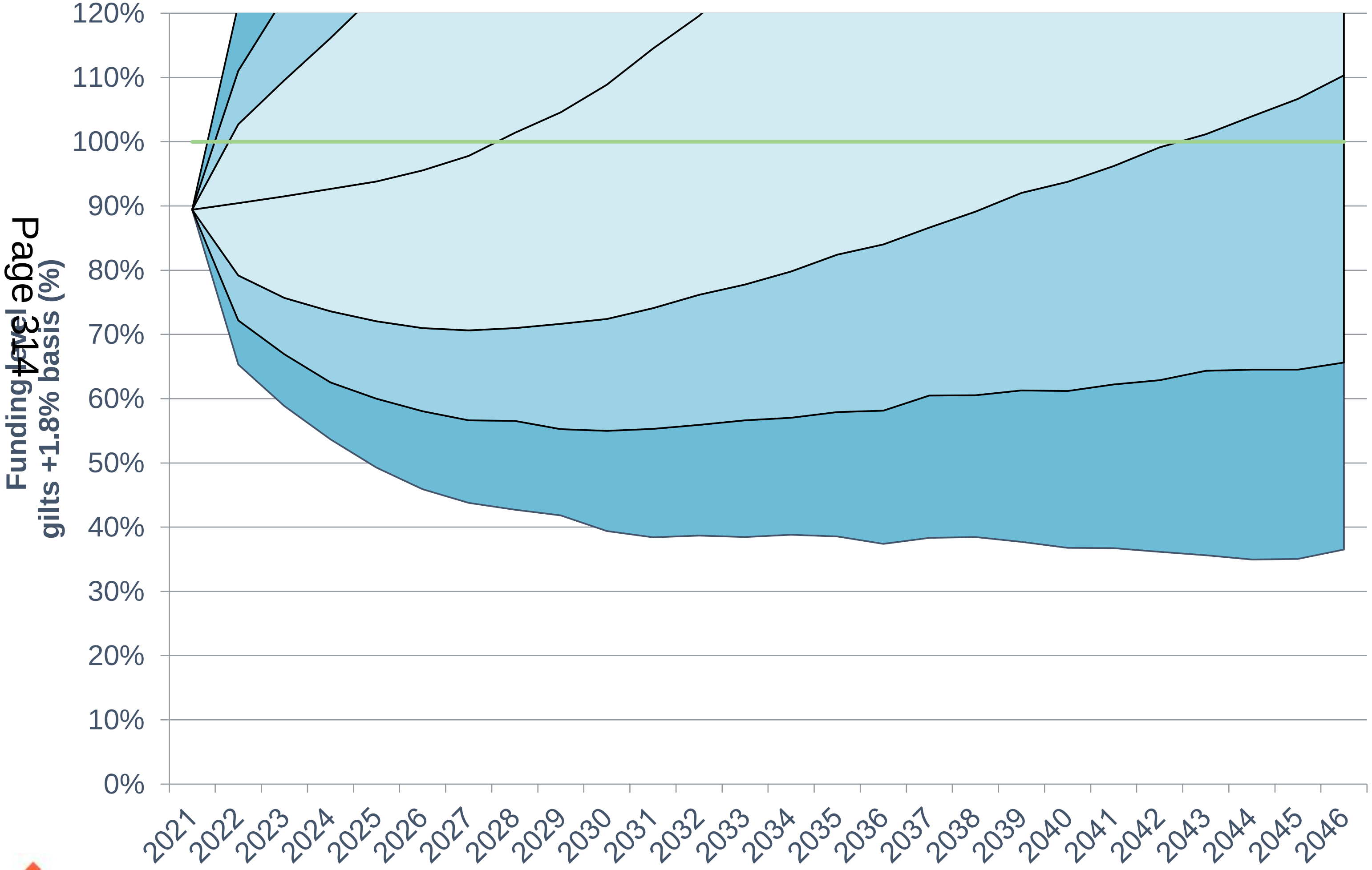


Current allocation



- We understand the Committee are considering reducing equities to 60%, reallocating 2% to real assets and 3% to LDI.
- Equities are modelled with a beta of 0.9 and currently account for the majority of the Fund's target allocation.
- Real assets portfolio is a combination of Property, infrastructure and timber.
- Debt portfolio is a combination of investment grade credit, private lending and cash.
- LDI portfolio is index-linked gilts with a small allocation to nominal gilts.

Funding level projection



Comments

- Assumes:
  - Discount rate of gilts + 1.8% p.a.
  - Current allocation
  - Current contribution schedule
  - Equity beta of 0.9
  - Central yield assumptions
- Full funding expected in 7 years (2028)
- 2/3rd probability of full funding in 12 years (2033)
- 82% probability of being at least 100% funded in 2040
- 4% probability of funding falling below 65% in 2023

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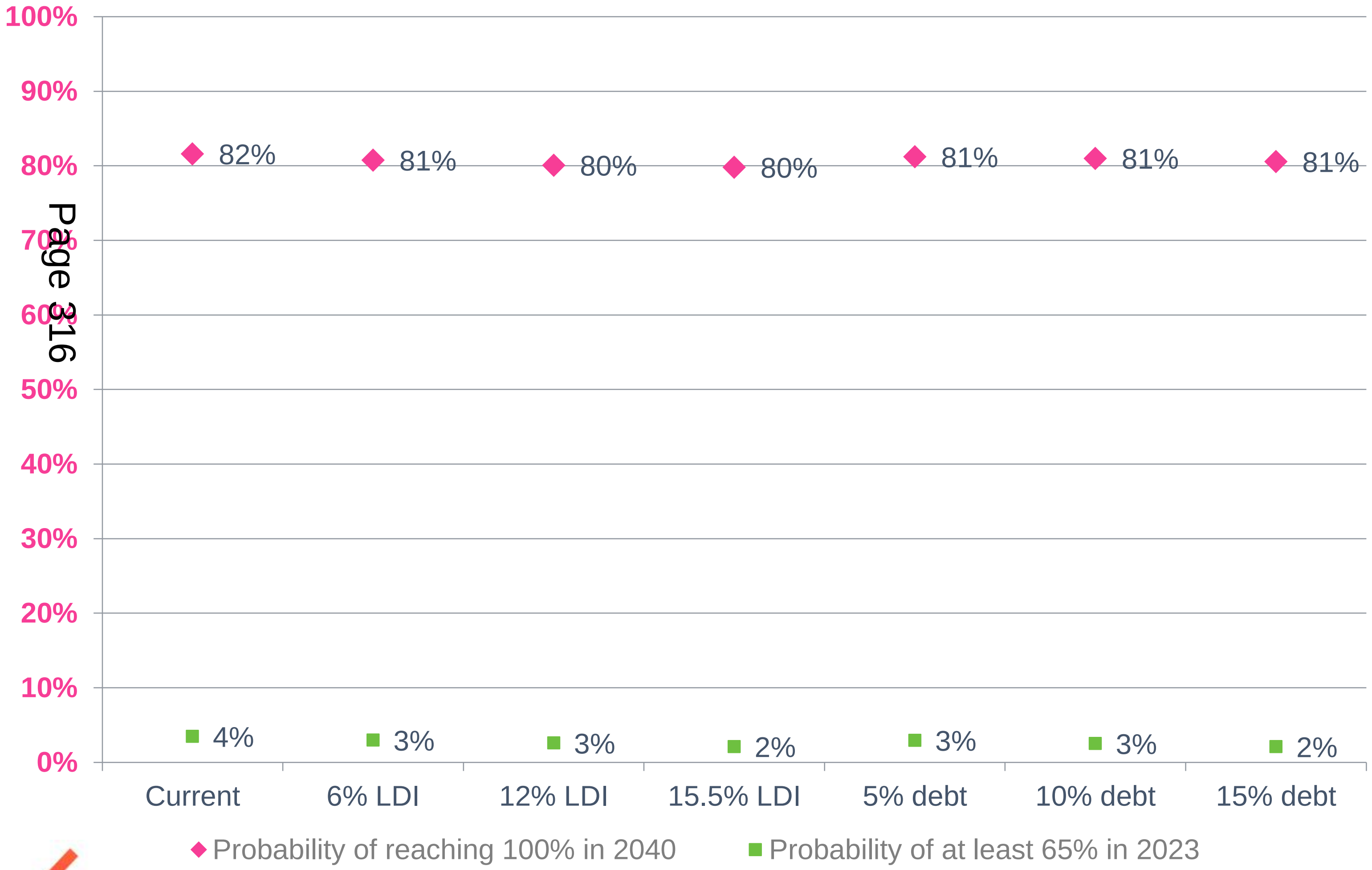
Alternative strategies

We modelled a number of alternative investment strategies with lower exposure to equities. We have tested the impact of reinvesting this into debt or LDI. The six investment strategies we would like to focus on are illustrated in the table below.

- **Strategy 1: 6% LDI**
- **Strategy 2: 12% LDI**
- **Strategy 3: 15.5% LDI**
- **Strategy 4: 5% debt**
- **Strategy 5: 10% debt**
- **Strategy 6: 15% debt**

	Current Allocation	6% LDI	12% LDI	15.5% LDI	5% debt	10% debt	15% debt
Equities	65%	60%	55%	50%	60%	55%	50%
Real Assets	18%	17%	16%	17.5%	17%	16%	15%
Debt	10%	10%	10%	10%	15%	20%	25%
LDI	7%	13%	19%	22.5%	8%	9%	10%

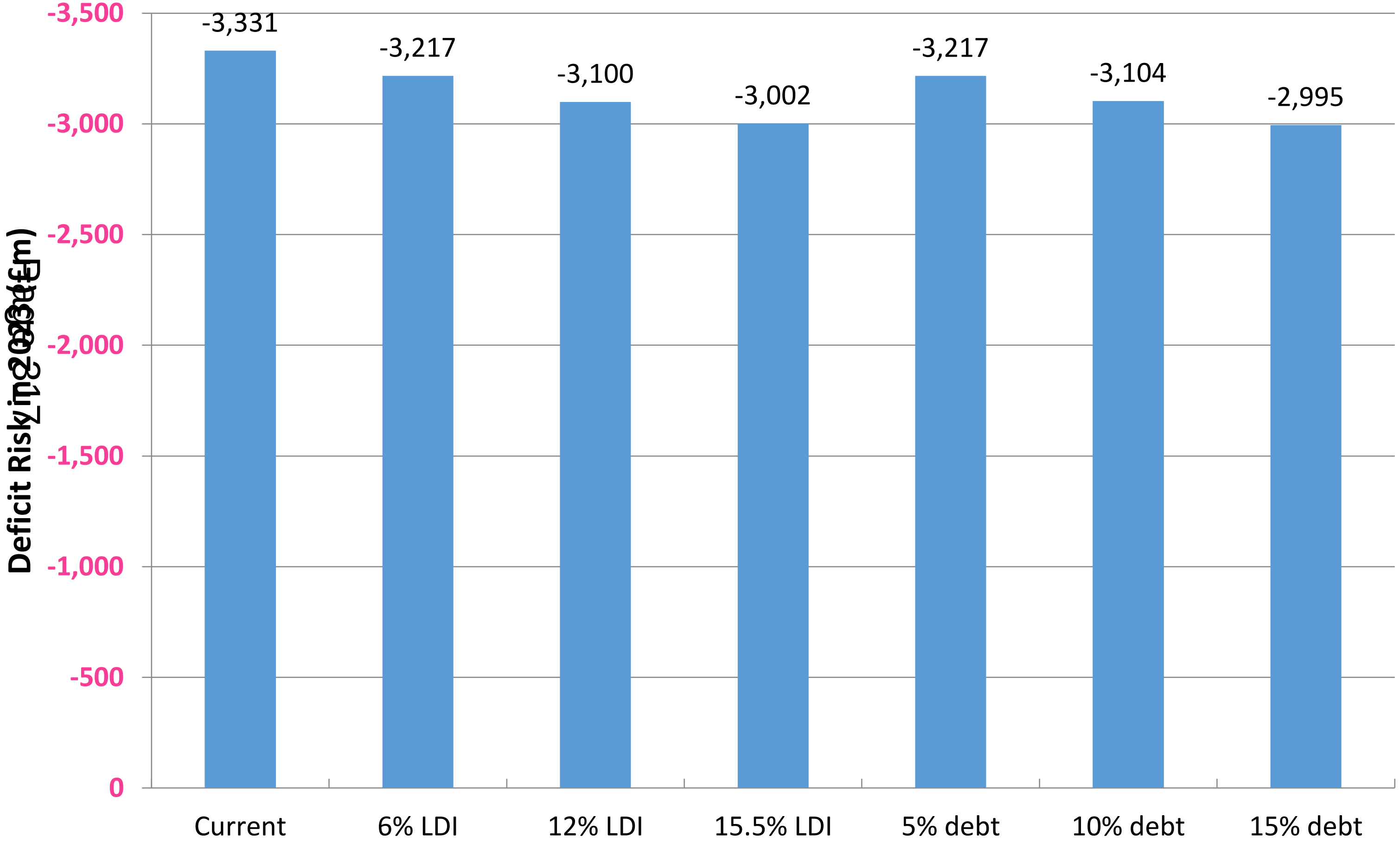
Probability of success / "failure"



Comments

- Assumes:
  - Discount rate of gilts + 1.8% p.a.
  - Current contribution schedule
  - Equity beta of 0.9
  - Central yield assumption
- Strong likelihood of reaching long-term objectives under central yield assumption.
- Under all strategies the probability of success is materially greater than the 2/3rds target and suggests there is scope to reduce investment risk.
- There is a very low probability that Fund's funding position will fall to below 65% (a 24% fall from the current position) by 2023.

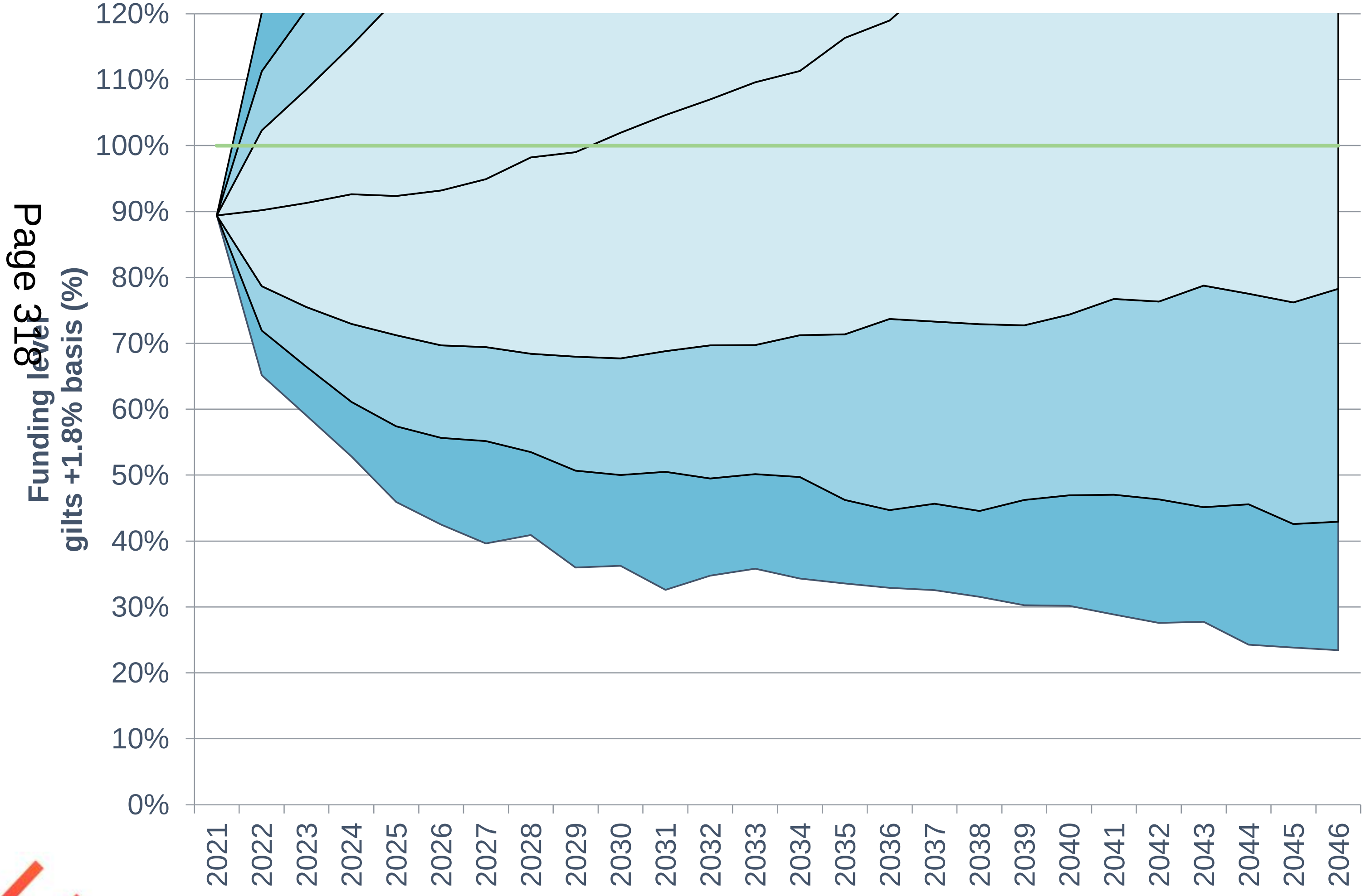
Downside risk



Comments

- Assumes:
  - Discount rate of gilts + 1.8% p.a.
  - Current contribution schedule
  - Equity beta of 0.9
  - Central yield assumptions
- 15% reduction in equities would reduce the downside deficit risk by over £300m (a 10% reduction in the risk) whilst still broadly maintaining 80% probability of being 100% funded in 20 years.

Low yield: Funding level projection



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Comments

- Assumes:
  - Discount rate of gilts + 1.8% p.a.
  - Current allocation
  - Current contribution schedule
  - Equity beta of 0.9
  - Low yield assumptions
- Full funding expected in 9 years (2030)
- 2/3rd probability of full funding in 17 years (2038)
- 69% probability of being at least 100% funded in 2040
- 3% probability of funding falling below 65% in 2023

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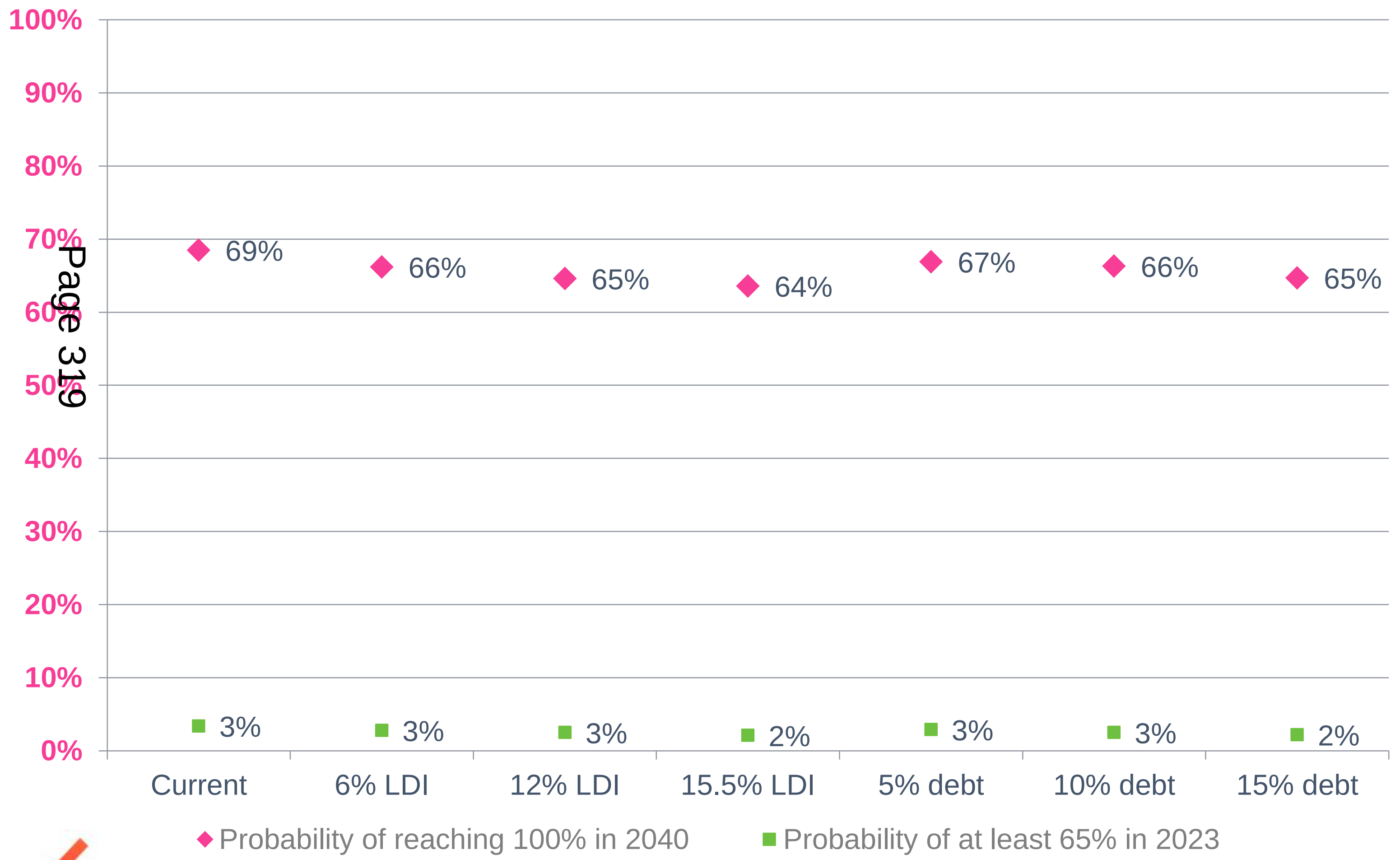
Low yield: Probability of success / "failure"



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Comments

- Assumes:
  - Discount rate of gilts + 1.8% p.a.
  - Current contribution schedule
  - Equity beta of 0.9
  - Low yield assumptions
- Under the low yield assumption there is less scope to reduce equity risk, though potentially still scope to reduce the equity exposure by 5-10%.
- There remains a very low probability that the Fund's funding position will fall to below 65% (a 24% fall from current position) by 2023.

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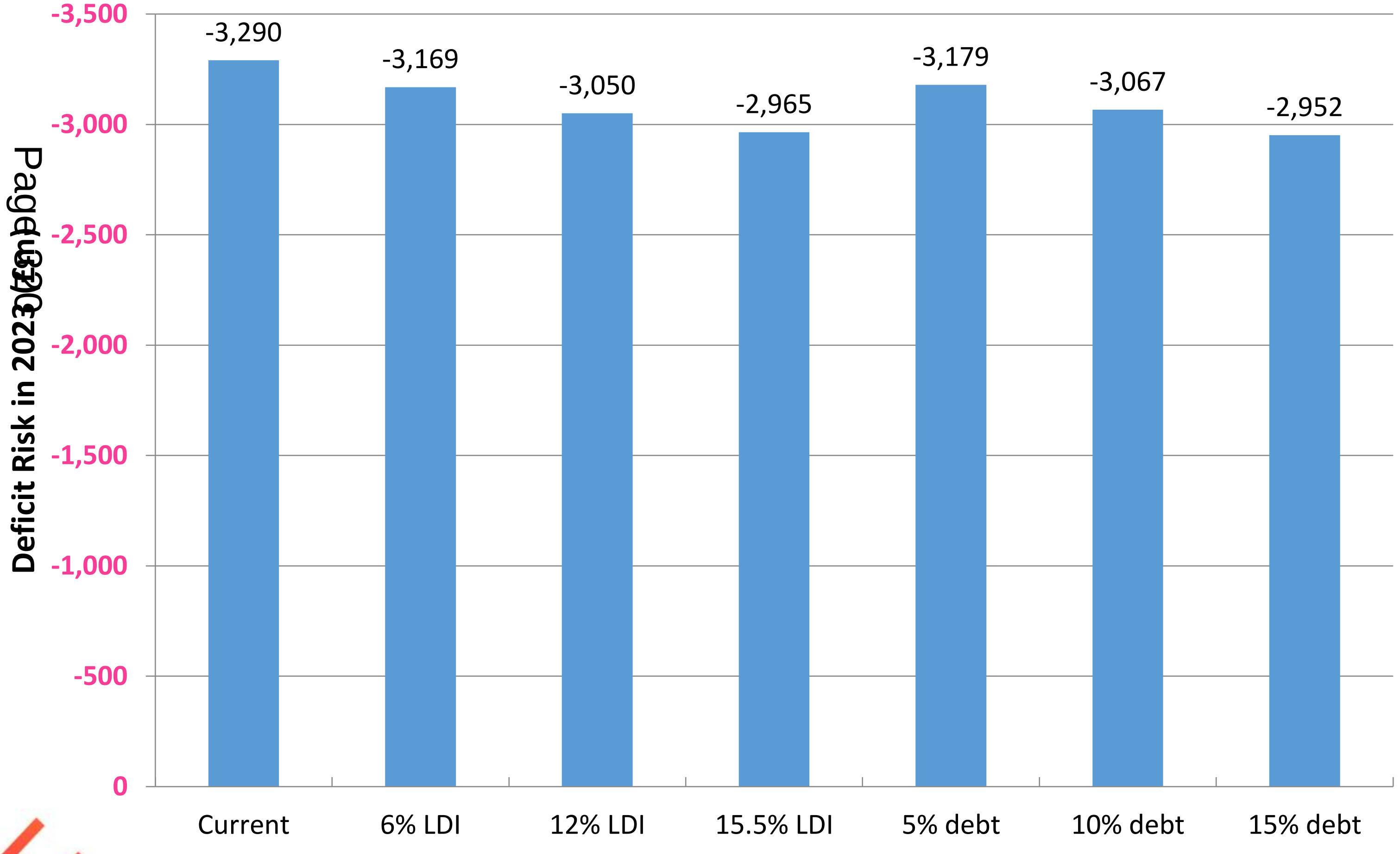
Low yield: Downside risk



Comments

- Assumes:
  - Discount rate of gilts + 1.8% p.a.
  - Current contribution schedule
  - Equity beta of 0.9
  - Low yield assumptions
- 15% reduction in equities would reduce the downside deficit risk by over £300m (a 10% reduction in the risk).

Impact of varying contributions

Probability of reaching 100% in 2040	Current allocation		12% LDI	
	Central yield	Low yield	Central yield	Low yield
Current contributions (21.6% of pay)	82%	69%	80%	65%
20% of pay	78%	64%	77%	60%

Comments

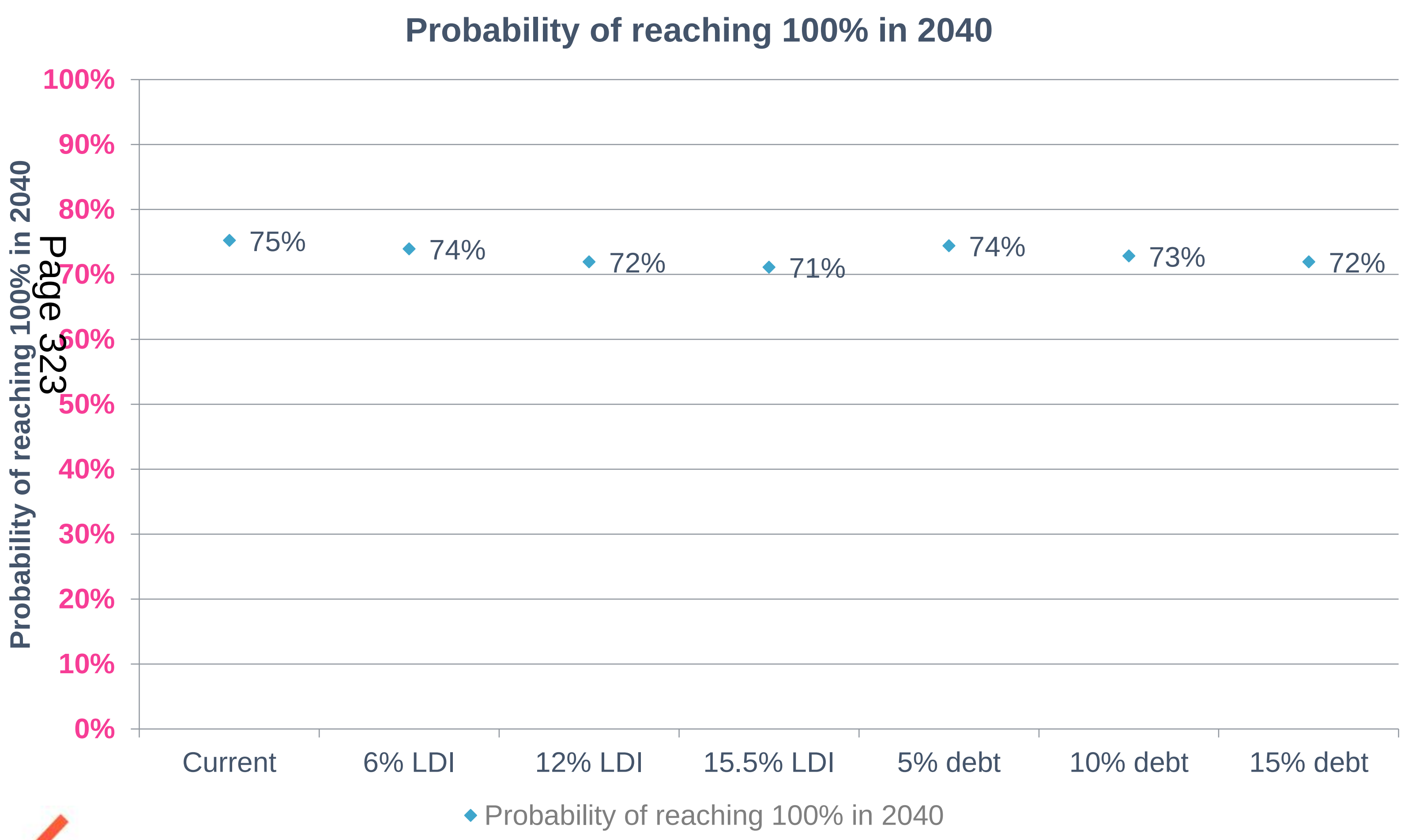
- Assumes:
  - Current allocation
  - Discount rate of gilts + 1.8% p.a.
  - Equity beta of 0.9
- Under the central yield assumption there is scope to reduce both investment risk and contributions.
- However, under the low yield assumption there is little scope to reduce contributions from the current level.
- Any potential reductions in contributions would need to be tested by the Scheme Actuary at next actuarial valuation.

Central yield: impact of equity market shock

Comments

- Assumes:
  - Discount rate of gilts + 1.8% p.a.
  - Current contribution schedule
  - Current allocation
  - Equity beta of 0.9
- Under our central yield assumption there is scope to materially reduce investment risk.
- However, on this slide we consider the probability of success following a 20% fall in equity markets.
- In the lower risk strategies, the initial hit to the funding level is lessened due to the lower equity exposure.
- As a result, the overall chance of reaching full funding (after a 20% fall in equity markets) is broadly similar across the strategies. Note that in lower risk strategies, the ability to re-risk could further improve the probability of success.
- Whilst probability of successes are not materially impacted, the level of downside risk (tail events) will reduce as a result of reducing the level of investment risk.

Low yield: impact of funding level increase



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Comments

- Assumes:
  - Discount rate of gilts + 1.8% p.a.
  - Current contribution schedule
  - Current allocation
  - Equity beta of 0.9
- This chart shows the probability of reaching full funding if we see a 10% improvement in the funding position from here.
- Under the low yield assumption, there is potentially scope to reduce equity exposure by 5-10% based on the current funding position.
- However, if we continue to see an improvement in the funding position then there will be even more scope to reduce the investment risk.

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Conclusions

- Lothian has material scope to reduce investment risk and perhaps, in the future, contributions **under the central yield assumption.** Reducing the equity risk exposure by 15% reduces the downside deficit risk by over £300m whilst still maintaining 80% probability of being 100% funded in 20 years.
- **Stripping out the impact of yield reversion** reduces the immediate scope to reduce investment risk, albeit a modest reduction in equities (5-10%) could still be justified.
- However, if we continue to see an improvement in the Fund's funding position there will be a more compelling case to reduce the equity exposure further. Under this scenario, the Committee could reduce equity exposure by as much as 15%, reallocate to LDI and still have a 70% probability of being fully funded in 2040.
- Currently, the allocation to equities is towards the higher end of the range at 65%. We understand that the Committee is currently considering reducing the equity allocation to 60% and our analysis would support this. If we continue to see an improvement in the funding position then we believe the equity exposure could be reduced to 50%.
- We believe the Committee should consider funding level triggers which further moves could be considered. Whilst we have considered the impact of a 10% improvement on the funding position, there is scope to set triggers sooner than this.
- If a reduction in the equity allocation is triggered, the current strategic ranges would need to be reviewed as the actual equity allocation is likely to be towards the lower end of the current range.
- Looking ahead to the next valuation, there is a very low probability of the funding level falling below 65% (the point at which further contributions would be likely).

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Appendix 1: sensitivity analysis

Sensitivity analysis - Lothian

Impact of different inflation scenarios

	Central inflation assumption	Deflation (3% of scenarios)	0-2% inflation (25% of scenarios)	2-4% inflation (47% of scenarios)	4%+ inflation (25% of scenarios)
Probability of reaching 100% in 2040	82%	82%	81%	81%	83%
Average worst 5% deficit outcomes at 31 March 2023	-£3,331m	-£3,044m	-£3,440m	-£3,281m	-£3,287m

Impact of different hedging levels

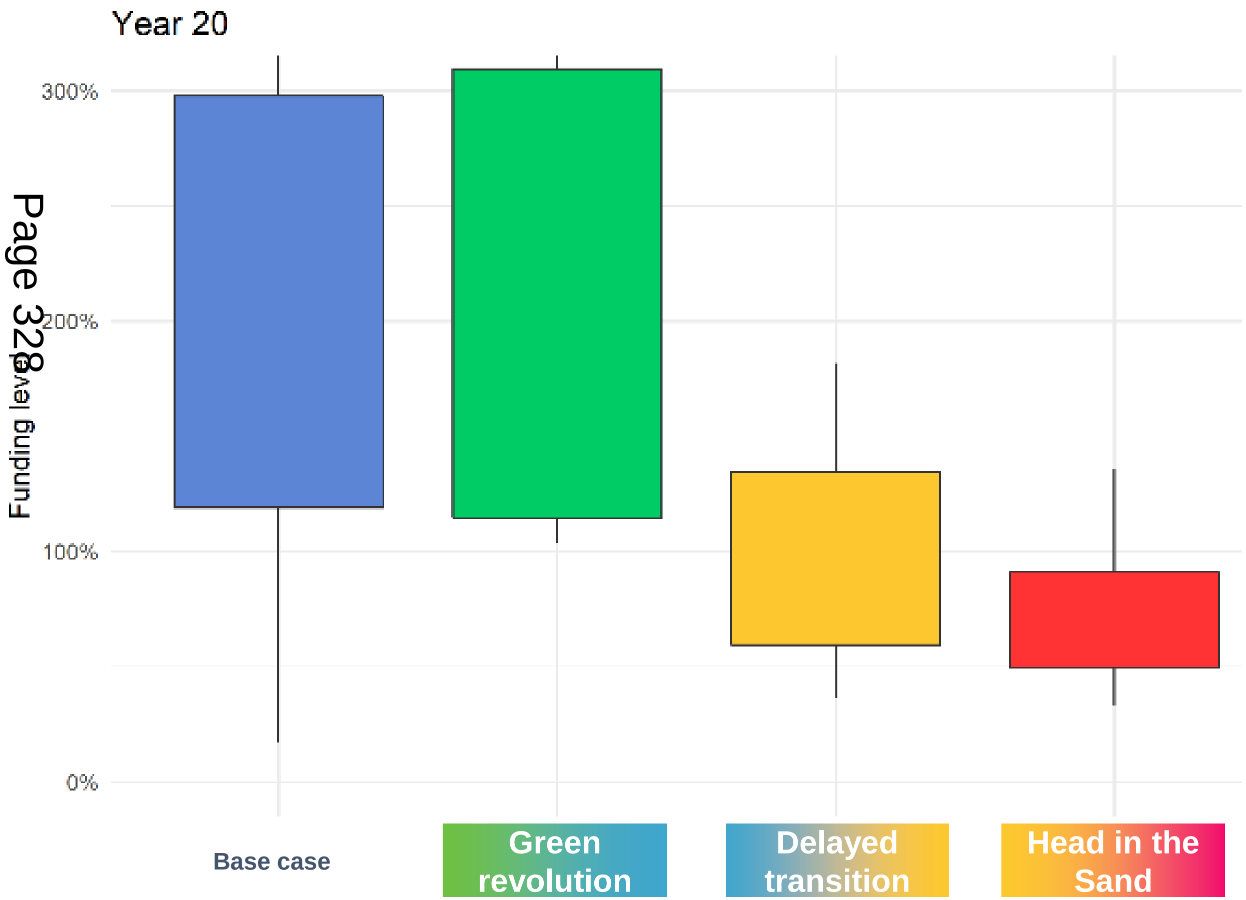
	Current	0% rates / 25% inflation	25% rates / 25% inflation	0% rates / 50% inflation	50% rates / 50% inflation
Probability of reaching 100% in 2040	82%	79%	77%	76%	68%
Average worst 5% deficit outcomes at 31 March 2023	-£3,331m	-£2,829m	-£3,484m	-£2,563m	-£3,262m

Comments

- Assumes:
  - Discount rate of gilts + 1.8% p.a.
  - Current contribution schedule
  - Current allocation
- The probability of success and downside risk metrics remain broadly unchanged under different inflation regimes.
- Inflation hedging in isolation helps to reduce the downside risk, but we see a significant drop in probability of success measures.
- Hedging interest rates reduces both probability of success and increases downside risks.

Appendix 2: sensitivity analysis

Comparison vs baseline at year 20 (Lothian)



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Comments

- Wide range of outcomes under all climate scenarios – still very uncertain
- Similar expected funding level in year 20 between the Green Revolution and core output
- Delayed Transition and Head in the Sand results are materially worse. This is largely driven by the expected impact on equity returns. We therefore expect a strategy with lower investment risk (lower equity exposure) to fare marginally better in each of these scenarios. Based on tis modelling, reducing the equity exposure would mitigate the more pessimistic climate scenarios.
- Ultimately the Funds will benefit most from a green revolution and should therefore actively encourage positive action to help address climate issues.

Results use current investment strategy and current contributions (21.6% of pay)

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Appendix 3: Reliances & Limitations

Reliances & Limitations (1)

Cashflows

- In projecting forward the evolution of the Fund, we have used estimated cashflows generated using our actuarial valuation system, based on information provided as part of the 2020 actuarial valuation of the Fund including the LGPS regulations.
- Except where stated, we do not allow for any variation in actual experience away from the demographic assumptions underlying the cashflows. Variations in demographic assumptions (and experience relative to those assumptions) can result in significant changes to the funding level and contribution rates. We allow for variations in inflation (RPI or CPI as appropriate), inflation expectations (RPI or CPI as appropriate), interest rates and asset class returns. Cashflows into and out of the Fund are projected forward in annual increments, are assumed to occur in the middle of each year and do not allow for inflation lags. Investment strategies are assumed to be rebalanced annually.
- There are a number of different types of increases applied before and after retirement to benefits payable from the Fund. We have made some simplifying assumptions when modelling the various types of increases.
- We have estimated future service benefit cashflows and projected salary roll for new entrants after the valuation date such that payroll remains constant in real terms (i.e. full replacement). There is a distribution of new entrants introduced at ages between 25 and 65, and the average age of the new entrants is assumed to be 40 years. All new entrants are assumed to join and then leave service at SPA, which is a much simplified set of assumptions compared with the modelling of existing members. The base mortality table used for the new entrants is an average of mortality across the LGPS and is not client specific, which is another simplification compared to the modelling of existing members. Nonetheless, we believe that these assumptions are reasonable for the purposes of the modelling given the highly significant uncertainty associated with the level of new entrants.
- In modelling some of the LGPS benefits, we have assumed;
- *Salary growth is assumed to have a floor of 0% and to be modelled in line with inflation plus (or minus) any additions applied.*
- *S148 salaries / national average earnings is assumed NOT have a floor and is projected in line with our projections of national average earnings and valued in line with inflation plus any additions applied.*
- *Non-accruing and accruing CARE benefits increase in line with CPI (no floor).*

Reliances & Limitations (2)

Economic Scenario Service

- The distributions of outcomes depend significantly on the Economic Scenario Service (ESS), our (proprietary) stochastic asset model. This type of model is known as an economic scenario generator and uses probability distributions to project a range of possible outcomes for the future behaviour of asset returns and economic variables. Some of the parameters of the model are dependent on the current state of financial markets and are updated each month (for example, the current level of equity market volatility) while other more subjective parameters do not change with different calibrations of the model.
- Key assumptions include:
  - The average excess equity return over the risk free asset and its volatility which affects growth asset returns
  - The level and volatility of yields, credit spreads, inflation and expected (breakeven) inflation, which affect the projected value placed on the liabilities and bond returns.
  - The gap between CPI and RPI. Target rates for CPI (inflation and inflation expectations) are RPI – 1% p.a. pre 2030, and RPI – 0% p.a. post 2030, which trends towards a long term CPI assumption of 2% p.a.
  - The output of the model is also affected by other more subtle effects, such as the correlations between economic and financial variables.
  - We expect that long-term real interest rates will gradually rise from their current low levels. This is based on a selection of yield normalisation levels (which can be interpreted as representing low, medium and high economic growth scenarios) reflecting the fundamental uncertainty around long term average yield levels. Higher long-term yields would mean a lower value placed on liabilities and hence an improvement in the current funding position unless the Fund is fully hedged.
- While the model allows for the possibility of scenarios that would be extreme by historical standards, including very significant downturns in equity markets, large systemic and structural dislocations are not captured by the model. Such events are unknowable in effect, magnitude and nature, meaning that the most extreme possibilities are not necessarily captured within the distributions of results.
- A summary of economic simulations used is included further on in this document. We would be happy to provide fuller information about the scenario generator, and the sensitivities of the results to some of the parameters, on request.

Reliances & Limitations (3)

Investment strategy and contributions

- The investment strategies and contributions modelled have been agreed as part of the scoping process and documented above.
- The most important assumption for the assets is which asset class to use for each of the assets. We have therefore agreed this during the scoping stage and further details are in the 'What we have modelled' section.
- We have modelled the impact of hedging by considering hypothetical portfolio that matches the changes in the value and cashflows of the liabilities on a gilts basis – for the following stochastic factors: interest rates and inflation. Where we have modelled the Fund's "LDI" hedge of interest rates and inflation, we have assumed the Fund uses a "delta" hedge approach. In practice and in our modelling, this means that a 100% hedge of interest rates and inflation leaves a residual risk arising from holding an imperfect (delta) hedge versus the gilts liabilities. It also allows for a potential reserve "unwinding" effect (positive or negative depending on the form of pension increases) due to any present valuation placed on caps and floors, vs the future paths taken in the modelling. The modelling of a "delta" hedge is therefore not equivalent to assuming "perfect" hedging where the overall risks would collapse to zero in the aforementioned scenario.
- Investment strategy is likely to change with significant changes in funding level, but unless stated otherwise we have not considered the impact of this in order to focus on the high-level investment strategy decision.
- The returns that could be achieved by investing in any of the asset classes will depend the exact timing of any investment/disinvestment, the costs associated with buying or selling these assets and liquidity of the asset classes. The model implicitly assumes that all returns are net of fees and ignores these other factors.
- Unless stated otherwise, we have assumed that all contributions are made and not varied throughout the period of projection irrespective of the funding position. In practice the contributions are likely to vary especially if the funding level changes significantly.
- In the modelling we have assumed that the Fund will update their contributions as in the data request form. Where stabilised contributions are applicable, our modelling assumes these will be updated annually and will come into force one year later. For stabilised contributions, the rate at which the contribution changes is capped and floored. There is no guarantee that such capping or flooring will be appropriate in future; this assumption has been made so as to illustrate the likely impact of practical steps that may be taken to limit changes in contribution rates over time. The contributions would be based on the theoretical rate of accrual and the deficit contributions spread over a fixed period. We have assumed that the Actuary to the Fund will make his or her calculations using broadly the same methodology as that currently used but note that this is a source of uncertainty that we have not attempted to measure in the model other than where noted specifically.

Reliances & Limitations (4)

Climate change scenarios – purpose

The purpose behind the modelling is to show the impact of three preconceived climate change scenarios and to promote engagement and discussion around the possible outcomes and impacts for the Fund around these scenarios. The modelling does not provide a framework for testing different courses of action by the Fund (via its funding and investment strategy) to mitigate against the risks discussed in this paper, due to the way in which the analysis has been constructed.

Climate change scenarios – method

We have used the Fund's ALM results (see the May 2021 Investment Review) to explore the impact on the Funds' solvency in the event that three pre-specified climate change scenarios occur. The Reliances and Limitations that apply to the Fund's ComPASS modelling also apply here.

The climate change scenario modelling assumes that economic and financial relationships are not broken and that climate outcomes exist within the extremes of the 5000 scenarios modelled for the ALM (as generated by our Economic Scenario Service (ESS)). Although the ESS captures a wide range of future financial conditions, it has not been calibrated to allow for climate change explicitly. **Importantly, this modelling does not place a likelihood of each of these scenarios occurring and the number of simulations captured under each scenario shouldn't be used as such.**

The longevity impact has been included approximately by scaling the liabilities linearly such that by time 20 the full impact is realised. In each year of the projection, this means that the liabilities are being adjusted to reflect updated beliefs about future longevity but the projected cashflows being paid out are not being modified away from the base ALM scenario. The longevity impacts are assumed to be the same in 20 years' time as they are today.

Reliances & Limitations (5)

The modelling uses an existing ALM, where the Fund's assets and liabilities have been projected forward under 5000 future financial conditions (including the ESS, our economic scenario generator), and highlights any simulations that satisfy the constraints which define each climate change scenario. The conditions are shown in the tables below:

Head in the Sand:

Economic Factor	Annualised returns (years 1 to 10)	Annualised returns (years 1 to 20)
Global equity	< median + 2%	< median – 3%
Inflation	> median	> median + 0.5%
Credit Spreads	> median – 0.5%	> median + 0.5%
Real yields	< median – 0.25%	< median – 0.5%

Delayed transition:

Economic Factor	Annualised returns (years 11 to 13)	Annualised returns (years 1 to 20)
Global equity	< median – 5%	< median – 3%
Inflation	> Median +1%	unconstrained
Credit Spreads	> median + 1%	unconstrained
Real yields	< median – 1%	unconstrained

Green Revolution:

Economic Factor	Annualised returns (years 1 to 3)	Annualised returns (years 1 to 20)
Global equity	< median - 2%	> median – 1%
Inflation	> median + 0.5%	< median + 1%
Credit Spreads	> median + 1%	unconstrained
Real yields	< median	< median + 1%

Expected Rate of Returns and Volatilities

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The following figures have been calculated using 5,000 simulations of the Hymans Robertson Economic Scenario Service, calibrated using market data as at 31 March 2021. All returns are shown net of fees. Percentiles refer to percentiles of the 5,000 simulations and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to the (simulated) yields in force at that time horizon.

		Annualised total returns														
		Cash	Index Linked Gilts (medium)	Fixed Interest Gilts (medium)	UK Equity	Overseas Equity	Private Equity	Property	Emerging Markets Equity	Infrastructure Equity	Multi Asset Credit (sub inv grade)	Senior Loans (sub inv grade)	High Yield Debt	Inflation (CPI)	17 year real yield (CPI)	17 year yield
5 years	16th %'ile	-0.3%	-3.2%	-2.5%	-3.9%	-3.6%	-7.1%	-3.5%	-7.0%	-5.0%	0.5%	1.2%	-0.4%	1.0%	-2.2%	0.8%
	50th %'ile	0.4%	-0.3%	0.1%	4.3%	4.4%	5.1%	2.5%	4.6%	4.1%	3.3%	3.7%	2.3%	2.6%	-1.4%	1.9%
	84th %'ile	1.2%	2.6%	2.6%	12.3%	12.4%	18.9%	8.8%	16.5%	14.1%	5.2%	5.2%	4.2%	4.1%	-0.4%	3.1%
10 years	16th %'ile	0.1%	-2.5%	-1.1%	-0.9%	-1.0%	-3.1%	-1.3%	-3.2%	-1.8%	1.8%	2.0%	0.8%	1.0%	-1.7%	1.0%
	50th %'ile	1.1%	-0.5%	0.3%	4.8%	5.0%	5.8%	3.2%	5.3%	4.9%	3.7%	3.9%	2.8%	2.6%	-0.5%	2.4%
	84th %'ile	2.3%	1.6%	1.6%	10.7%	10.9%	15.6%	8.0%	13.7%	12.0%	5.3%	5.7%	4.3%	4.3%	0.7%	4.1%
20 years	16th %'ile	0.6%	-2.0%	0.2%	1.4%	1.3%	0.4%	0.8%	0.0%	0.9%	3.0%	3.2%	2.2%	0.8%	-0.7%	1.3%
	50th %'ile	2.0%	-0.3%	1.0%	5.8%	5.8%	6.8%	4.2%	6.0%	5.9%	4.6%	4.9%	3.8%	2.3%	1.0%	3.2%
	84th %'ile	3.6%	1.5%	1.7%	10.4%	10.3%	13.6%	8.1%	12.5%	11.0%	6.3%	6.8%	5.4%	3.9%	2.7%	5.7%

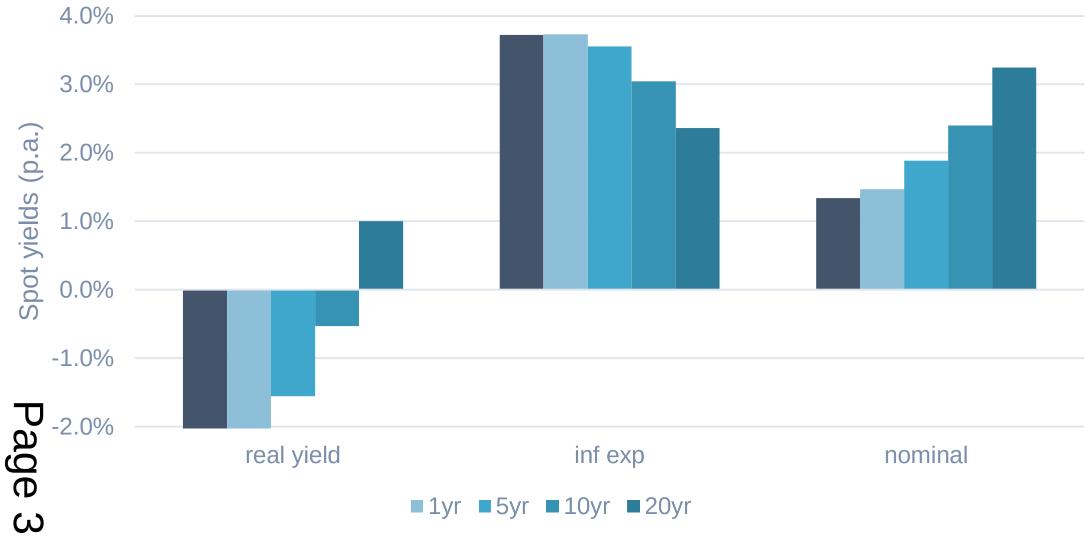
The current calibration of the model indicates that a period of outward yield movement is expected. For example, over the next 20 years our model expects the 17 year maturity annualised real (nominal) interest rate to rise from -2.3% (1.3%) to 1.0% (3.2%)

Risk and return assumptions (31 March 2017)

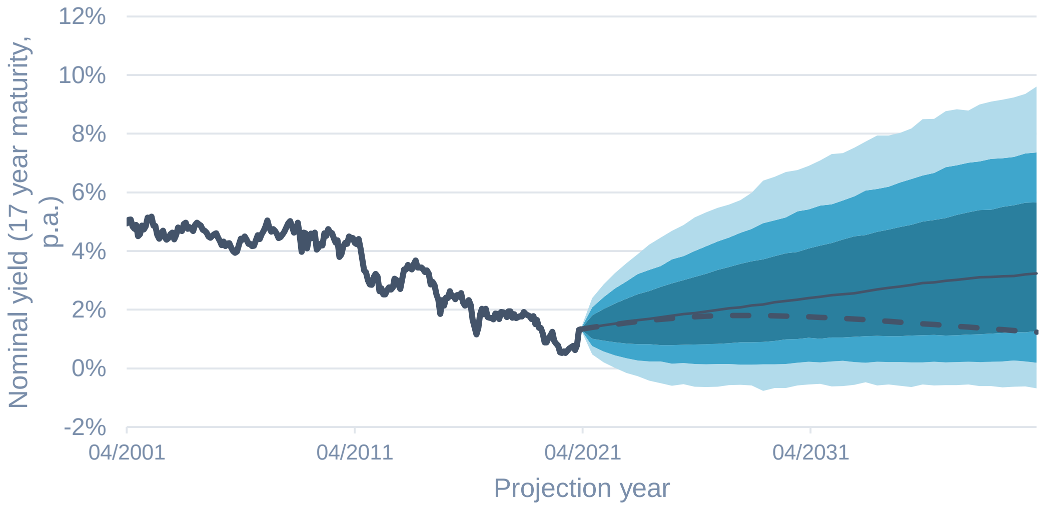
Asset class	Median return (%p.a. 20 year horizon)		1 year volatility (%)
	Nominal	Real (above RPI)	
Global equity (beta = 1)	5.5	2.4	18.3
Global equity (beta = 0.9)	5.5	2.4	16.5
Diversified growth	4.1	1.0	14.1
Property	3.7	0.6	14.2
Private equity	6.8	3.7	29.3
Infrastructure	4.6	1.5	20.1
Private debt	6.2	3.1	7.2
High yield bonds	5.1	2.0	7.8
Corporate bonds (A rated average)	2.1	-1.0	10.1
Cash	2.5	-0.6	0.5
Med gilts	1.3	-1.8	9.5
Med ILGs	0.5	-2.6	7.1

ESS vs. market implied yields - 31.03.21

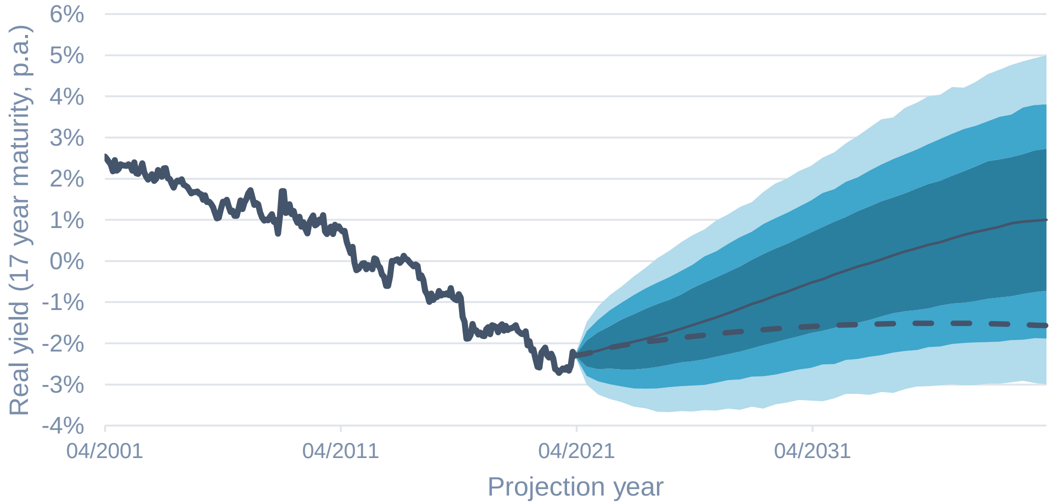
Evolution of (17yr maturity) gilt yields



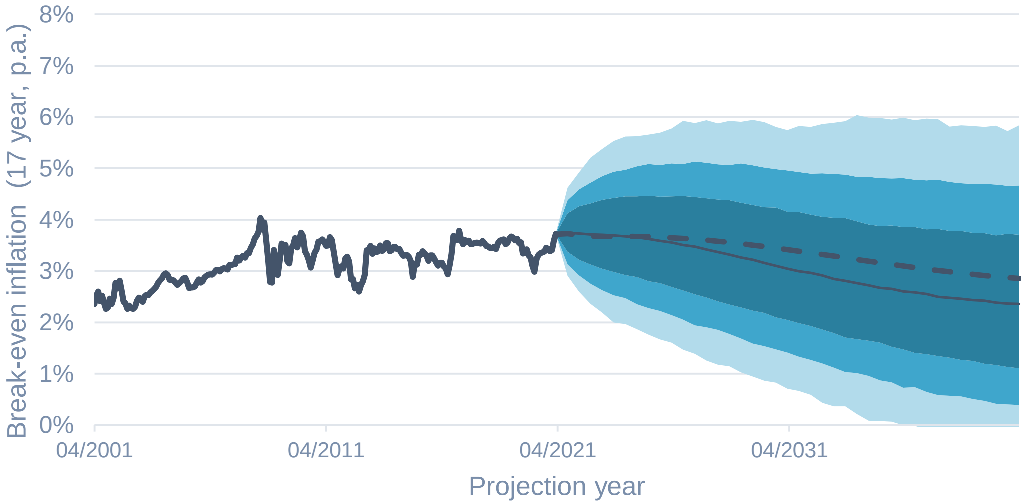
Nominal yields



Real yields



Break-even inflation



Risk warnings

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

This paper should not be released or otherwise disclosed to any third party except as required by law or regulatory obligation or without our prior written consent. We accept no liability where the paper is used by, or released or otherwise disclosed to, a third party unless we have expressly accepted such liability in writing. Where this is permitted, the paper may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.

Pensions Committee

2.00pm, Wednesday, 23 June 2021

Statement of Investment Principles

Item number 6.8

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 adopt the revised Statement of Investment Principles.

Doug Heron
Chief Executive Officer, Lothian Pension Fund

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

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

Statement of Investment Principles

2. Executive Summary

2.1 The report presents the Statement of Investment Principles (SIP) for Lothian Pension Fund and Scottish Homes Pension Fund (The Funds). It was last reviewed by Committee in June 2020.

2.2 The material changes to the SIP can be found in Appendix A where the new investment strategies are detailed. Strategic advice was sought from investment consultant Hymans Robertson and the independent advisers on the Joint Investment Strategy Panel following completion of the latest triennial actuarial valuation.

3. Background

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

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

4. Main Report

4.1 The Statement of Investment Principles (SIP) is formally reviewed by Committee annually whether there are changes or not. It takes advice from officers and advisers of the Joint Investment Strategy Panel (JISP). At its meeting in early June 2021, the JISP confirmed its belief that the SIP satisfies Committee's statutory duty and is an accurate reflection of current advice, which includes reconsideration of long-term investment strategy following the triennial actuarial valuation.

4.2 The SIP describes the Funds' investment strategies as allocations to various asset categories, or Policy Groups. These asset allocations and the investment performance of the Funds are reviewed annually and are the subject of a separate paper on the agenda.

4.3 The amended SIP includes revisions to investment strategy, which is the subject of a separate paper on the Committee's agenda. These can be found in Appendix A.

4.4 The FRC introduced a new Stewardship Code in 2020. This is a voluntary code for asset owners, asset managers and service providers, who support them. The code aims to promote responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy.

4.5 Unlike the prior Stewardship Code, signatories to the revised Code are required to file an annual Stewardship Report with the FRC explaining how they have applied the 12 Principles contained in the Code over the previous 12 months. The FRC will evaluate reports against its assessment framework. This is a much more onerous requirement, demanding resources similar to PRI reporting with which there is considerable overlap. Unfortunately, the reporting format is completely different, so synergies are limited. There are multiple opportunities to submit reports to the FRC during 2021, the next of which is at the end of October. The Fund plans to submit a report to the FRC during 2021.

5. Financial impact

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

6. Stakeholder/Regulatory Impact

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 governance, compliance or regulatory implications as a result of this report.

7. Background reading/external references

7.1 None.

8. Appendices

Appendix 1 – Statement of Investment Principles including:

- Appendix A – Investment Strategies (23 June 2021)
- Appendix B – Investment Strategy Implementation (23 June 2021)

- Appendix C –UK Stewardship Code 2020 - Principles
- Appendix D – Statement of Compliance with the CIPFA Principles for Investment Decision Making in the Local Governance Pension Scheme

LOTHIAN PENSION FUND

Statement of Investment Principles

LOTHIAN
PENSION FUND

1) INTRODUCTION

1.1 This Statement of Investment Principles (**SIP**) was agreed by the Pensions Committee (**Committee**) of the City of Edinburgh Council (**CEC**) on 23 June 2021. CEC is the administering authority for the Lothian Pension Fund and Scottish Homes Pension Fund (**the Funds**).

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

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

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

2) GOVERNANCE

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

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

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

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

3) HIGH LEVEL INVESTMENT PRINCIPLES

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

Governance

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

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

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

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

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

Funding

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

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

Investments

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

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

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

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

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

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

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

4) RESPONSIBLE INVESTMENT

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

4.2 To demonstrate and embrace an open and transparent approach, the Funds became a signatory of the Principles for Responsible Investment (PRI) in 2008. Signatories commit to six principles and, since 2014, to an annual assessment of their responsible investing practices, which is published on the Funds' website. The Funds demonstrate their open and transparent approach to Responsible Investing by publishing a Statement of Responsible Investment Principles (**SRIP**). This document explains how the Funds practise responsible investment asset class by asset class, and how it is committed to limiting the impact of climate change. The SRIP is published as a standalone document. It represents the Funds' position on Responsible Investment, and it forms part of the Pensions Committee's regular review of Stewardship and Engagement activities.

4.3 The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting. The Funds previously published details of their adherence to the FRC's Stewardship Code. The FRC launched a new Stewardship Code with a new and more onerous requirement – the filing of a comprehensive report on Stewardship activity and Responsible Investment policy covering the 12 Principles of the new Stewardship Code, which are listed in Appendix C. The Funds plan to produce a report compliant with the new Stewardship Code during 2021, which it will submit to the FRC for assessment.

5) FUNDS' OBJECTIVES

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

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

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

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

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

- **Equities** provide an equitable share in the assets and profits of companies. Income is provided through discretionary share dividends. Equities are listed in the UK or overseas, or are unlisted (private equity). Equities have historically produced returns above inflation.
- **Other Real Assets** are typically investments in a share of income and capital appreciation of tangible assets, including **property** (land and/or buildings for commercial or residential use), **infrastructure** (assets deemed essential to the orderly functioning of daily life, such as renewable energy generation and transmission assets, water utilities, airports and toll roads) and **timberlands**. Income comes from dividends and rents.
- **Non-Gilt Debt** instruments are issued by a range of borrowers to finance their activities in various sectors of the economy, which means that they carry varying degrees of credit risk. Income is provided through interest, which is typically paid to the lender on a regular basis until the loan capital is repaid, generally at par by the issuer at a pre-determined date. Bonds can pay a fixed, variable or inflation-linked rate of interest. Bonds are either listed in the UK or overseas or are unlisted (private debt).

- **<u>Gilts</u>** are debt instruments issued by the UK Government. Typically, these provide interest payments on a regular basis over the life of the loan until capital is repaid at maturity. Some gilts provide interest payments and capital repayment value that is directly linked to price inflation (the Retail Price Index (RPI)). These are known as <u>Index Linked Gilts</u> and they provide the closest match to the Funds' liabilities, most of which are inflation-linked, albeit to a different measure of price inflation (the Consumer Price Index (CPI)). Some other governments also issue this type of debt, but in different currencies tied to price inflation in their own countries.
- **<u>Cash</u>** is also a form of investment used to provide instant or short-term liquidity, and can be held in both sterling and foreign currencies (including Treasury Bills, Money Market Funds and Secured Investments). Cash generates interest income, but typically at a lower rate than bonds and other debt.

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

6) FUNDS' STRATEGIES

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

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

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

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

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

6.6 **Buses Strategy** is a diversified portfolio of assets tailored to suit the risk appetite of the Lothian Buses company**.** The Lothian Buses Pension Fund merged with Lothian Pension Fund in Q1 2019. It represents approximately 7% of Fund assets.

6.7 There may also be demand from individual employers for other investment strategies. The Fund will consider such requests, subject to practical implementation of such strategies and, if appropriate, a review of employer contribution rates. It is not practical for the Fund to offer individual employers full flexibility on asset allocation.

6.8 **Scottish Homes Pension Scheme** was fully funded at the most recent actuarial valuation in March 2020. Its investment strategy protects this closed and mature scheme from short-term changes in funding level and increases in contribution rates by investing in UK gilts and cash.

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

7) STRATEGY IMPLEMENTATION

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

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

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

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

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

8) OTHER INVESTMENT CONSIDERATIONS

Realisation of investments

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

Stock Lending

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

Underwriting

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

Derivatives

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

Safekeeping of Assets

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

9) COMPLIANCE

Regulations and Investment Limits

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

9.2 The Regulations contain limits on the percentage of a pension fund that may be invested in certain asset types. In accordance with the Regulations, the Committee have agreed the limits applicable to the Funds' investments in partnerships to accommodate the allocation to unlisted investments, including infrastructure, timber, property, equity and debt. The limits agreed by Committee are:

- All contributions to any single partnerships: 5% (statutory maximum of 5%)
- Contributions to all partnerships: 20% (statutory maximum of 30%)

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

CIPFA Principles for Investment Decision Making

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

Review of SIP

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

LOTHIAN
PENSION FUND

APPENDIX A – INVESTMENT STRATEGIES (23 JUNE 2021)

LOTHIAN PENSION FUND: MAIN STRATEGY

Investment Objectives: to generate returns sufficient to pay pensions as they fall due.

Investment Strategy:

Policy Group	Target Weight 2021 - 2024	Permitted Range
Equities	60%	50% - 70%
Real Assets	20%	10% - 30%
Non-Gilt Debt	10%	0% - 20%
LDI (formerly Gilts)	10%	0% - 25%
Cash	0%	0% - 15%
Total	**100%**	

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

Investment Objective: to achieve a return in line with gilts that match the duration of the liabilities.

Investment Strategy: the MEG Strategy invests exclusively in UK Gilts and Cash matching the duration of employer liabilities with the duration of the invested assets.

LOTHIAN PENSION FUND: 50/50 STRATEGY

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

Investment Strategy:

Policy Group	Target Weight 2021 - 2024	Permitted Range
Equities	30%	25% - 35%
Real Assets	10%	5% - 15%
Non-Gilt Debt	5%	0% - 10%
LDI (formerly Gilts)	55%	45% - 65%
Cash	0%	0% - 10%
Total	**100%**	

LOTHIAN PENSION FUND: BUSES STRATEGY

Investment Objective: to generate sufficient returns to pay pensions as they fall due.

Investment Strategy: to achieve its objective, the Buses Strategy invests in a proportion of the Main Strategy and the MEG Strategy that reflects the maturity of liabilities. This is currently 50:50. Based on the Main Strategy above, the Buses Strategy will have the following exposures. [Initial recommendation subject to adviser agreement – to be confirmed at Pensions Committee meeting.]

Policy Group	Target Weight 2021 - 2024
Equities	30%
Real Assets	10%
Non-Gilt Debt	5%
LDI (formerly Gilts)	55%
Cash	0%
Total	**100%**

SCOTTISH HOMES PENSION FUND

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

Investment Strategy: all assets are invested in UK gilts and cash. As some liabilities are fixed in nature and some are inflation-linked, the Fund invests in both nominal and index-linked gilts to match cash flows with liability payments one year beyond the next actuarial valuation. Longer dated liability payments are duration matched.

APPENDIX B – INVESTMENT STRATEGY IMPLEMENTATION (23 JUNE 2021)

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

Policy Groups & Mandates	Manager	Actual Allocation 31 March 2020	Actual Allocation 31 March 2021
EQUITIES		**58.3%**	**60.0%**
Global Low Volatility	Internal	**13.2%**	**13.1%**
Global High Dividend Yield	Internal	**13.7%**	**13.4%**
Global Stable Multi-factor	Internal	**12.1%**	**13.7%**
Global Stable Equities	Nordea	**3.9%**	**3.5%**
Global Value	Harris	**2.4%**	**1.4%**
Global Alpha	Baillie Gifford	**1.6%**	**2.2%**
UK All Cap	Internal	**2.9%**	**3.1%**
UK Mid Cap	Internal	**1.2%**	**1.6%**
Europe (ex UK) Quality	Internal	**2.7%**	**2.7%**
US Value	Internal	**2.7%**	**3.4%**
Private Equity	Various	**1.7%**	**1.7%**
Currency Hedge	Internal	**0.2%**	**0.0%**
REAL ASSETS		**22.0%**	**18.2%**
Property	Various	**7.4%**	**6.4%**
Other Real Assets	Various	**14.7%**	**11.8%**
NON-GILT DEBT		**7.8%**	**9.2%**
Other Bonds	Various	**7.8%**	**9.2%**
LDI		**6.9%**	**5.6%**
UK Gilts	Internal	**6.9%**	**5.6%**
CASH		**4.9%**	**7.1%**
TOTAL FUND		**100.0%**	**100.0%**

Note: numbers may not sum due to rounding

APPENDIX C – UK STEWARDSHIP CODE 2020 - PRINCIPLES

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 Stewardship Code 2020 requires signatories to report comprehensively on the following 12 Principles:

Principle 1: Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

Principle 2: Signatories' governance, resources and incentives support stewardship.

Principle 3: Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

Principle 4: Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

Principle 5: Signatories review their policies, assure their processes and assess the effectiveness of their activities.

Principle 6: Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

Principle 7: Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

Principle 8: Signatories monitor and hold to account managers and/or service providers.

Principle 9: Signatories engage with issuers to maintain or enhance the value of assets.

Principle 10: Signatories, where necessary, participate in collaborative engagement to influence issuers.

Principle 11: Signatories, where necessary, escalate stewardship activities to influence issuers.

Principle 12: Signatories actively exercise their rights and responsibilities.

APPENDIX D – CIPFA PRINCIPLES FOR INVESTMENT DECISION MAKING AND DISCLOSURE

The Chartered Institute of Public Finance and Accountancy (CIPFA) published six Principles for Investment Decision Making and Disclosure in the Local Governance Pension Scheme in the UK in 2012. Details of the principles and the Funds' compliance are described below.

Principle 1 – Effective decision making

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

- The Funds' Trustee Training Policy (comprising a compulsory training seminar for all new trustees and ongoing training of at least three days per year for all members of the Pensions Committee and Pension Board) provides the knowledge to enable them to evaluate and challenge the advice they receive. Standards relating to the administration of the Committee's business are strictly up-held.

- The Fund has appointed an Independent Professional Observer to strengthen governance. The role of the Observer is to provide the Committee with an impartial, additional source of experience and technical knowledge.

- The Pensions Committee focuses on setting the strategy for the Funds and monitoring performance. The Pension Board also attends Committee meetings and is responsible for assisting the Committee in securing compliance with relevant regulations and other legislation.

- The Committee delegates the day-to-day running of the Funds to the Executive Director of Resources, who in turn delegates to the Funds' officers. The Executive Director of Resources is responsible for the provision of the training plan for Committee to help them to make effective decisions to ensure that they are fully aware of their statutory and fiduciary responsibilities, and to regularly remind them of their stewardship role.

- The Joint Investment Strategy Panel advises the Executive Director of Resources on the implementation of the agreed strategies, reviewing structure, funding monitoring, performance and risk and asset allocation. The Joint Investment Strategy Panel meets at least quarterly and is made up of experienced investment professionals, including independent advisers.

- The in-house team undertakes day-to-day monitoring of the Funds. The team includes personnel with suitable professional qualifications and experience to provide the necessary skills, knowledge, advice and resources to support the Joint Investment Strategy Panel and the Pensions Committee.

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

Principle 2 – Clear Objectives

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

- The Statement of Investment Principles and the Funding Strategy Statement define the Funds' primary funding objectives.

- Asset-liability modelling is undertaken with the help of external advisers to aid the understanding of risks and the setting of investment strategy. Each Fund has a scheme-specific investment strategy.

- Employers' attitude to risk is specifically considered in the setting of strategy, and employers can request a bespoke investment strategy.

- Reviews of investment strategy focus on the split between broad asset classes (equities, real assets, non-gilt debt, LDI and cash).

- Investment Management Agreements set clear benchmarks and risk parameters and include the requirement to comply with the Funds' Statement of Investment Principles.

- Appointments of advisers are reviewed regularly. Investment and actuarial advisers are appointed under separate contract. Procurement of advisers is conducted within European Union procurement regulations.

- The setting of the Funding Strategy includes specific consideration of the desire to maintain stability in employer contribution rates.

Principle 3 – Risk and liabilities

In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities. These include the implications for council tax payers; the strength of the covenant of participating authorities; the risk of their default, and longevity risk.

- The Funds take advice from the scheme's actuary regarding the nature of its liabilities. Asset-liability modelling is undertaken periodically to aid the setting of investment strategy, and these exercises specifically take account of covenant strength and longevity risk.

- Lothian Pension Fund recognises that employers' circumstances vary and an alternative investment strategy for their section(s) of the Fund may be deemed suitable. The Fund will consider requests for such alternatives, subject to practical implementation of such strategies and, if appropriate, a review of employer contribution rates. It is not practical for the Fund to offer individual employers full flexibility on asset allocation.

- The Funding objectives for the Funds are expressed in relation to the solvency and employer contribution rates. The Funds regularly assess the covenants of participating employers.

- The Executive Director of Resources is responsible for ensuring the appropriate controls of the Funds. Controls are subject to internal audit, and results of audits are submitted to the Pensions Audit Sub Committee and/or the Pensions Committee.

- The Funds maintain a risk register, which is reviewed on a quarterly basis.

Principle 4 – Performance assessment

Arrangements should be in place for the formal measurement of the performance of the investments, investment managers and advisers. Administering authorities should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members.

- The Funds' performance and risk analysis is produced by an independent external provider.

- The internal investment team monitors the external investment managers' performance and risk on a regular basis and reports this to the Joint Investment Strategy Panel. The Joint Investment Strategy Panel assesses the performance and risk of both internal and external investment managers on a regular basis (typically quarterly).

- The Funds' contracts with its advisers are regularly market tested.

- The Joint Investment Strategy Panel assesses its own performance on a regular basis and reports to Committee on its activities, typically annually.

- Training and attendance of members of the Pensions Committee and the Pensions Board are monitored and reported on a regular basis. The composition of the Committee and Pension Board is reviewed on a regular basis.

Principle 5 – Responsible ownership

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

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

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

- The Funds' approach to responsible investment is described in the Statement of Investment Principles and on the Funds' website.

- The Funds' policy on responsible ownership is included in the statement on the Financial Reporting Council's Stewardship Code (see Appendix C of the Statement of Investment Principles).

- Details of the Funds' voting and engagements are available on the Funds' website. The Funds' annual report and accounts includes a summary of the Funds' approach to responsible investment. A summary of the report and accounts is sent to members. The full report is available on the website and is sent to members on request.

Principle 6 – Transparency and reporting

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

- Meetings of the Pensions Committee are open to the public. Members of the public are entitled to make a deputation at Committee meetings. Committee papers are available on the City of Edinburgh Council's website. The Pension Board joins the Committee at all meetings.

- The Committee's remit covers wider pension scheme issues, other than the management and investment of funds.

- The Funds' policy statements, including the Communications Strategy, Statement of Investment Principles and Funding Strategy Statement are maintained regularly. Stakeholders are consulted on changes. Documents are available on the Funds' website.

- The Funds produce an Annual Report & Accounts. The full report is available on the website, and is sent to members on request. The Funds also produce regular newsletters for members as well as an annual benefit statement. Regular briefings are provided to employers. The Funds' website is updated regularly.

Pensions Committee

2.00pm, Wednesday, 23 June 2021

Risk Management Summary

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the Quarterly Risk Overview as at 06 May 2021

Struan Fairbairn
Chief Risk Officer, Lothian Pension Fund

Contact: Sean Reid, Risk and Compliance Manager, Lothian Pension Fund

E-mail: sean.reid@edinburgh.gov.uk | Tel: 0131 529 7259

Risk Management Summary

2. Executive Summary

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

3. Background

3.1 LPF's risk management procedures require it to:

3.1.1 maintain a detailed operational risk register which sets out all the risks identified and assessed by the officers on an ongoing basis 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).

3.2 The Conveners and Independent Professional Observer receive a copy of the full risk register every quarter.

3.3 The Audit Sub Committee routinely reviews the full risk register on an annual basis as part of its in-depth review, which also includes a review of the group's overall risk assurance and risk appetite.

3.4 The LPFI Limited (LPFI) and LPFE Limited (LPFE) boards consider their own risks separately and, in the case of LPFI, in line with the regulatory requirements of the Financial Conduct Authority. However, material risks relating to these operational subsidiaries do feed into the overarching group risk management process.

4. Main Report

4.1 The Quarterly Risk Overview as at 06 May 2021 (Appendix 1) is included for the Committees consideration.

4.2 The risk management process for the LPF group is integrated throughout the group's governance and controls. In particular, the Committee should be aware of the following:

4.2.1 *Risk appetite*: considered and set by the Senior Leadership Team (SLT) in conjunction with the Risk Management Group.

4.2.2 *Risk management group (RMG)*: routine meetings held quarterly and otherwise on an as required basis to consider and assess all elements of the LPF group's risk framework, including the risk appetite, register, overall assurance position and any more granular risks escalated from other sub-groups. The group comprises representation across all functions and includes the SLT.

4.2.3 *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 SLT, with key actions being tracked by the risk function and relevant business units.

4.2.4 *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 RMG and SLT, and presented to the Committee annually.

4.2.5 *LPF group systems and controls assessment*: managed by SLT and the LPFI and LPFE boards and reported to Committee and JISP annually.

4.2.6 *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. This framework continues to be developed and enhanced in conjunction with other developments within the group.

4.2.7 *Internal Capital Adequacy Assessment Process (ICAAP)*: which is managed on an ongoing basis by SLT and RMG. 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. This process will be the subject of regulatory change from January 2022 and the group are currently involved in a programme to comply by that date.

4.2.8 *ICT oversight and governance procedures*: which are managed by the ICT Oversight Group on an ongoing basis and overseen by the SLT.

4.2.9 *People and HR Procedures*: which are managed by the People Group on an ongoing basis and overseen by the SLT and the LPFE board.

4.2.10 *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).

4.2.11 *Overall review of governance and the LPF group structure*: managed by SLT and overseen annually by the Committee and Pensions Committee.

4.2.12 *COVID*-19: as above, managed by SLT on an ongoing basis, in conjunction with the Risk Management Group and other dedicated sub-groups as required.

5. Financial impact

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

6. Stakeholder/Regulatory Impact

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

7.1 None.

8. Appendices

Appendix 1 – Quarterly Risk Overview, as at 06 May 2021

LOTHIAN
PENSION FUND

Quarterly Risk Overview

6 May 2021

Executive Summary

This document provides a summary of the assessment of the LPF group's risks by the Risk Management Group (RMG) on 6 May 2021. The RMG oversees the LPF group risk register, which is reviewed on an ongoing basis by the risk function and at least quarterly by RMG itself.

Risks are managed across the group by existing controls – activities and measures put in place to prevent and detect risks. These controls are subject to ongoing monitoring and assurance. Where further one-off actions are needed to mitigate risks, these actions are managed at an operational level with reporting to, and oversight by, the RMG. This report provides a narrative update on relevant key risks, rather than lists of actions and controls.

Prevailing risk climate

The LPF group continues to carry a higher than normal level of operational risk as it transitions its model to an increasingly arms-length structure, but in doing so it is significantly mitigating other fundamental structural and operational risks. This period of organisational transformation is now (excluding consideration of Project Forth) giving way to a more settled stage of 'bedding-in' and reflective assurance work, with the ongoing project to implement a separate managed service provider for core ICT being the only significant non-BAU initiative.

The group began supporting its collaborative partners with portfolio management services from December 2020. That brought heightened client servicing and regulatory risks, but improved business resilience, sustainability and enhanced cost sharing. The service is expected to build throughout the next 12 months, subject to JISP and partner fund take-up, but then level off thereafter. That AUM build is progressing slower than originally reported, simply due to competing demands on resource both within LPF and amongst our collaborative partners. That is important to note in terms of assessing the current and projected risk environment, but is not of itself a concern.

The group continues to operate on a fully remote basis and its business continuity plan is still operating effectively. Good progress has also been made in anticipating medium term adjustments (such as its office refit) to further mitigate the position as soon as that becomes possible. Shorter-term mitigation strategies remain under review, as in some cases these were required to be put in place quickly and on an agile basis. Business continuity in all its facets therefore continues to be a key focus, including around heighted risk of cyber security, fraud, group resilience, culture and staff conduct.

Risk register at 6 May 2021

Total risks	High	Moderate	Low
35	3	13	19

See Appendix 2 for full overview of risks.

Changes since last review 8 Feb 2021

New	Closed	Improved	Deteriorated	Unchanged
0*	1	7	4	24

**1 new risk will be added to the risk register next quarter, on Climate-related issues.*

1 risk has been closed and removed from the register:

- **Risk 13 – Loss due to stock lending.** This risk has been closed. It is no longer deemed useful to monitor as a separate risk. Any stock lending issues arising in future can be captured and monitored as part of Risk 1, on investment performance.

Scoring changes since the last risk review:

- **Risk 4 – Recruitment & retention of staff.** Deteriorated from 24 to 30. Potential for recruitment issues due to flooded market and we're seeing an increased number of unskilled applicants to advertised vacancies.
- **Risk 7 – Failure of IT systems.** Deteriorated from 48 to 54. Temporary increase due to upcoming ICT transition, and risk of disruption during migration.
- **Risk 12 – Data loss or breach.** Deteriorated from 36 to 42. Also a temporary increase from potential data related risks arising from forthcoming ICT migration.
- **Risk 17 – Portfolio Transition Issues.** Deteriorated from 8 to 12, due to proposed collaborative partner transitions.
- **Risk 5 – Fraud relating to members.** Improved from 24 to 16. LPF has signed up to the TPR Pledge to combat pension scams, and implemented new processes to identify potential fraud and ensure members are aware of potential scams. There is nevertheless no complacency around the heightened risk around cyber and other fraud arising from the pandemic driven remote working.
- **Risk 9 – Pension Committee (or other) members take decisions against sound advice.** Improved from 30 to 24. LPF liaised with Democracy, Governance and Resilience team and Azets, it was agreed that the annual report for LPF will only be considered and approved by the Pension Committee.
- **Risk 10 - Pension Board not operating effectively.** Improved from 28 to 20. The Chair has agreed to extend their tenure for another year. Two of three vacancies have now been filled.
- **Risk 14 – Risk of incorrect pension payments.** Improved from 16 to 9. All recommendations from previous audits have been implemented, with mitigating controls in place and working as expected.
- **Risk 15 – Failure to pay pensions as they fall due.** Improved from 36 to 27. Some progress made with AVC issues, although not fully resolved.
- **Risk 22 – Incorrect communications with members.** Improved from 20 to 16. Work underway on hosting service and review of communications channels.
- **Risk 30 – Limited or incorrect data from Employers.** Improved from 20 to 16. Progress made on ensuring Employers are using data validation when submitting information.

The scoring for one remaining material risk – **11 Business Continuity Issues -** remains unchanged. Elevated score is partly due to COVID-19 and continuing remote arrangements. This risk will improve meaningfully once a partial return to office occurs, and the move to the new ICT provider is complete and related enhancements are delivered.

Other relevant updates

Material litigation – none

Detailed Update

Update on all 'High' or 'Moderate' risks:

Risk & reference number	Update	Score & movement
7 - Failure of IT systems	COVID-19 remote working remains in place. Resilience is good and stable, but impact and probability remain increased to reflect these circumstances. Score temporarily elevated due to upcoming ICT provider change, and risk of disruption during migration. A migration project group meets weekly to manage the transition.	**54 Deteriorated**
11 - Business continuity issues	Remains high due to the prevailing COVID-19 situation. All staff continue to work remotely. Move to IT provider expected to improve system robustness. Office refit completed within timescales – some adjustments and snagging to be finished. Expected to be fully ready by end May.	**42 Unchanged**
12 - Members' confidential data is lost or made public. Breach of Data Protection Act	There continues to be 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 attempts. This risk has been elevated due to upcoming ICT provider change, and related risks on data loss / corruption during migration. A migration project group meets weekly to manage the transition.	**42 Deteriorated**
36 - Cybersecurity protections and/or back-up not sufficient to prevent/minimise cyber-attacks.	As above, risk raised due to COVID and remote working. Formal training and awareness programmes are in place for staff. An independent security consultant has been appointed and will carry out penetration testing and information security reviews pre and post migration.	**32 Unchanged**
4 - Recruitment & retention of staff	Score increased - potential recruitment issues on getting appropriate calibre of talent due to flooded market, and an increased number of unskilled applicants.	**30 Deteriorated**
8 - Staff culture & engagement issues	A refreshed annual performance process has been embedded, with 2021 plans and objective for all colleagues in place. A People & Communications review by an external consultant was carried out in Mar/Apr with no material adverse findings. Recommendations are being reviewed and implemented.	**30 Unchanged**
20 – Regulatory breach	Continuing to implement operational changes required for compliance following the extensions of LPFI's regulatory permissions and new investment management services.	**30 Unchanged**
23 - Acting beyond proper authority/delegations	Due to the prevailing circumstances and outstanding actions the risk remains on amber, although there has been no breach in existing delegations. 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	**30 Unchanged**

Risk & reference number	Update	Score & movement
	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. The group's sub-delegations require to be updated and will need to be refreshed again on the new CEO joining.	
25 - Procurement/framework breach	LPF is continuing to work closely and well with CEC's procurement team to align procurement processes to the specific needs of the LPF group business and also satisfy CEC's oversight requirements. 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 – with progress having been hampered by the prevailing circumstance of the last 6 months.	**30** **Unchanged**
27 - Group structure and governance fully compliant and up-to-date.	Resourcing of committee services under review generally, with enhanced recent engagement, and as part of the Governance Review process.	**30** **Unchanged**
33 - Staff Resource within the Fund not sufficient to carry out core tasks	This risk remains amber due to the additional resource attributable to significant strategic initiatives such as the implementation of the Digital Strategy, extension of investment management services and Project Forth.	**30** **Unchanged**
3 - Failure of an employer to pay contributions	Employers continue to be under increasing financial pressure due to the global pandemic and resulting economic implications. The fund continues to monitor this on an ongoing basis and has established structures and processes to engage with its employers around affordability and potential exit.	**28** **Unchanged**
15 - Late payment of pension	Score improved, moved to amber from red – AVC provider issues and delays to member payments have improved somewhat, but not fully resolved. Remains under close review.	**27** **Improved**

Appendix 1 – Risk Scoring & Distribution Chart

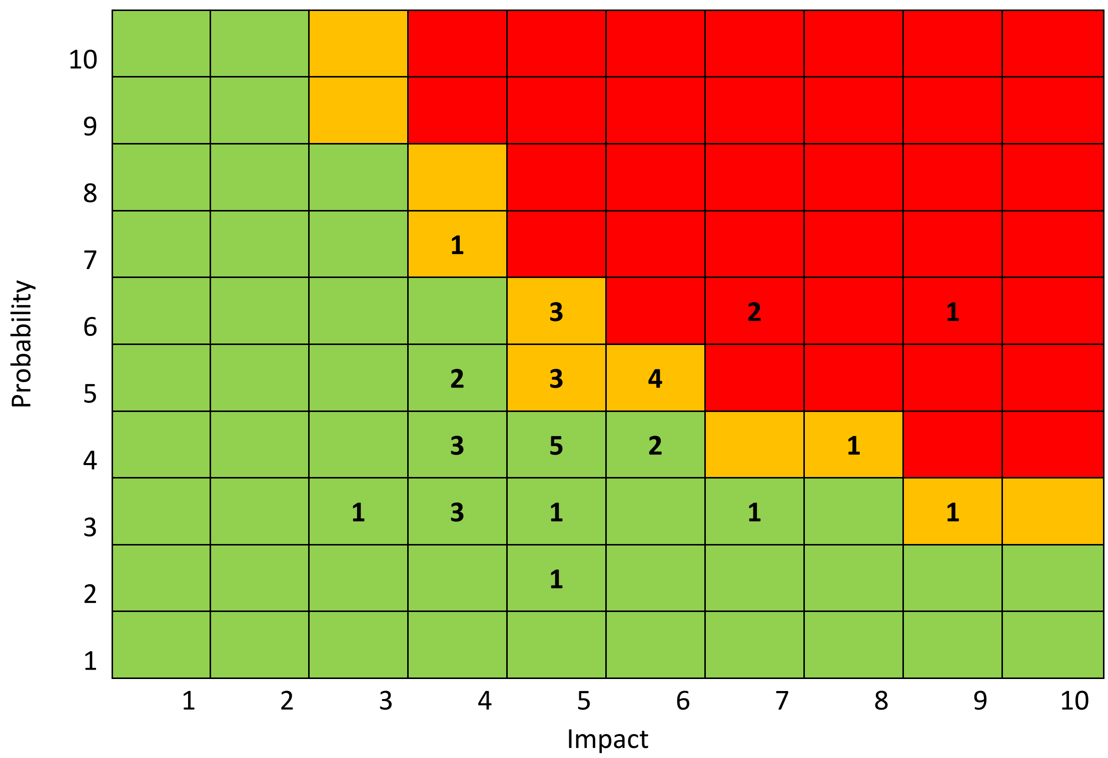
Risk scoring:

	Impact	Probability
1	No discernible effect	Virtually impossible
2	Little discernible effect	Extremely unlikely
3	Some effect noticeable	Remotely possible
4	Some effect on service provision	May occur
5	Noticeable effect on service provision	Fairly likely to occur
6	Some disruption of service	More likely to occur than not
7	Significant service disruption	Likely to happen
8	Material disruption to services	Probably will happen
9	Major service disruption	Almost certainly will happen
10	Catastrophic	Already happening

RAG (Red Amber Green) status:

	Risk Status
(Red)	High: resolve urgently where possible (probability and impact total 35 and above)
(Amber)	Moderate: resolve where possible (probability and impact total 25 to 34)
(Green)	Low: monitor (probability and impact total 24 and below)

Risk Distribution - at 6 May 2021:



Appendix 2 – Full Risk Key

Full risk register scores, including Red Amber Green (RAG) status at 6 May 2021:

Ref	Risk	RAG
1	Investment Performance pressure on employer contributions	
2	Adverse Movement - pressure on employer contributions	
3	Failure of an employer to pay contributions	
4	Recruitment & retention of staff	
5	Fraud by LPF staff or relating to members (including pension liberation fraud)	
6	Staff negligence, maladministration or lack of specialist knowledge	
7	Failure of IT systems	
8	Staff culture & engagement issues	
9	Pension Committee (or other) members take decisions against sound advice	
10	Pension Board not operating effectively	
11	Business continuity issues	
12	Members' confidential data is lost or made public. Breach of Data Protection Act	
13	*Loss due to stock lending default (removed – will no longer appear from next quarter)*	
14	Risk of incorrect pension payments	
15	Late payment of pension	
16	Market abuse by investment team	
17	Portfolio transition issues	
18	Disclosure of confidential information	
19	Material breach of contract	
20	Regulatory breach	
21	FOI process in accordance with law	
22	Incorrect communication with members	
23	Acting beyond proper authority/delegations	
24	Inappropriate use of pension fund monies	
25	Procurement/framework breach	
26	Procurement process compromising ability to secure required resource.	
27	Group structure and governance fully compliant and up-to-date.	
28	Claim or liability arising from shared services	
29	Unauthorised access to employer online system	
30	Incorrect data from Employers leading to fines	
31	Inadequate contractual protection for services	
32	Over reliance on single core service provider	
33	Staff Resource within the Fund not sufficient to carry out core tasks	
34	Breach of Health and safety regulations	
35	Inadequate, or failure of, supplier and other third-party systems (including IT and data security).	
36	Cybersecurity protections and/or back-up not sufficient to prevent/minimise cyber-attacks.	

Appendix 3 – Three year risk trends

Ref	Risk	Q2 2018/19	Q3 2018/19	Q4 2018/19	Q1 2019/20	Q2 2019/20	Q3 2019/20	Q4 2019/20	Q1 2020/21	Q2 2020/21	Q3 2020/21	Q4 2020/21	Q1 2021/22
1	Investment Performance pressure on employer contributions	Green	Green	Green	Green	Green	Green	Green	Amber	Amber	Amber	Amber	Amber
2	Adverse Movement - pressure on employer contributions	Red	Red	Red	Red	Red	Red	Amber	Amber	Amber	Amber	Amber	Amber
3	Failure of an employer to pay contributions	Amber	Amber	Amber	Amber	Amber	Amber	Green	Green	Green	Amber	Amber	Amber
4	Recruitment & retention of staff	Red	Amber	Green	Green	Green	Green	Green	Green	Green	Green	Green	Amber
5	Fraud by LPF staff or relating to members (including pension liberation fraud)	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
6	Staff negligence, maladministration or lack of specialist knowledge	Amber	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
7	Failure of IT systems	Red	Red	Red	Red	Red	Red	Red	Red	Red	Red	Red	Red
8	Staff culture & engagement issues										Amber	Amber	Amber
9	Pension Committee (or other) members take decisions against sound advice	Amber	Amber	Amber	Amber	Green	Green	Green	Amber	Amber	Green	Amber	Green
10	Pension Board not operating effectively	Green	Green	Green	Green	Green	Green	Amber	Amber	Amber	Green	Amber	Green
11	Business continuity issues	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Red	Red	Red	Red	Red
12	Members' confidential data is lost or made public. Breach of Data Protection Act	Amber	Amber	Green	Green	Amber	Amber	Amber	Red	Red	Red	Red	Red
13	Loss due to stock lending default	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	
14	Risk of incorrect pension payments	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
15	Late payment of pension	Green	Green	Green	Green	Green	Green	Green	Amber	Amber	Amber	Red	Amber
16	Market abuse by investment team	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
17	Portfolio transition issues	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
18	Disclosure of confidential information	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
19	Material breach of contract	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
20	Regulatory breach	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber
21	FOI process in accordance with law	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
22	Incorrect communication with members	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
23	Acting beyond proper authority/delegations	Green	Green	Green	Green	Green	Green	Amber	Amber	Amber	Amber	Amber	Amber
24	Inappropriate use of pension fund monies	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
25	Procurement/framework breach	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber
26	Procurement process compromising ability to secure required resource.								Green	Green	Green	Green	Green
27	Group structure and governance fully compliant and up-to-date.	Green	Green	Green	Green	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber
28	Claim or liability arising from shared services	Green	Green	Green	Green	Green	Green	Green	Green	Green	Amber	Green	Green
29	Unauthorise access to PensionsWEB	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
30	Incorrect data from Employers leading to fines	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
31	Inadequate contractual protection for services	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
32	Over reliance on single core service provider	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Green	Green	Green
33	Staff Resource within the Fund not sufficient to carry out core tasks	Red	Red	Red	Red	Amber	Amber	Amber	Amber	Amber	Amber	Amber	Amber
34	Breach of Health and safety regulations	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
35	Inadequate, or failure of, supplier and other third-party systems (including IT and data security).	Green	Green	Green	Green	Green	Green	Green	Green	Green	Amber	Amber	Amber
36	Cybersecurity protections and/or back-up not sufficient to prevent/minimise cyber-attacks.					Green	Green	Green	Amber	Amber	Amber	Amber	Amber

Appendix 4 – Background and Parameters (extract from Risk Register)

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. Those 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'****.*

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

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