Public Document Pack

Notice of Meeting and Agenda

Pensions Committee

2.00 pm Wednesday, 21st June, 2023

Carrick Suite, EICC, Morrison Street Edinburgh - EICC

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

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 Any items under "Private Business" will not be published, although the decisions will be recorded in the minute.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

Susan Handyside, Governance Manager, Lothian Pension Fund
Tel: 07771 378 238
Email: susan.handyside@edinburgh.gov.uk

Lesley Birrell, Committee Services, City of Edinburgh Council
Tel: 0131 529 4240
Email: lesley.birrell@edinburgh.gov.uk

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

4. Deputations

4.1 If any.

5. Minutes

5.1	Minute of Pensions Committee of 23 March 2023 (circulated) – submitted for approval as a correct record	7 - 16

6. Reports

6.1	Referrals and Recommendations from Pensions Audit Sub-Committee	
6.2	Agenda Planning – report by the Chief Executive Officer, Lothian Pension Fund (circulated)	17 - 24
6.3	Funding Strategy Statement - report by the Senior Pensions Employers and Members Manager, Lothian Pension Fund (circulated)	25 - 74
6.4	Lothian Pension Fund – Annual Report and Accounts (Unaudited) - report by the Chief Executive Officer, Lothian Pension Fund (circulated)	75 - 274
6.5	Statement of Investment Principles - report by the Chief Investment Officer, Lothian Pension Fund (circulated)	275 - 298
6.6	Joint Investment Strategy Panel Activity – report by the Chief Investment Officer, Lothian Pension Fund (circulated)	299 - 308
6.7	Annual Investment Update - Lothian Pension Fund – report by the Chief Investment Officer, Lothian Pension Fund (circulated)	309 - 324
6.8	Annual Investment Update - Scottish Homes Pension Fund – report by the Chief Investment Officer, Lothian Pension Fund (circulated)	325 - 330
6.9	Risk and Compliance Quarterly Update - report by the Chief Risk Officer, Lothian Pension Fund (circulated)	331 - 348

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 Executive Officer, Lothian Pension Fund (circulated)	349 - 396
9.2	Project Forth – report by the Chief Executive Officer, Lothian Pension Fund (circulated)	397 - 416

Nick Smith

Service Director, Legal and Assurance

Committee Members

Councillors Watt (Convener), Burgess, Doggart, Nicolson and Neil Ross; John Anzani and Richard Lamont.

Please note that members of the Pensions 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).

This meeting is being held in the Carrick Suite, EICC, Morrison Street, Edinburgh. The meeting is open to all members of the public.

Pension Board Members

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

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 Deborah Smart, Executive Director of Corporate Services 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:

David Vallery, Chief Executive Officer
Bruce Miller, Chief Investment Officer
Kerry Thirkell, Chief Risk Officer
Helen Honeyman, Chief People Officer

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 han24S33@lpf.org.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, Thursday 23 March 2023

Present:

Councillors Watt (Convener), Burgess, Doggart, Nicolson and Neil Ross; John Anzani and Richard Lamont.

Pension Board Members present:

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

Independent Professional Observer:

Andy McKinnell.

Other Attendees:

Laura Calder, Head of Internal Audit, City of Edinburgh Council.

Apologies: Brian Robertson and Alan Williamson.

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 confirmed that there was no change to the order of business.

3. Declaration of Interests

John Anzani declared a non-financial interest in item 16 – Employers Participating in Lothian Pension Fund as his wife was a non-Executive Director on the Board of Enjoy Leisure East Lothian.

4. Minutes

Decision

To approve the minute of the Pensions Committee of 7 December 2022 as a correct record subject to including the following two actions omitted in error from the minute of 28 September 2022:

1) To circulate the link to minutes of the Scottish Scheme Advisory Board to committee members for information.

2) To circulate the Local Authorities Pension Fund Forum minutes to committee members for information.

5. Agenda Planning

An overview of proposed reports for Pensions Committee and Pensions Audit Sub-Committee meetings for June, September and December 2023 was presented.

Decision

1) To note the agenda planning document and revisions for the June, September and December 2023 meetings.

2) To note that the Pension Board Members were invited to comment on agenda items during Committee meetings.

3) To note the introduction of the new governance portal.

(Reference – report by the Chief Executive Officer, Lothian Pension Fund, submitted)

6. Referrals and recommendations from Pensions Audit Sub Committee

John Anzani advised the Committee of the discussion and decisions taken at the Pensions Audit Sub-Committee meeting on 21 March 2023.

(Reference – Pensions Audit Sub-Committee 21 March 2023)

7. Lothian Pension Fund – Internal Audit Update – February 2023

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

Delivery of the four audits included in the 2022/23 internal audit annual plan was underway with the two audits completed and a further audit in progress.

A report detailing the outcome of the Third-Party Supplier Management audit was also included for review and scrutiny.

Due to unforeseen absence of key contacts, the Information Security Arrangements audit had been delayed and it was proposed, in the circumstances, that this audit should be deferred to Quarter 1 of the 2023/24 IA Plan.

Internal Audit's opinion was that the three audits due for completion in the 2022/23 IA Plan would be sufficient to provide an annual audit opinion for the year end 31 March 2023.

As at 9 February 2023, LPF had fourteen agreed management actions with one action past the original implementation date.

Decision

1) To note progress of delivery with the 2022/23 LPF annual internal audit plan including the outcomes of the recent Third-Party Supplier Management Audit.

2) To note progress with delivery of the Information Governance audit currently underway.

3) To approve a request to defer the Information Security Arrangements audit to the 2023/24 Internal Audit Plan.

4) To note that the draft 2023/24 LPF annual internal audit plan was presented to the Committee for approval in a separate paper at this meeting (item 8 below refers).

5) To progress with implementation of agreed management actions from previously completed internal audits.

6) To note that the City of Edinburgh Council procurement and contract management was scheduled to be audited in 2023/24 and that any outcomes from that audit would be reported back to the Pensions Committee for information.

(References – Pensions Audit Sub-Committee 21 March 2023 (item 7); report by the Head of Internal Audit, City of Edinburgh Council, submitted)

8. Lothian Pension Fund – Proposed Internal Audit Plan for 2023/24

The proposed Internal Audit (IA) Plan for the period 1 April 2023 to 31 March 2024 was submitted. The audit universe had been expanded for 2023/24 to include the LPF Group structure and to provide assurance for the LPFI and LPFE boards where appropriate. The plan would also include ongoing IA follow-up on implementation of management actions arising from previous internal audit reports.

In April 2020, the Chartered Institute of Public Finance and Accountancy (CIPFA) recommended introduction of standard definitions for audit report opinions to support consistency across public body organisation. It was proposed that the standard CIPFA definitions were adopted to apply for LPF internal audit reports from 2023/2024 onwards.

Decision

1) To approve the proposed Lothian Pension Fund 2023/24 Internal Audit Plan.

2) To note the expansion of the audit universe to included LPFE and LPFI enabling provision of a single integrated audit programme.

3) To approve proposals to adopt the CIPFA standard definitions for audit report overall opinions from 2023/24 onwards.

4) To note that any changes to the audit plan would be brought back to the Pensions Committee for approval.

(References – Pensions Audit Sub-Committee 21 March 2023 (item 8); report by the Head of Internal Audit, City of Edinburgh Council, submitted)

9. External Audit Plan 2022/23 by Azets

Audit Scotland had appointed Azets as the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund for the period 2022/23 to 2026/27.

The planned programme of work to support the statutory audit for 2022/23 was presented. The core elements of the work included:

- Audits of the 2022/23 annual report accounts
- Consideration of the wider scope areas of public audit work
- Consideration of the Funds' arrangements to secure Best Value
- Assessment of the Funds' participation in the National Fraud Initiative
- Any other work requested by Audit Scotland

Decision

1) To note the planned programme of work to support the statutory audit 2022/23 set out in appendix 1 of the report.

2) To note that progress against the Lothian Pension Fund External Audit Annual Plan 2022-23 would be reported to future meetings of the Pensions Audit Sub-Committee and the Pensions Committee.

(References – Pensions Audit Sub-Committee 21 March 2023 (item 9); report by the Head of Internal Audit, City of Edinburgh Council, submitted)

10. Lothian Pension Fund Cost Benchmarking

Information was provided on the annual results from benchmarking of investment costs for the Lothian Pension Fund and pensions administration costs for Lothian Pension Fund and Scottish Homes Pension Fund.

LPF's annual report for 2021/22 had identified £38.0m of total management expenses with investments costs of £34.2m 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 2022 and the CEM Pension Administration benchmarking report 2022 had been provided on a confidential basis to the Conveners of the Committee and Audit Sub-Committee and the Independent Professional Observer.

3) To request that a briefing email be circulated to members setting out the information on the underlying calculation in relation to LPF's 8-year net return as set out in section 3.4 of the report together with information on how CIPFA calculated comparator funds.

(Reference – report by the Chief Executive Officer, Lothian Pension Fund, submitted)

11. 2023-2024 Strategy and Business Plan (including Functional Plan and Budget)

The Strategy and Business Plan for 2023-24 was presented. The Strategy and Business Plan set out the proposed medium-term strategy for Lothian Pension Fund and the business priorities for the calendar years 2023-24 including the budget and performance targets.

The overall Strategy remained the same with the following four strategic goals:

- To develop and deliver a member and employer proposition for service excellence
- To earn an appropriate risk adjusted investment return as responsible investors
- To extend collaboration and services to existing partners and deepen where possible
- To achieve greatness in the Fund's people, teams and culture.

Decision

1) To approve the Strategy and Business Plan for 2023-24.

2) To approve the respective budgets as detailed in the Financial Projections section of appendix 1 for:

   - LPF Group business as usual 2023-24, net expenditure of £16,460k
   - Project Forth, next expenditure of £866k
   - Office relocation, capital outlay of £900k, revenue expenditure in 2023/24 of £327k with full year total future revenue expenditure of £675k as referenced in paragraph 3.5.7.

3) To note the indicative budget for 2024-25, net expenditure of £16,093k.

(Reference – report by the Chief Executive Officer, Lothian Pension Fund, submitted)

12. 2022/23 Business Plan and Budget Update

An update was provided on progress against the 2022-23 Business Plan, performance indicators and the actions to enable Lothian Pension Fund to meet its key objectives. The Plan set out the work plans, budget and targets for 2022-23 and formed the baseline against which performance would be and had been judged.

Decision

1) To note progress of the Fund against the 2022-23 Strategy and Business Plan together with specific updates on:

   - Performance indicators
   - Membership and cashflow monitoring
   - Investment strategy update

2) To approve the extension of the global custody services contract with the Northern Trust Company by way of a waiver of the Council's Contract Standing orders for the period from 1 October 2023 to 30 September 2024.

3) To approve the extension of services to include performance measurement for the period 1 July 2023 to 30 September 2024 as the result of the exit of our current supplier from the market.

(Reference – report by the Chief Executive Officer, Lothian Pension Fund, submitted)

13. Administering Authority Discretions Policy

Approval was sought for an addition to the administering authority discretions policy. The change related to early payment of deferred benefits on ill-health grounds, in particular cases where the member was terminally ill and the priority was to ensure that benefits could be paid to the member quickly.

Decision

1) To approve the draft revised Administering Authority Discretions Policy.

2) To agree to highlight the policy change in the next Employers' Bulletin for awareness.

3) To review the content of the Employer Manual around incorporating guidance on the impact of the policy when dealing with employees who were members of multiple pension funds.

(Reference – report by the Chief Operating Officer, Lothian Pension Fund, submitted)

14. Risk Management Summary

In line with the Lothian Pension Fund's (LPF) ongoing risk management procedures, an overview was provided of LPF's monitoring and assurance arrangements during 2022 noting any material observations or exceptions.

The Risk Management Group continued to meet regularly to assess all elements of the LPF Group's risk framework including the risk appetite, register, overall assurance position and any more granular risks escalation from other sub-groups.

Information was also provided on the background driving the intention to review the current Risk Management Framework.

Decision

1) To note the LPF Group's risk register and quarterly risk overview.

2) To note that exploratory work and analysis had commenced regarding the creation of a single integrated audit programme for LPF.

3) To note that, due to governance complexities and ambiguities with existing arrangements, no changes would be made in the 2023/24 cycle arrangements.

4) To note that the proposed scope of CEC's internal audit plan for the next year would be extended to provide coverage to LPFE and LPFI.

(References – Pensions Audit Sub-Committee 21 March 2023 (item 10); report by the Chief Risk Officer, Lothian Pension Fund, submitted)

15. Project Forth

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

An update was presented on the proposed collaboration within the Local Government Pension Scheme and the feasibility and evaluation work which had been undertaken to progress the project.

Decision

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

(References – Pensions Committee 29 September 2020 (item 18), 29 September 2021 (item 14), 29 June 2022 (item 18), 28 September 2022 (item 15), 7 December 2022 (item 12); report by the Chief Executive Officer, Lothian Pension Fund, submitted)

16. Employers Participating in Lothian Pension Fund

The Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the item of business on the grounds that it involved the disclosure of exempt information as defined in Paragraphs 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 Operating Officer, Lothian Pension Fund, submitted)

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

Pensions Committee

2.00pm, Wednesday, 21 June 2023

Agenda Planning

Item number 6.2

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the agenda planning document and the revisions to the agenda planning document; and

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

David Vallery
Chief Executive Officer, Lothian Pension Fund

Contact: Susan Handyside, Governance Manager, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

Agenda Planning

2. Executive Summary

1.1 This report and the agenda planning document (appendix 1) 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.

1.2 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

2.1 In order for the Committee and Pension Board to gain an overview of the content of future meetings, and an awareness of the annual cycle of items, an agenda planning document is submitted each quarter.

2.2 Committee meetings are held on a quarterly basis and additionally as required; 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 in the following tables, based on the usual Committee cycle plus any additional and intra-cycle requests.

September 2023

Pensions Committee	Audit Sub Committee
• Referrals/ recommendations from Pensions Audit Sub Committee • Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund • Annual Report by External Auditor (if available) • Employer Covenant Review • Stewardship Code Review • Business Plan and Budget Update • Lothian Pension Fund Contract Awards Report • Employers Participating in Lothian Pension Fund • Risk and Compliance Update	• Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund • Annual Report by External Auditor (if available) • Internal Audit Update • Fraud Prevention • Risk and Compliance Update

December 2023

Pensions Committee	Audit Sub Committee
• Referrals/ recommendations from Pensions Audit Sub Committee • Annual Report by External Auditor (if not available in September) • Stewardship and Engagement • Business Plan and Budget Update • Risk and Compliance Update	• Annual Report by External Auditor (if not available in September) • Investment Income review Cross border Withholding Tax • Global Custody Services Performance • Pensions Data Quality • Internal Audit Update • Additional Voluntary Contribution (AVC) Review (NEW) • Internal Audit Update • IT Information Security Update (NEW) • Risk and Compliance Update

March 2024

Pensions Committee

- LPF Strategy and Business Plan (operating plan) and Budget
- Actuarial Valuation for Lothian Pension Fund
- Actuarial Valuation for Scottish Homes Pension Fund
- Funding Strategy Statement
- Audit Plans (Internal and External)
- LPF Internal Audit Review
- Policies and Strategies Update
- Benchmarking
- Risk and Compliance update

The Audit Sub Committee meet three times a year but have an additional meeting scheduled on Tuesday 19 March 2024. The audit committee will agree whether there is sufficient reason to hold the meeting in due course.

Future Pensions Committee and Audit Sub Committee dates

4.2 The Committee meeting dates for 2023/24 are set out below and calendar invites have been issued to you. These meetings will be held in person with the option, if required, to attend virtually.

Pensions Committee	Audit Sub Committee
• Wednesday 27 September 2023 at 2pm • Tuesday 5 December 2023 at 1.30pm • Wednesday 20 March 2024 at 2pm • Wednesday 26 June 2024 at 2pm	• Tuesday 26 September 2023 at 2pm • Monday 4 December 2023 at 2pm • Tuesday 19 March 2024 at 2pm • Tuesday 25 June 2024 at 2pm

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 City of Edinburgh Council, Committee Terms of Reference (sections 13 and 24)

8. Appendices

Appendix 1 – LPF's Annual Agenda Planning Cycle

Appendix 1

Frequency	Pensions Committee	Audit Sub Committee
Every 3 years	**December or March**	
	Actuarial Valuation: LPF SHPF (next report due Mar 2024)	N/A
	March	
	Funding Strategy Statement (review due June 2023 with final version presented for approval in March 2024)	N/A
Biennial	**September**	
	Pension Administration Strategy (presented in March 2022)	N/A
	Administrating authority Discretions Policy. Next review due September 2024	N/A
Annually	**March**	
	LPF Strategy and Business Plan and Budget	N/A
	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 and circulated to the Audit Sub Committee members for comment.*
	Benchmarking – Investment and Administration Costs	N/A
	June	
	LPF Annual Report and Accounts (Unaudited)	LPF Annual Report & Accounts (Unaudited)
	LPF Internal Audit Opinion	LPF Internal Audit Opinion
	Statement of Investment Principles	N/A
	Joint Investment Strategy Panel Activity	N/A
	Annual Investment Updates - Lothian Pension Fund and Scottish Homes Pension Fund	N/A
	Annual LPF Group Governance Update	N/A

Appendix 1

Frequency	Pensions Committee	Audit Sub Committee
	September Employer Covenant Review Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund (including the Annual Report by External Auditor) Stewardship Code Review N/A Lothian Pension Fund Contract Awards Report **December** Annual Report by External Auditor **(or September if available)** N/A Stewardship and Engagement N/A N/A N/A N/A	N/A Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund (including the Annual Report by External Auditor) N/A Fraud Prevention N/A Annual Report by External Auditor **(or September if available)** Investment Income Review-Cross-Border Withholding Tax N/A Pensions Data Quality Global Custody Services Performance Compliance Update and Risk Management: In-depth review Additional Voluntary Contributions (AVC) Review
Semi Annually	**March & September** Employers Participating in Lothian Pension Fund **June & December** N/A	N/A IT Information Security Update
3 Times per year	**March[1], September & December** Operating Plan and Budget Update	N/A

[1] The March update will have the dual purpose of a business strategy update, budget review and budget approval for the forthcoming financial year

Appendix 1

LOTHIAN PENSION FUND

Frequency	Pensions Committee	Audit Sub Committee
	June, September & December Referrals / recommendations from Pensions Audit-Sub N/A	N/A Risk and Compliance Update
Quarterly	**March, June, September & December** Risk and Compliance Update	Internal Audit Update
As required	Investment Strategy Reviews (at least every 3 years – next due June 2024)	N/A

This page is intentionally left blank

Pensions Committee

2.00pm, Wednesday, 21 June 2023

Funding Strategy Statement Update

Item number 6.3

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note that the fund intends to consult with employers on the revised Funding Strategy Statement; and

1.2 approve the draft revised Funding Strategy Statement, subject to any further amendment arising from the forthcoming employer consultation being reported to Pensions Committee at its next meeting.

David Vallery
Chief Executive Officer, Lothian Pension Fund

Contact: Erin Savage, Senior Pensions Employer and Member Manager, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

Funding Strategy Statement Update

2. Executive Summary

2.1 The Lothian Pension Funds' Funding Strategy Statement (FSS) has been reviewed following feedback from employers. This feedback concerns Appendix F of the FSS – the Salary Strain Recharging Mechanism. Appendix F has been amended to incorporate a revised process for assessing salary strain and offsetting any resultant recharges.

2.2 As required under the Local Government Pension Scheme (Scotland) Regulations, a consultation exercise will be carried out with the fund's employers following Committee.

3. Background

3.1 The FSS is a policy document which summarises the approach to funding pension liabilities of Lothian Pension Fund and the Scottish Homes Pension Fund. Relevant policies are appended to the FSS for completeness, including:

- employer admission to the fund; and
- employers leaving the fund.

3.2 The FSS is formulated under guidance issued by the by the Chartered Institute of Public Finance and Accountancy (CIPFA), which states that the FSS must be reviewed formally at least every three years as part of the triennial valuation. The valuation sets employer contribution rates within the framework provided by the FSS. The FSS should also be reviewed if there are any material changes in the policy set out in the FSS.

3.3 A full review of the FSS was last carried out in September 2022 following amendments to the Local Government Pension Scheme (Scotland) Regulations. These amendments introduced additional flexibilities to the regulations for employers exiting the fund.

3.4 The draft revised FSS is attached as Appendix 1 to this report.

4. Main Report

Funding Strategy Statement – review in advance of Actuarial Valuation 2023

4.1 As required under the Scheme regulations, a valuation of the funds will be carried out as at 31 March 2023. As part of this process, fund officers have already had several meetings with the fund actuary. Data has been provided to the actuary to allow work to begin on the valuation of the Scottish Homes Pension Fund. Data cleansing for Lothian Pension Fund is currently ongoing following submission of employer year-end data and it is anticipated that data will be submitted to the actuary in July 2023. Initial employer results will be available in autumn 2023. The final valuation report and final revised FSS will be presented to Pensions Committee in March 2024.

4.2 As has been the practice in recent valuations, consideration of proposed changes to the FSS and the required employer consultation exercise is being undertaken at an early stage in the actuarial valuation process. This approach has the advantage of attaining clarity from the fund's key stakeholders on the proposed changes prior to the issue of draft results and indicative contribution rates to individual employers. Further, should any additional changes be required either as a result of feedback from the consultation exercise or as the valuation proceeds, there is still sufficient time to make changes and carry out a further consultation exercise as required.

Review of salary strain recharging mechanism

4.3 A salary strain recharging mechanism was introduced from 1 April 2021 following the 2020 valuation. This followed a change to the salary growth assumption used. The revised assumption agreed was significantly lower than that used at previous valuations and equated to the rate of long-term consumer price inflation (CPI) plus 0.5% p.a. An age-related allowance for promotional salary growth was also included.

4.4 Although this lower assumption benefits employers by placing a lower value on liabilities and therefore an improved funding position, if actual salary increases are greater than those assumed, there is a risk that employers will be unable to meet pension costs in the future. For this reason, rather than wait to review the position at the next valuation a salary strain recharging mechanism was introduced. This additional monitoring mechanism involves a review of member data on an annual basis. If salary growth is higher than expected (based on comparing actual salary at year-end to the salary at the last valuation), then a salary strain will occur.

4.5 The FSS requires the fund to charge employers at the time the strain occurs rather than waiting until the next valuation which could potentially lead to a large increase in contribution rates. An invoice is raised for the cost with payments either paid as a lump sum or spread over the period to the next valuation if the strain is over £5,000.

4.6 The salary strain mechanism does not apply to employers which are part of the contribution stability mechanism. In addition, the salary strain monitoring only relates to benefits built up in the scheme before 1 April 2015. Such benefits are final salary benefits and therefore salary increases have a direct impact on the member's benefits on retirement.

4.7 Two monitoring exercises have now been carried out under this policy and following feedback from scheme employers a change in policy is proposed. Some employers have salary strains, yet these employers have queried the rationale for recharging as the 2020 actuarial valuation determined that they were well-funded to an extent that no employer contributions are due. Following this feedback invoices have been suspended pending this proposed change to the FSS.

4.8 It is proposed therefore to amend the FSS, and the process used to identify whether salary strains should be recharged. In addition to the review of member salary information, the actuary will also carry out a review of each applicable employers estimated funding position. This information will be considered in tandem with the salary strain results and the following process, (agreed following actuarial advice) will be applied:

- Where the employer has a funding level in excess of 130% the strain will be waived (although the employer can still pay), subject to the agreement of the scheme employer acting as guarantor (where applicable);
- Where the employer has a funding level between 115% and 130% a lower strain payment will be due, subject to the agreement of the scheme employer acting as guarantor (where applicable). The amount due will be capped at the amount that would allow a funding level of 130%; and
- Where the employer's funding level is less than 115% any salary strain identified will be recharged in full.

4.9 It is proposed that these amendments to the policy are backdated to December 2022, which is when the most recent salary strain exercise was carried out. If this amendment is approved, fund officers will arrange for the actuary to carry out a review of the funding position at that date and then reassess the results of the salary strain exercise accordingly.

4.10 There are no other proposed changes except updating the applicable dates in Section 1.

Next steps

4.11 The fund will carry out a consultation with employers and provide an update to Committee at a later date.

5. Financial impact

5.1 The funding strategy should ensure that the fund has sufficient assets in the long term to meet is liabilities. There is no direct financial impact aside from potential recovery of costs in the event of employer failure to provide specified information within required timescales.

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

8.1 Appendix 1: Draft revised Funding Strategy Statement.

LOTHIAN
PENSION FUND

Funding Strategy Statement

CONTENTS

1. INTRODUCTION

This is the Funding Strategy Statement (FSS) of Lothian Pension Fund ("the Fund"). It has been prepared and maintained by the City of Edinburgh Council, in its capacity as the Administering Authority of the Fund, in consultation with the Fund's Actuary and following a period of consultation with participating employers.

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues.

This FSS is produced in accordance with the Chartered Institute of Public Finance & Accountancy (CIPFA) revised statutory guidance "Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme (LGPS) 2016", which affirms the FSS as being a key part of a pension fund's risk management framework.

This statement was approved by the Pensions Committee on 21 June 2023 and is effective from 22 June 2023. It replaces all previous Funding Strategy Statements and policies on funding.

1.1 Maintenance

The Administering Authority will review the FSS every three years in conjunction with actuarial valuations or more frequently if considered appropriate.

1.2 Availability

This document is available on the Fund's website (www.lpf.org.uk).

2. PURPOSE OF THE FUNDING STRATEGY STATEMENT

CIPFA's 'Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme 2016' states that the purpose of the FSS 'is best defined by reference to the discussion paper issued by the Office of the Deputy Prime Minister (ODPM) on 23 July 2003, 'Local Government Pension Scheme – Strategy Proposals: Stocktake Discussion Paper – Funding Strategy Statement Proposals' ', namely:

1. to establish a clear and transparent fund-specific strategy that will identify how employers' pension liabilities are best met going forward;
2. supports the desirability of maintaining as nearly constant a primary contribution rate as possible; and
3. takes a prudent longer-term view of funding those liabilities.

These objectives are desirable individually - but may be mutually conflicting.

The FSS shall also ensure that the regulatory requirements to set contributions to ensure the solvency and long-term cost efficiency of the Fund, as defined by the Public Service Pensions Act 2013, are met.

The statement and appendices set out how the Administering Authority balances the potentially conflicting aims of affordability of contributions, transparency of process, stability of employers' contributions, and prudence in the funding basis. Specific clarity is provided as to the Fund's policies in respect of:

1. employers being admitted to the Fund;
2. employers leaving the Fund (exits);
3. bulk transfers; and
4. the charging for services and recovery of costs incurred.

2.1 Regulatory Framework

Pension benefits accrued by members of the Fund are determined by statute.

The contributions paid by the members of the Fund are fixed in the Scheme Regulations (defined below). Employers pay the balance of the cost of delivering the benefits, however, in line with the requirements of the Public Service Pensions Act 2013, the Scheme Regulations incorporate a cost sharing mechanism to ensure sustainability of the Scheme over the long term.

The FSS focuses on the pace at which employers pay for the benefits i.e. the approach used to determine contribution rates. It forms part of a framework that includes:

- the Local Government Pension Scheme) (Scotland) Regulations 2018 (as amended), the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 and the LGPS (Management and Investment of Funds) (Scotland) Regulations 2010 (the 'Scheme Regulations');
- the Pensions Committee, the Pensions Audit Sub-Committee and the Pension Board;

- the Rates and Adjustments Certificate, which can be found appended to the Fund Actuary's valuation report;
- actuarial factors for valuing early retirement costs and the cost of buying extra service; and
- the Fund's Annual Report, including the Annual Governance Statement, the Governance Compliance Statement and the Statement of Investment Principles.

This is the framework within which the Fund's Actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund.

3. AIMS AND PURPOSE OF THE FUND

3.1 Aims of the Fund

The aims of the Fund are to:

- manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due;
- seek returns on investment within reasonable risk parameters; and
- enable primary contribution rates to be kept as nearly constant as possible and (subject to the Administering Authority not taking undue risks) at reasonable cost to scheduled and admitted bodies, whilst achieving and maintaining fund solvency and long-term cost efficiency. This should be assessed taking appropriate cognisance of the risk profile of the fund and employers and the risk appetite of the administering authority and employers alike.

3.2 Purpose of the Fund

The Fund provides benefits to members and their dependants. In this regard, the purpose of the Fund is to:

- receive monies in respect of contributions, transfer payments and investment income and recover costs and charges, pay pension benefits, transfer values and administration costs, charges and expenses; and
- make investments to meet the future costs of pension promises made to members of the Scheme.

4. AIMS AND RESPONSIBILITIES OF THE KEY PARTIES

The sound and effective management of the Fund can only be achieved if all interested parties exercise their statutory responsibilities conscientiously. Although a number of these parties, including investment managers and external auditors, have a responsibility to the Fund, the following may be considered of particular relevance to the funding strategy:

4.1 The Administering Authority should:

- operate the Fund as per the Scheme Regulations;
- collect and account for employer and employee contributions, investment income and other amounts due to the Fund as stipulated in the Scheme Regulations;
- invest surplus monies in accordance with the regulations;
- ensure that sufficient cash is available to meet liabilities as and when they fall due;
- pay relevant benefits from the Fund as set out in the Scheme Regulations;
- manage the actuarial valuation process in consultation with the Fund's Actuary, including providing all required data and employer covenant analysis;
- prepare and maintain a Funding Strategy Statement and Statement; of Investment Principles after proper consultation with interested parties;
- monitor all aspects of the Fund's performance and funding, and amend the Funding Strategy Statement/Statement of Investment Principles accordingly;
- take measures as set out in the Scheme Regulations to safeguard the Fund against the consequences of employer default;
- effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and scheme employer;
- manage any exit valuation in consultation with the Fund's Actuary;
- prepare and maintain admission, exit, bulk-transfer and charging policies, copies of which are included in this document,
- enable the Pension Board to review the valuation process as set out in their Constitution; and
- fulfil all other duties as specified in Lothian Pension Fund's Pensions Administration Strategy – available in the 'Publications' section of the Fund's website www.lpf.org.uk

4.2 The individual Employers should:

- calculate an employee's contribution rate and deduct the correct contributions from members' salaries;
- pay employee and employer contributions to the Administering Authority on a timely basis and provide appropriate supporting documentation in a format and timescale specified by the Fund;
- develop and maintain a policy where discretion can be exercised within the regulatory framework (e.g. granting enhanced benefits) bearing in mind costs;
- make additional contributions, in accordance with agreed arrangements, for example, award of additional pension and early retirement strain costs;
- notify the Administering Authority promptly of organisation changes for example, changes in ownership or structure, TUPE transfers which could affect future funding;
- notify the Administering Authority of a possible ending of its admission agreement/participation in the Fund within the terms of that agreement or otherwise as required by the Scheme Regulations (typically a 3 month notice period is required), including closed employers where the last employee member is leaving (whether due to retirement, death or otherwise leaving employment);

- pay any exit payments due on ceasing participation in the Fund in line with provisions set out in the Fund's Policy on employers leaving the Fund (see Appendix C);
- meet costs as specified in the Charging Policy (see Appendix D); and
- fulfil all other duties as specified in the Fund's Pensions Administration Strategy. This includes provision of all data required for effective administration and record-keeping, and payment of any charges levied by the Fund following poor performance by the employer.
- participate in annual covenant reviews carried out by the Fund, the results of which will be shared with the employer's guarantor or aligned body as appropriate.

4.3 The Fund Actuary should:

- prepare actuarial valuations to assess the solvency of the Fund and the required employers' contribution rates;
- engage with the Administering Authority in consultation processes;
- prepare advice and calculations in connection with bulk transfers and the funding aspects of individual benefit related matters such as pension strain costs, ill-health retirement costs, compensatory added years costs, etc.;
- provide advice and valuations on the on the exit of employers from the Fund;
- provide advice to the Administering Authority as required on bonds or other forms of security against the financial effect on the fund of employer default;
- assist the Administering Authority in assessing whether employer contributions need to be revised between valuations as required by the Scheme Regulations; and
- ensure that the Administering Authority is aware of any professional guidance or other professional requirements that may be of relevance to his or her role in advising the Fund.

5. GENERAL FUNDING AND SOLVENCY ISSUES

5.1 Funding Principles

The cost of the benefits is not known in advance. The approach to funding determines the pace at which employers pay for the benefits and the ways in which the Fund ensures that it will have enough money to pay the benefits due to its members.

5.2 Solvency

The notes to the Public Service Pensions Act 2013 state that solvency means that the rate of employer contributions should be set at "such level as to ensure that the scheme's liabilities can be met as they arise".

It is not regarded that this means that the pension fund should be 100% funded at all times. Rather, and for the purposes of Section 13 of the Public Service Pensions Act 2013, the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency if they are set to target a funding level (assets divided by liabilities) for the whole fund of 100% over appropriate time periods and using appropriate actuarial assumptions.

If the conditions above are met, then it is expected that the Fund will be able to pay scheme benefits as they fall due.

The Fund's Actuary is required to report on the solvency of the Funds and recommend future employer contribution rates every three years. In assessing the solvency and employer contribution rates, the Actuary must make a number of financial and demographic assumptions (see below). The solvency of the Funds and the contribution rates can be very sensitive to these assumptions.

In calculating solvency, the Actuary values the benefits using the assumptions described below. Assets are taken into account at their market value.

The Scheme Regulations specify the principles which must be used in the funding strategies. However, it is the responsibility of the Administering Authority, acting on the advice of the Fund's Actuary, to determine the precise approach and the financial and demographic assumptions to be used in the actuarial valuation.

The principal issues facing the solvency of the Funds include the ability to finance liabilities as and when they arise, the rate or volatility in the rate of contribution paid by the employers, the pace at which deficits are recovered (or surpluses used up) and the returns on the Fund's investments.

The Fund carries out annual employer covenant reviews to gather a range of key financial and non-financial information. This includes a request for details of funding sources and for annual financial statements to be provided. In addition, membership numbers are regularly reviewed to monitor membership maturity. The results of the covenant review are used to rank employers on risk level, with details being provided to the Fund's Actuary to inform the actuarial valuation.

As required under Section 13(4)(c) of the Public Service Pensions Act, The Scottish Public Pensions Agency has appointed the Government Actuary's Department to report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure the solvency of the Fund and the long-term cost efficiency of the Scottish Local Government Pension Scheme, so far as relating to the Fund. Such reports must be made following each triennial valuation of the Fund.

When developing this Funding Strategy, the Administering Authority has had regard to the review under Section 13(4)(c).

5.3 Long term cost efficiency

The notes to the Public Service Pensions Act 2013 state "Long-term cost-efficiency implies that the rate must not be set at a level that gives rise to additional costs. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the time".

The rate of employer contributions shall be deemed to have been set at an appropriate level to ensure long-term cost efficiency if the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the Fund.

In assessing whether the above condition is met, the review under Section 13(4)(c) may have regard to the following considerations:

- the implied average deficit recovery period
- the investment return required to achieve full funding over different periods, e.g. the recovery period
- if there is no deficit, the extent to which contributions payable are likely to lead to a deficit arising in the future
- the extent to which the required investment return is less than the administering authority's view of the expected future return being targeted by a fund's investment strategy, taking into account changes in maturity/strategy as appropriate.

5.4 Financial Assumptions and link to investment strategies

The key financial assumption in calculating the solvency and contribution rates is the rate of return which will be achieved on the Funds' investments. 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 (resulting from the investment strategy). To the extent that investment returns may be lower than expected, then higher contributions may be required from employers, and vice versa. Hence, the funding and investment strategy are inextricably linked.

The discount rate(s) adopted in the actuarial valuation is derived by considering the expected rate of investment return which is anticipated to be achieved by the underlying investment strategy.

The Funds invest in assets other than gilts in order to reduce the cost to the employers in the long term, subject to the alignment to the expected duration and admission basis of the individual employer's membership. However, the investments are not guaranteed to deliver returns in excess of gilts. This means that the funding level can be volatile, particularly in the short term. In order to minimise the degree of short-term change in employer contribution rates, expected investment returns are considered over the long term.

The Pensions Committee is responsible for setting investment strategies after taking professional investment advice.

A formal review of the Funds' investment strategies is undertaken at least every three years to ensure appropriate alignment with liabilities. This is typically after the results of the triennial Actuarial Valuation are known. Guidance for the Pensions Committee on investment strategy is provided by a Joint Investment Strategy Panel (JISP), working in collaboration with the Falkirk Council Pension Fund and Fife Council Pension Fund.

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

The JISP is comprised of senior fund officers from the three pension funds plus external investment advisers.

The JISP meets quarterly to monitor the risk, return and implementation of the investment strategy, and to discuss current issues, including asset allocation. This involves an appraisal of the current investment market opportunities and risks and the distribution of the Funds' investments across different assets, countries, sectors and companies to ensure that overall risk is being managed appropriately.

Further information on the investment strategies can be found in the Funds' Statement of Investment Principles which is available on the Fund's website (www.lpf.org.uk).

5.5 Demographic Assumptions

The Actuary makes a number of demographic assumptions including mortality, salary growth, rates of retirement, commutation experience and withdrawal. They are intended to be best estimates of the future experience of the Funds.

The assumptions take into account the past experience of the employer and Funds, other Local Government Pension Schemes and/or the general population, as considered appropriate by the Actuary.

5.6 Contributions

Employee contributions are determined by the Local Government Pension Scheme (Scotland) Regulations 2018. A member's contribution rate is calculated by the employer on an annual basis, dependent on their actual pensionable pay at 1 April each year and allowing for any election made under Regulation 10 (50:50 option).

Employer contributions are calculated by the Fund Actuary. They are made up of two elements:

A: the **primary** rate of the employers' contribution. This is the contribution rate required to meet the cost of the future accrual of benefits expressed as a percentage of pensionable pay ignoring any past service surplus or deficit but allowing for any employer specific circumstances, such as the membership profile of that employer, the funding strategy adopted for that employer, the actuarial method chosen and/or the employer's covenant, and,

B: the **secondary** rate of the employers' contribution. This is an adjustment to the primary rate to arrive at the rate each employer is required to pay. In broad terms, payment of the Secondary rate is in respect of benefits already accrued at the valuation date. The time horizon over which an employer is asked to target full funding is covered further in Sections 6 and 7 below.

For employers open to new entrants, secondary contributions are expressed as a percentage of payroll

For employers closed to new entrants, secondary contributions, where positive, are expressed as a fixed monetary sum, rather than as a percentage of payroll. Any fixed monetary deficit contributions should be paid in equal monthly instalments along with the primary rate contributions, or by prior arrangement as a one-off lump sum at the start of the year.

For any employer, the rate they are required to pay is the sum of the primary and secondary rates.

The Fund operates a salary strain recharging mechanism to recoup any funding strain associated with salary increases above expectations. Further detail of this mechanism is detailed in Appendix F.

The rates for all employers are shown in the Fund's Rates and Adjustments Certificate, which forms part of the formal Actuarial Valuation Report. The contributions stated are minimum amounts – employers can pay more than this. The Actuary will take account of any higher amounts paid at subsequent valuations.

All employers are required to pay the estimated additional cost (strain cost) of **non-ill health early retirements**, to allow for the fact that the pension is paid earlier and for longer. This is calculated at the time of the early retirement. The Fund's general policy is that strain costs are payable as a one-off payment at the time of the early retirement, however, at the Fund's discretion, alternative arrangements may be permitted if the early retirement occurs at the time of exit, depending on the employer's circumstances.

The Administering Authority monitors the actual contributions received to ensure they are in line with those expected. As set out in the Fund's Pensions Administration Strategy, employers are expected to provide requisite detailed information on a monthly basis to assist this monitoring exercise and to substantiate the payments made.

6. FUNDING – SCOTTISH HOMES PENSION FUND

Scottish Government acts as guarantor to the Scottish Homes Pension Fund. A bespoke funding strategy has been developed for the Scottish Homes Pension Fund. This has been agreed by the Administering Authority, the Fund's Actuary and the Scottish Government (previously known as the Scottish Executive).

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

As the Fund is closed to new members and the liabilities will mature over the time, the investment strategy is designed to reflect the expressed requirements of the Scottish Government, namely low risk, with investments now exclusively bonds.

7. FUNDING – LOTHIAN PENSION FUND

7.1 Objectives of the Lothian Pension Fund's Funding Strategy

The objectives of the funding strategy include:

- to ensure the long-term solvency of the overall Fund;
- to ensure the solvency of each individual employers' share of the Fund based on their expected term of participation in the Fund;
- to minimise the degree of short-term change in employer contribution rates;
- maximise the returns from investments within reasonable and considered risk parameters, and hence minimise the cost to the employer;
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment;
- to help employers manage their pension liabilities; and
- where practical and cost effective, to make allowance for the different characteristics of different employers and groups of employers.

7.2 Investment Strategy

The Fund has put in place four investment strategies for differing employer risk profiles.

<u>Primary Strategy</u>

This strategy 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.

This strategy applies to the following types of employers:

- Large employers with enduring membership which are open to new entrants (including but not limited to Councils and other statutory bodies);
- All other employers which are open to new entrants and have 5 or more active members
- Transferee Admitted Bodies; and
- Employers admitted to the Fund following a transfer of staff from another Fund employer. *
- Employers which have exited the Fund and their guarantor/aligned body agrees that assets can be moved to the primary strategy in order to maximise investment returns.
- Any employer which has provided the Fund with requisite and sufficient legal security over assets

*the question of whether an employer was admitted following a transfer of staff from another Fund employer shall be determined at the Fund's discretion, provided that the ceding employer may dispute such determination should there be any ambiguity or uncertainty relating to historic transfers of staff. In such scenarios, the ceding employer shall be required to present the rationale and sufficient evidence to satisfy the Fund that the employer should not be treated as a Transferee Admitted Body for funding purposes.

Employers invested in the Primary Strategy will have individual contribution rates certified by the Actuary.

Any employer who does not admit any new entrants within a reasonable period is deemed to be closed to new entrants. For the purposes of this statement, a reasonable period is an inter-valuation period (i.e. three years between formal valuations of the Fund). Where an employer is deemed closed, they will move to the Medium Risk strategy or Lower Risk strategy as appropriate. Any employer classed as deemed closed which takes on new staff who join the Fund will revert to the Primary strategy with immediate effect.

Lower Risk Strategy

This strategy adopts a lower-risk approach for employers which have a short expected duration in the Fund and invests in index-linked government bonds to reduce the degree of short-term change in funding level and employer contribution rates in the period prior to the employer leaving the Fund and hence manage risks for both the individual employer and for the Fund as a whole.

This strategy was first introduced with effect from 1 April 2015.

This strategy applies to the following types of employers:

- Employers who have left the Fund (excluding bodies which may be aligned);
- Employers which are closed to new entrants and:
    - Have fewer than five active members and/or
    - Average membership age of 55 or higher.

Such employers will have individual contribution rates certified by the Actuary.

Medium Risk Strategy

This strategy adopts a balanced investment strategy reflecting the maturing membership and liability profile of the relevant employers. It is intended to act as a transition between the Primary Strategy and the Lower Risk Strategy, for those employers which are closed to new entrants. Accordingly, investments will be targeted to represent 50% allocation from the Primary Strategy and the Lower Risk Strategy. This will serve to reduce the degree of change in employer contribution rates which would result from moving immediately from the Primary Strategy to the Lower Risk Strategy. This strategy was first introduced with effect from 1 April 2018.

This strategy applies to the following types of employers:

- Employers which are closed to new entrants but do not meet the criteria for the lower-risk strategy.

Such employers will have individual contribution rates certified by the Actuary

Lothian Buses

A bespoke strategy is in place for Lothian Buses. Lothian Buses closed to new entrants in 2008 and this strategy reflects the maturity of the membership, the liability profile and the existence of a shareholders' guarantee.

Allocation to strategies

An employer will change to an alternative investment strategy with immediate effect between valuations in the following situations:

- An employer closing to new entrants will move to the medium-risk or lower-risk strategy as appropriate;
- An employer that is part of the medium risk strategy which falls below five active members, will move to the lower-risk strategy.

In these circumstances, the Actuary will provide revised employer contribution rates.

Where an employer has closed to new entrants, it will not be able to reverse this decision and offer membership to new staff without the agreement of the Administering Authority and where applicable, the body acting as guarantor.

The Fund may consider a request for an employer to be assigned to an alternative investment strategy to that which strict application of the criteria would indicate, but only in circumstances where a higher risk strategy is supported by an explicit guarantor and/or where the Fund would not consider such to represent a scenario of greater risk exposure to other employer(s). The Fund may also consider a request to be assigned to an alternative (higher risk) investment strategy should provision of satisfactory security over assets be offered.

It is not practical for the Fund to offer individual employers full flexibility on asset allocation.

7.3 Employer Asset Tracking

The Lothian Pension Fund is a multi-employer fund. Previously, individual employer asset shares have been calculated triennially at formal valuations by the Fund's Actuary using an analysis of surplus technique and tracked between valuations using a cash flow or roll forward approach. However, in order to enhance the transparency, accuracy and auditability of individual employer asset allocations and reduce any cross-subsidy between participating employers, from 1 April 2014 the Fund introduced an employer asset tracking system based on cash flows. This is a form of unitisation of investments, where each investment or disinvestment of monies involves the purchase or selling of units in the Fund. By sub-dividing the assets into units, the Fund can more easily and accurately track each individual employer's assets. Changes in the value of the underlying assets are reflected by changes in unit prices.

Such unitisation therefore provides an efficient way of accurately apportioning assets to individual employers by allowing for employer cash flows and investment returns achieved by the Fund. In addition, this provides a mechanism for facilitating and managing a range of investment strategies within the single Fund to meet the needs of employers with different maturity profiles, funding levels or investment objectives.

7.4 Setting employer contribution rates

All employers in the Fund are required to fund the benefits of their own employees; therefore, the Actuary calculates a different contribution rate specific to each employer.

The Actuary uses a three-step process to calculate employer contribution rates which requires Fund and the Actuary to consider the following factors for each employer:

1. The employer's **funding target**, which is based on a set of ongoing assumptions about the future (e.g. investment returns, inflation, pensioners' life expectancies). If an employer is approaching the end of its participation in the Fund then its funding target may be set on a more prudent basis, so that its liabilities are less likely to be spread among other employers after its cessation.

2. The **time horizon** required over which the funding target is achieved. Employers may be given a lower time horizon if they are closed to new entrants, or do not have tax-raising powers to increase contributions if investment returns under-perform.

3. The **likelihood of achieving** the funding target over that time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer is considered to have weaker financial strength then the required likelihood will be set higher, which in turn will increase the required contributions (and vice versa).

A risk-based approach is used to set employer contribution rates. This risk-based approach allows for thousands of possible future economic scenarios when assessing the likelihood of contributions being sufficient to meet both the accrued and future liabilities over a given time horizon for each employer.

Changes in employer contributions may be phased over time in order to minimise the degree of short-term change and enhance affordability. The Administering Authority, in consultation with the Fund's Actuary decides how any reductions or increases to contribution rates are introduced, taking into account specific employer circumstances. From 1 April 2021, contribution rates for open employers that were previously part of the small employer pool will be phased in over 9 years.
Further information on calculating employer contribution rates is set out in Appendix E.

7.5 Contribution Stability

The policy of the Fund is to operate a Contribution Stability Mechanism on an ongoing basis, subject to regular reviews, in order to provide certainty of pension contributions to Fund employers for future years, together with ensuring appropriate assurance of funding level to the Fund. Access to the Contribution Stability Mechanism will not be offered to all employers – each employer's particular circumstances will be considered, in particular the strength of the covenant offered and the extent of membership commitment to the Fund. Employers are not obliged to participate in the Contribution Stability Mechanism, but if they wish to opt out, they must make an election at the outset. This election will cover the entire duration of the Contribution Stability Mechanism as well as future reviews of the Contribution Stability Mechanism. Any decision to allow an employer to join the Contribution Stability Mechanism at a later date will be at the discretion of the Administering Authority.

An employer which chooses not to participate will instead pay the risk-based contribution rate as set by the Fund Actuary at the actuarial valuation.

Employers which are open to new entrants and have contribution rates calculated based on their individual circumstances will be offered access to the Contribution Stability Mechanism subject to:

- satisfactory assessment of the employer covenant; and
- agreement by their guarantor to inclusion of the employer in the Contribution Stability Mechanism (where appropriate).

An employer's participation in the Contribution Stability Mechanism is expected to extend to the full duration of the mechanism. However, access to the Contribution Stability Mechanism will be subject to ongoing review by the Fund which reserves the right to remove an employer from the Contribution Stability Mechanism should particular circumstances deem it prudent to do so, for example assessment of employer covenant, financial or demographic experience. In addition, if an employer closes to new entrants they will be removed from the Contribution Stability Mechanism and a recalculation of their contribution rate may be required.

Access to the Contribution Stability Mechanism will not be afforded to the following employers:

- Employers which are closed to new entrants;
- Transferee Admission Bodies; and
- Small Community Admission Bodies without a guarantor.

Full information on the Contribution Stability Mechanism is available on the Fund's website.

In 2019, the Fund, in conjunction with the Actuary reviewed the Contribution Stability Mechanism introduced at the 2014 valuation. This review concluded that for the majority of employers who are eligible for stabilised rates, contribution rates from 1 April 2021 will:

- remain frozen for 4 years; and
- then increase/decrease by a maximum of 0.5% per annum.

The remaining stabilised employers will see rates increase by 0.5% for 4 years, then increase/decrease by a maximum of 0.5% per annum.

The Fund will aim to keep contribution rates for stabilised employers within agreed parameters, however, there may be specific circumstances relevant to an employer which will merit the Actuary certifying a rate outside these parameters. Each case will be reviewed at the Fund's discretion.

7.6 Employer time horizons

In deciding the period over which any funding deficit or surplus is spread, the Administering Authority considers a number of factors including the objective of minimising the degree of short-term change in employer contribution rates and employers' ability to meet their commitments to the Fund.

The time horizons used for different employers range from 20 years for Councils, to the remaining contract period for Transferee Admission Bodies which can in some cases be a matter of months. The differences in time horizons reflect the financial strength of the employers and the perceived long-term commitment to the Fund.

The following table shows the employers in the Fund for which are required to fund the benefits of their own employees, setting out the key characteristics of each type of employer which influence the period over which any surplus/deficit has been spread.

Where an employer can offer security over assets or otherwise improve their covenant, the Fund may, at its discretion, allow a longer time horizon to be used.

	Employer	Time Horizon (Years)
Councils/Large Scheduled bodies	City of Edinburgh Council	20
	Midlothian Council	
	West Lothian Council	
	East Lothian Council	
	Scottish Fire & Rescue Service (Civilians)	
	Scottish Police Authority	
	Lothian Valuation Joint Board	
	Scottish Water	
	Visit Scotland	15
Universities / Colleges	Heriot-Watt University	15
	Newbattle Abbey College	
	Queen Margaret University College	
	Napier University	
	Edinburgh College	
	West Lothian College	
	Scottish Rural University College	FWL [1]
	University of Edinburgh	
	Edinburgh Leisure	15
	Lothian Buses	20 (TBC)
Transferee Admission Bodies		Shorter of FWL [1] or contract period
Employers open to new entrants	Scheduled bodies and open Community Admission Bodies not named above	15
Employers closed to new entrants	Closed Community Admission Bodies not named above	FWL [1]

[1] Future Working Lifetime of current active members or duration in Fund if shorter

7.7 Admission bodies – affordability constraints

As noted in section 5.6 above, the Fund Actuary certifies minimum contributions which each employer is required to pay. In circumstances where an employer's membership of the Fund is not mandated by Regulations and that employer is unable to meet the minimum certified contributions, then its membership will be terminated, with notice period of three months being applied by the Fund.

At each valuation, therefore, every employer will require to confirm its commitment to meet the certified minimum contributions. If an employer fails to provide such confirmation, following the notice period as specified above, the Administering Authority will terminate the admission agreement, and Appendix C: "Policy on employers leaving the Fund" will apply. Specifically, the Fund will arrange for an exit valuation to be carried out to assess the level of the employer's liabilities. The Fund will then engage with the employer in relation to the payment of any exit debt due to the Fund, determined in accordance with the Scheme Regulations.

7.8 Post Valuation adjustments

When determining future employer contributions at the triennial actuarial valuation the Administering Authority may (after consultation with the Fund Actuary) take into account any events that arise after the valuation date, but before the formal valuation report is signed off (which must occur within one year of the valuation date), that materially affect the employer contributions referred to above. In doing so, the Fund will aim to minimise the degree of short-term change in employer contribution rates while still ensuring the long-term solvency of the overall Fund.

The contribution rates are subject to review and change if there are changes in employer circumstances between actuarial valuations, for example, if an employer has closed to new members or has left the Fund. In the latter case, any residual liability may impact upon the rate(s) payable by employer(s) remaining in the Fund. In all instances, any such changes would be determined by the Administering Authority and require certification by the Fund Actuary.

7.9 Review of Employer Contribution Rates

The Fund may review employer contribution rates between actuarial valuations in the following circumstances:

- It is likely that the amount of liabilities arising or likely to arise relating to an employer has changed significantly since the last valuation;
- There has been a significant change in the employer covenant, as assessed in the annual employer covenant review; or
- The employer has requested a review of the contribution rate.

Where such a review is carried out the Fund will consult the affected employer(s) and the actuary in order to provide revised rates.

7.10 Employers joining the Fund

Appendix A sets out in full the Fund's policy on employers joining the Fund.

Bodies applying to join the Fund will be provided with a copy of this Statement and will be required to provide a written undertaking that they understand and are aware of the long-term financial implications of participation in the Fund prior to their admission.

7.11 Employers leaving the Fund

Appendix C sets out in full the Fund's policy on employers leaving the Fund in any of the following circumstances:

- When the employer is wound up or liquidated;

- When the last active member leaves or retires from an employer;
- When the admission agreement is otherwise terminated by either the employer or the Administering Authority, subject to the notice period specified in the admission agreement;
- In the case of Transferee Admission Bodies, when the contract comes to an end and is not renewed; and
- In the case of scheduled bodies, when the body no longer has an active member contributing to the Fund or through changes in over-riding legislation or Government policy can no longer contribute to the Local Government Pension Scheme.

Where an employer's admission agreement remains in full force and effect, but the employer has no active members and no new members will join in the future, then the admission agreement will be terminated. The actions detailed in Appendix C will apply, other than where specific provision exists in the admission agreement for such circumstances.

7.12 Bulk Transfers

The treatment of bulk transfers of pension rights to and from the Fund are detailed in Appendix B.

LOTHIAN PENSION FUND

8. KEY RISKS AND CONTROLS

The Administering Authority has an active risk-management programme in place. The risk register is reviewed on an ongoing basis by the Risk Management Group, with a quarterly summary provided to the Pensions and Audit Sub-Committees. The following extract from the risk register, with Impact and Probability for each risk scored on a scale of 0-10, highlights those risks which can be considered of particular relevance to the funding strategy:

Risk Register as at 2 November 2020

Risk	Existing controls	Impact	Probability	Current Risk
Adverse Investment performance leading to pressure on employer contributions	• Investment management oversight model including reviews, policy statements and quantitative analysis. • Review of funding strategy, including longevity assessment • Formal review of strategy and investment assumptions as part of triennial actuarial valuation • Regular asset liability studies • Quarterly performance assessment by Joint Investment Strategy Panel. • Bespoke investment strategy offered to eligible employers.	5	5	25
Failure of an employer to pay contributions causes either a significant fall in funding level or requires higher contributions from other employers.	• Admissions Policy including use of guarantees. • Regular contact with employers. • Education to improve understanding, including grant funding implications. • Employer covenants review including quarterly membership monitoring • Funding Strategy Statement includes alignment of higher risk employers to Councils as appropriate. • Funding agreements in place for payment of cessation debt and security sought where appropriate • Affordability confirmation built into Funding Strategy Statement • Staff being reminded of internal reporting procedures regarding late payments to enable prompt action from the Fund • Additional employer covenant analysis and engagement in response to COVID-19 carried out with updates to be provided to all four Councils regarding aligned bodies	4	7	28

Adverse change in non-investment actuarial assumptions causes either funding levels to fall or requiring higher employer contributions	• Regular actuarial valuations and review of funding strategy, including longevity assessment. • Contribution stability mechanism in place and reviewed for eligible employers • Scheme cost and design monitoring by the Scheme Advisory Board • Monitor funding level (ongoing) • Employer covenant and affordability reviews	5	5	25

APPENDIX A: ADMISSION POLICY

1. Background

The Local Government Pension Scheme (LGPS) (Scotland) Regulations 2018 contain powers for the City of Edinburgh Council (acting in its separate capacity as administering authority) of the Lothian Pension Fund (LPF) to admit bodies into the Fund. Those bodies must meet certain conditions (generally relating to their purpose and aims), contained in the Scheme Regulations before being considered for admission.

This document sets out the policy of LPF in applying discretion to admit, on application, a new body into the fund for the purposes of allowing employees of that body access to the LGPS.

This policy will be reviewed as and when considered necessary.

2.General application of discretion to admit new bodies

LPF's Pensions Committee, as the executive body responsible for the administering authority function, delegates power to approve or reject applications to the Chief Executive Officer of Lothian Pension Fund.

LPF will consider all applications from bodies who meet the conditions of the Scheme Regulations. In making its decision, the Fund will carry out covenant analysis of all prospective new employers and due weight will be given to its relative merit.

Approved applications will be subject to the conclusion of an admission agreement containing the appropriate matters prescribed in Scheme Regulations. Appropriate legal advice will be obtained in drafting and concluding admission agreements.

The body will be provided with a copy of LPF's current Funding Strategy Statement and will be required to provide a written confirmation that they understand and are aware of the long-term financial implications of participation in the Fund.

A bi-annual report will be submitted to the Pensions Committee providing details of the delegated decisions made during the year.

3.Policy in relation to bodies admitted following the transfer of services from a Scheme Employer (TABs)

Part 1 of Schedule 2 of the Scheme Regulations lists a number of scheme employers. Certain employers may be admitted to the Fund following the transfer of services to that body, subject to the conclusion of an admission agreement between LPF, the scheme employer (where different) and the TAB. The scheme employer will also be required to act as a guarantor and undertake to meet any amounts due to the Fund in respect of any funding or contribution shortfall either during the period of their participation in the scheme or upon termination of the admission agreement.

4.Policy in relation to other admission bodies

The body applying to be admitted into the Fund must provide documentary evidence of their:

1. aims and objectives;
2. articles of association;

3. latest annual accounts; and
4. future income streams including the source and timing.

The body will be expected to find a guarantor who will undertake to meet any amounts due to the Fund in respect of any funding or contribution shortfall either during the period of their participation in the scheme or upon the termination of the admission agreement. The body must supply documentary evidence of the guarantee obtained and, where considered necessary by LPF, of the financial security of the guarantor.

LPF will try to recover any funding or contribution shortfall from the admission body in the first instance, before seeking any recovery from the guarantor.

LOTHIAN PENSION FUND

APPENDIX B: BULK TRANSFER POLICY

1. Background

This is the policy of Lothian Pension Fund as regards the treatment of bulk transfers of pension rights to and from the Fund.

The purpose of bulk transfer negotiations is to determine the amount of service credits to be awarded and transfer payment to be paid when a number of members transfer their benefits from one pension scheme or LGPS fund to another.

1.1. Regulatory Framework

The Local Government Pension Scheme (Scotland) Regulations 2018 outline the general framework for employees and employers participating in the Local Government Pension Scheme in Scotland.

1.2 Reviews of Policy

This policy will be reviewed at least every three years following triennial valuations or following changes in the Scheme Regulations pertaining to employees transferring rights.

It should be noted that this statement is not exhaustive and individual circumstances may be taken into consideration where appropriate.

2. Principles

2.1. Over-riding Principles

Each bulk transfer will be dealt with on a case by case basis, however, in general the principles below will be applied.

Transfers Out

On transfers out to other LGPS Funds or other schemes, it is the Fund's general policy that:

- If the transfer out will result in the employer having no remaining active members, the bulk transfer amount should not leave the Fund (and the specific employer concerned) with insufficient assets to meet the remaining members' liabilities assessed on the appropriate exit basis as outlined in the Fund's 'Policy on employers leaving the Fund';
- For all other cases, unless otherwise agreed, the transfer amount will be set equal to the value of the benefits accrued to the transfer date for transferring members on the Fund's ongoing valuation basis, adjusted to take account of any underfunding in the transferring employer's share of the Fund, such that the maximum transfer value is not greater than the reserves held for the transferring members. This is known as a 'share of deficit' approach and is subject to a cap equal to 100% of the value of the transferring benefits.

Transfers in

In the event of a transfer in, the Fund's Actuary will be instructed to agree transfer terms with the transferring scheme's (or fund's) Actuary. For transfers in from a funded scheme (or another LGPS Fund), the Fund's Actuary will be instructed to agree terms where the minimum transfer amount from the transferring scheme is calculated on a 'share of deficit' basis. This approach is consistent to the calculation of the transfer amount if there was a transfer out of the Fund.

If the proposed transfer amount will result in a significant deterioration in the funding level of the receiving employer (due to, for example, the transferring scheme having a poor funding position), the Fund Actuary may be instructed to seek a higher transfer amount. If the transfer is from an unfunded scheme, the Fund Actuary will be instructed to ensure the transfer value is equal to the value of transferring benefits based on the Fund's ongoing valuation basis.

If a bulk transfer in results in a deterioration of the receiving employer's funding level, the receiving employer will be required to make good the shortfall. The Fund's general policy is that the employer will be required to restore the funding level to the position immediately prior to the transfer. The employer will be required to repay the required top-up as a lump sum, or where the Fund considers the employer's covenant to be sufficiently strong, over an agreed recovery period or through the ongoing contribution rate (subject to the Fund's discretion).

The Fund reserves the right to refuse to accept a transfer in should the receiving employer's covenant be weak.

<u>Intra-fund transfers</u>
On transfers from one Fund employer to another existing Fund employer, assets equal to 100% of the transferring liabilities will be transferred, unless otherwise agreed.

On transfer from one Fund employer to a new Fund employer, the following principles will apply:

1. A fully funded transfer, on the ongoing valuation basis, if the new employer is a TAB, unless otherwise agreed.
2. A share of deficit transfer, on the ongoing valuation basis for all other types of employer, unless otherwise agreed.

<u>Direction Orders</u>
The Scheme Regulations specify the appropriate pension fund to which certain Scheme employers should belong. However, provisions exist to allow the Scottish Ministers to issue a direction order substituting a different Fund from that which is specified within the Scheme Regulations.

In these situations, the Fund will require the following assurances from the scheme employer before agreeing to a transfer under a direction order:

When liabilities are transferred into the Fund:

- Before agreement to the transfer can be provided, the employer must provide sufficient assurance to the Fund's satisfaction;
- Where applicable, the employer's guarantor/aligned body must agree to the transfer;
- In situations where the transfer will result in a deterioration of the employer's funding level, the employer must undertake to make such additional contributions to make good the shortfall. The level of contributions required, and the period of time over which these will be paid will be determined by the Fund in consultation with the Actuary; and
- The ceding fund must provide assurance that membership data meets the Pension Regulator's common and conditional standards. This will ensure that liabilities transferred are correct.

Where liabilities are transferred out of the Fund:

1. Where all the employer's liabilities are transferred out, all of the employer's assets will be transferred, such that the transferring employer has no remaining assets or liabilities in the Fund.
2. Where all of the employer's active members are being transferred out, but the liabilities relating to deferred and pensioner members remain with the Fund, the employer must ensure that the remaining liabilities are fully funded on the exit basis. The Fund will not recognise a Direction Order unless this condition is met.

2.2 Interaction with funding policy

It is the Fund's policy that each employer is responsible for the funding of all fund benefits of its own members, including current and previous employees. For the purpose of triennial funding valuations, the individual funding position for each employer is tracked by the Actuary at each valuation.

Any transfer of pension rights may have an effect on the valuation position of the employer and as noted above, a revised employer contribution rate may be required depending on the impact of the transfer on the employer's funding position and membership profile.

2.3 Principles for determining payment

The Fund will determine the transfer payment and service credits having taken actuarial advice.

The assumptions used to calculate transfer values out of the Fund will be based on those adopted for the latest formal valuation of the Fund updated for financial conditions on the date of transfer.

Transfers in should equally be updated to reflect financial conditions on the transfer date

There is normally a lag between the date of the actual transfer of staff and the date of payment. During this period, on transfers out, the agreed transfer value will be adjusted by a factor determined by an estimate of the movement in the investments as determined by the asset allocation of the Fund and the respective market indices.

This method of rolling up the transfer payment is to be recommended for incoming bulk transfers as well.

3. Process

3.1. Responsibilities of ceding/receiving employers

An employer which is aware of a transfer from or into the Fund is required to:

- advise the Fund, in writing, of the transfer. This communication should indicate where members are transferring to/from and how many members will potentially transfer;
- provide information and data as requested by the Administering Authority and the Fund's Actuary which is relevant, including in particular any changes to the membership which could affect the liabilities (e.g. salary increases and early retirements), contact details for the ceding/receiving scheme, etc.; and
- assist in the administration of option forms to transferring members as and when required.

3.2. Responsibilities of the Administering Authority

The Administering Authority will gather information as required, including, but not limited to, the following:

- details of the transfer – where are members transferring to/from, how many members are involved and (where a transfer out to a non-LGPS scheme) if the receiving scheme is broadly comparable to the LGPS;
- complete membership data for the transferring members;
- commission the Fund's Actuary to carry out bulk transfer negotiations where necessary;
- where applicable, liaise with the employer and ensure they are aware of their responsibilities, in particular for any residual deficit or risk associated with the transfer; and
- ensure that payments or receipts of transfer value payments are carried out on the agreed dates.

3.3. Responsibilities of the Actuary

Following commission of bulk transfer negotiations by the Administering Authority, the Fund Actuary will:

- on notification of the transfer, ensure that the data and information required is collated;
- propose/agree assumptions and transfer values based on the policies set out by the Fund;
- propose/agree service credits in line with relevant legislation and policies; and
- negotiate and agree the final transfer payment date and amount.

APPENDIX C: POLICY ON EMPLOYERS LEAVING THE FUND

1. Introduction

This is the policy of Lothian Pension Fund as regards the treatment of employers leaving the Fund.

This policy replaces all previous policies on employer termination and is effective from 29 September 2022.

1.1 Scope of Policy

This policy covers employers leaving the Fund in any of the following circumstances:

- when the employing authority is wound up or liquidated;
- when the last active member leaves or retires from an employer;
- when the admission agreement is otherwise terminated by either the employing authority or the admission authority, subject to the notice period specified in the admission agreement;
- in the case of Transferee Admission Bodies, when the contract comes to an end and is not renewed; and
- in the case of scheduled bodies, when the body no longer has an active member contributing to the Fund or, changes in over-riding legislation or Government policy determine that employees can no longer contribute to the Local Government Pension Scheme;

1.2 Reviews of Policy

This policy will be reviewed at least every three years following triennial valuations or following changes in the Scheme Regulations relevant to employers leaving the Fund.

2. Principles

2.1. Overriding Principles

If an employer leaves the Fund, or their admission agreement is otherwise terminated, the Administering Authority will instruct the Fund's Actuary to carry out a valuation of that employer's liabilities (an 'exit valuation').

Payment of any deficit does not guarantee that the assets in the Fund will be sufficient for the liabilities in the future: the actual cost of benefits will only be known after the last dependant dies and there is a risk that the amount estimated in the exit valuation does not cover the actual cost of the liabilities. In this situation, the Fund would seek recourse from the body which acted as guarantor to the employer, or alternatively the body which the employer was aligned.

The basis used to carry out such a valuation will depend on the circumstances of the change. The Fund's general policy is that the valuation will be carried out on a more prudent basis than that used in the ongoing actuarial valuation. However, the Fund may take into account the covenant strength of any successor body and/or guarantor which may be in place after the exit date.

The employer, successor body and/or guarantor may be required to pay additional contribution(s) or capital payments to the Fund.

.

In normal circumstances, the Actuary will use the following assumptions for the exit valuation:

- A discount rate equivalent to the gilt yield at the date of the exit, with no allowance for outperformance of investments;
- An increase in the liabilities by 3% reflecting anticipated additional future improvements to life expectancies (over and above the ongoing valuation assumption); and
- Other assumptions would be consistent with the most recent actuarial valuation.

However, where the employer leaving the Fund is a Transferee Admission Body or an employer admitted to the Fund following a transfer of staff from another Fund employer the actuarial basis used will adopt a discount rate that is consistent with the basis used to assess the employer's opening assets and liabilities when the employer joined the Fund (updated for market conditions). On joining the Fund, Transferee Admission Bodies are set up on a fully funded basis with contribution rates calculated based on the duration of the contract in order to reduce the likelihood of a deficit arising on exit.

The Actuary may include an additional level of prudence when carrying out the exit valuation to take into consideration the McCloud judgement which found that the transition protections put in place when new public sector schemes were introduced were discriminatory. As a result, the benefit structure of the LGPS is being reviewed. Until clarity on a remedy is available, a loading factor may be applied to exit valuations.

If an employer becomes insolvent and it, or its guarantor, is unable to meet any deficit, additional contributions will be required from each remaining employer in the Fund, in proportion to their liabilities. This means that the majority of any deficit will fall on the large employers. However, where it has been established that there is a specific alignment to one or more other employers, then the pension liability will be assigned or apportioned accordingly to those other employer(s).

In the event of a Transferee Admission Body leaving the Fund and being unable to pay additional contributions to the Fund, the employer granting the contract will be liable for the additional contributions or capital payments.

The purpose of an exit valuation is to determine the level of any surplus or deficit in an employer's share of the Fund as at the date the employer leaves the Fund. Unless the cost of doing so is deemed to outweigh the likely recovery to the Fund, the Fund will pursue an outgoing body (including the liquidator, receiver, administrator or successor body if appropriate) for any deficit. The Fund will also pursue the guarantor for payment, where appropriate.

It is the Fund's policy that the determination of any surplus or deficit on termination should aim to minimise, as far as is practicable, the risk that the remaining, unconnected employers in the Fund have to make contributions in future towards meeting the past service liabilities of current and former employees of employers leaving the Fund.

2.2 Principles for Determining Payment of Exit Debt

The Administering Authority will determine the deficit/surplus attributable to the employer on exit having taken actuarial advice.

Where an exit valuation identifies that an employer is in surplus, this surplus will be returned to the employer in accordance with the Scheme Regulations.

If it is determined that there is a deficit and the employer will be required to make a payment to the Fund, the administering authority will advise the employer of the amount required. The Fund's general policy is for any deficit on exit to be recovered through a single lump sum payment to the Fund.

The Fund may, at its discretion issue a suspension notice to an employer leaving the Fund, suspending the employer's liability to make an exit payment. In such cases, the employer must continue to make contributions to the Fund at a level agreed by the Fund and the Fund Actuary. The suspension notice will specify the period during which the suspension notice is to apply. However, the fund may, at its discretion withdraw a suspension notice prior to the expiry of the suspension period. Once the suspension period has come to an end, or the fund has withdrawn the suspension notice, a further exit valuation will be carried out based on the relevant market conditions, asset values and updated membership data at that time.

In exceptional circumstances, and where it considers that this does not pose a material risk to the solvency of the Fund, the Fund may consider:

- allowing payment of any exit debt over longer terms rather than insisting on payment as a one-off payment or over shorter terms previously agreed;
- foregoing interest on such longer-term debt;
- agreeing repayment of an amount less than the exit debt in order to avoid the employer's 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 a legal agreement to address future improvements in the employer's financial circumstances. The Fund may take into account the covenant strength of the employer (including the availability of security in respect of the exit debt) and any successor body and/or guarantor which may be in place after the exit date. Interest at a rate advised by the Actuary may be applied to determine the appropriate payments to be made to the Fund.

The Fund may, at its discretion, enter into a written agreement with an exiting employer for that employer to defer their obligation to make an exit payment and to instead continue to make contributions at the secondary rate (a deferred debt agreement). Such agreements require a review of contributions every three years (ie in line with the triennial valuation of the Fund). The Fund will only consider a deferred debt agreement in situations where:

- the exiting employer has a strong financial covenant sufficient to meet the contributions during the term of the agreement and also any residual exit liability at the end of the agreement; and
- the exiting employer is willing to offer the fund suitable protection against the risk of future investment downturn or any other factors which may negatively impact the final exit valuation at the end of the agreement. As such, this may require the fund to be granted security over

the employer's assets; and

- a deferred debt agreement offers a better solution for the relevant employer than a debt spreading agreement as outlined above.

Adopting such principles would protect the interests of the Fund as a whole.

APPENDIX D: CHARGING POLICY

This is the policy of Lothian Pension Fund as regards meeting the cost of actuarial fees and other service costs which are recharged to employers. It covers the main circumstances where fees are payable but is not exhaustive.

The Fund will obtain the consent of the employer or member before carrying out any work which is likely to lead to fees being recharged.

1. Costs recharged to scheme members

The costs of general pension administration are not recharged to members of the Fund. However, costs associated with complex pieces of work, as well as costs of providing certain other confirmation may be recharged. This includes (but is not limited to) the following:

- costs associated with providing valuations under the Family Law (Scotland) Act 1985;
- costs of implementing pension sharing orders;
- costs of providing further cash equivalent transfer values where this information has already been provided once in the last twelve months; and
- costs of appointments with the Fund's independent medical advisers where appointments have been repeatedly missed without good reason, or where habitual requests for assessment are received without new medical evidence.

Details of the costs payable can be found on the Fund's website (www.lpf.org.uk). These costs will increase annually each April by CPI over the 12 months to the previous September.

2. Costs recharged to scheme employers

Employers should always contact the Fund in the first instance to establish whether fees will be recharged for any administration process or obtaining professional advice, and to obtain an estimate of likely fees.

Actuarial charges will be met by the Fund where the work is common to all or most employers, or where the work is required by the Scheme regulations and the employer has no choice whether or not the work is carried out.

However, where work is carried out or advice obtained at the request of a single or small number of employers, is not required by other employers, and is not a requirement of the Scheme Regulations, then the charges for that work or advice are generally recharged to the employer(s) concerned.

Details of the activities for which fees will be charged to the Fund and those that will be recharged to the relevant employer are set out in the schedule below.

3. Schedule

3.1 Actuarial Fees

Activities for which Lothian Pension Fund should be charged:

- all matters relating to the triennial actuarial valuation, except additional work done at the direct request of an individual employer;
- interim actuarial valuations if and when the Administering Authority require such valuations;
- actuarial advice regarding questions concerning the interpretation of Scheme Regulations and matters pertaining to the administration of Fund benefits;
- preparation for and attendance at the Fund meetings; and
- any other matters which affect or are likely to affect all or a significant number of Fund employers.

Activities for which actuarial fees will be recharged to an employer:

- extra, non-standard triennial actuarial valuation work done for and at the direct request of an individual employer;
- a common actuarial service used by most employers is the provision of figures for IAS19/FRS17/FRS102 accounting disclosure purposes. As this information is for the benefit of individual employers and not the Fund itself, the relevant costs are recharged to the individual employers;
- interim valuations where these are not a requirement for all employers but are either: -
    - required by an employer's admission agreement or;
    - not required but specifically requested by the employer concerned;
- calculations etc. in respect of the admission of a new Fund employer;
- Best Value and other outsourcing calculations and consequent interim valuations;
- where an employer has been admitted to the Fund and is required to provide a bond or indemnity to meet any shortfall in funding in the event of the employer ceasing to participate in the Pension Fund, the cost of assessment and subsequent annual reassessment of the value of the bond or indemnity;
- assessing whether a potential/actual contractor's pension arrangement is "broadly comparable" to the Local Government Pension Scheme;
- any other interim valuations for an employer that is required through some action, or failure to act, by that employer;
- bulk transfer work in respect of transfers out of or into the Fund;
- exit valuations; and
- any other charges specific to one employer, or specific to such a small number of employers that it would be unreasonable to spread the cost between the membership as a whole. Where a number of employers are involved, the charges will be proportioned in light of the circumstances of the case.

3.2 Other charges

In addition to recharging actuarial fees as specified above, and for those activities listed below, employers will be recharged for fees incurred in relation to certain requests which result in:

- additional administrative work and advice over and above the standard that is required;
- complex calculations;
- specific work for high earners; and

- if the Fund requires to seek advice or commission work from other providers (e.g. lawyers), costs arising will be recharged to employers in full if this work is specific to that employer or specific to such a small number of employers that it would be unreasonable to spread the cost across all employers in the Fund. Where more than one employer is involved, charges will be apportioned reflective of the circumstances.

Activities for which fees will be recharged to an employer:

- disclosure of information relating to Senior Officers and Councillors for inclusion in Local Authority Accounts:
    - provision of Cash Equivalent Transfer Value calculations and appropriate pension benefit calculations;
    - charges applied per case;
- setting up an Admission Agreement with the Fund for new employers joining the Fund;
    - costs to cover legal fees incurred by the Fund in drafting and finalising the Admission Agreement;
    - See note 1 below;
- attendance at meetings and associated work in connection with Employer projects involving transfers of staff (e.g. outsourcing, mergers etc);
    - a charge will be made where the Fund considers the work undertaken to be in excess of normal advice to employers;
    - costs will be based on Fund Officers time plus VAT; and
- interest payable on an exit valuation where the Fund allows payment to be spread over an agreed period; and interest will be charged at a rate advised by the Fund Actuary

Regulatory recharges

Where an employer has chosen to award compensation in the form of additional membership under Part III of the Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998, for ease of administration the Fund will pay the compensation pension to the member along with the funded pension. The compensation pension will be recharged to the employer on a monthly basis. However, should the awarding employer cease to exist, the compensation pension will cease. The funded pension would be unaffected.

Notes:

1. Any additional costs arising if specialist actuarial, legal etc advice is requested will be charged in full in addition to the figures quoted above.
2. The Fund will act in accordance with relevant procurement guidance in obtaining external professional services.

APPENDIX E: CALCULATION OF EMPLOYER CONTRIBUTIONS

Section 7.4 of the Funding Strategy Statement sets out a broad description of the way in which employer contribution rates are calculated. This appendix considers these calculations in more detail.

The Fund Actuary uses a three-step process to calculate an employer's contribution rate:

1) Calculate the funding target for that employer, i.e. the estimated amount of assets it should hold in order to be able to pay all its members' benefits. The funding target is based on a set of assumptions about the future (e.g. investment returns, inflation, pensioners' life expectancies). If an employer is approaching the end of its participation in the Fund then its funding target may be set on a more prudent basis, so that its liabilities are less likely to be spread among other employers after its cessation;
2) Determine the time horizon over which the employer should aim to achieve that funding target. Employers may be given a lower time horizon if they have a less permanent anticipated membership, or do not have tax-raising powers to increase contributions if investment returns under-perform; and
3) Calculate the employer contribution rate such that it has at least a given likelihood of achieving that funding target over that time horizon (allowing for various possible economic outcomes over that time horizon). The likelihood of achieving the funding target over the employer's time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer's financial strength is considered to be weaker, then the required likelihood will be set higher, which in turn will increase the required contributions (and vice versa).

The table below sets out how this methodology will be applied to each type of employer:

Type of Employer	**Scheduled**			**Transferee Admission Bodies**	**Community Admission Bodies**					
Sub-Group	Group 1	Group 2	Group 3	N/A	Open 1	Open 2	Closed 1	Closed 2	Closed 3	Lothian Buses
Investment Strategy	Main	Main	Main	Main	Main	Main	Medium	Low	Main	Lothian Buses
Stabilised contribution rate?	Yes	Yes	No	No	Yes	No	No	No	No	No
Funding Target Basis used	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Gilts	Gilts	Ongoing	Gilts
Time Horizon (years)	20	15	15	Shorter of FWL [1}/ contract length	15	15	FWL	FWL	FWL	20 TBC
Likelihood of achieving target	67%	67%	[2]	[2}	[2]	[2]	N/A	N/A	N/A	[2]

The Administering Authority recognises that there may occasionally be particular circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement. Therefore, the Administering Authority reserves the right to direct the Fund's Actuary to adopt alternative funding approaches on a case-by-case basis for specific employers.

[1] Future Working Lifetime of current active members or duration in Fund if shorter
[2] Likelihood based on employer covenant rating

This methodology is suitable for employers who are open to new entrants and who therefore have a long time horizon and are not expected to leave the Fund. This applies to all employers in the primary investment strategy. The risk-based method uses a long-term economic model of the future to set contributions which take account of expected future economic conditions rather than being dominated by current conditions. It also places much less reliance on the current funding position, particularly as the funding position in itself is of less importance to employers who aren't planning to leave the Fund.

The employers who participate in the medium and low risk investment strategies have had their contribution rates determined using a single set of economic assumptions about the future ("deterministic method"). These employers are all closed to new entrants and will eventually leave the fund, at which point their funding position will crystallise. The current funding position is therefore of more importance for these employers, as they have shorter time horizons which means that current or 'near term' market conditions become more relevant than long-term assumptions. It therefore makes more sense to use a deterministic method in which the current funding position and current market conditions are used as the basis for setting contributions.

These general principles apply to the majority of the Fund's employers. However, the Fund retains discretion to choose the most appropriate method based on an employer's specific circumstances, and this affects a small number of employers in practice.

Calculation of employer contribution rates: calculation methodology

The Primary rate is calculated such that it is projected to:

1) meet the required funding target for all future years' accrual of benefits*, excluding any accrued assets,
2) within the determined time horizon;
3) with a sufficiently high likelihood, as set by the Fund's strategy for the category of employer

*The projection is for the current active membership where the employer no longer admits new entrants, or additionally allows for new entrants where this is appropriate.

The Secondary rate is calculated as the balance over and above the Primary rate, such that the total contribution rate is projected to:

1) meet the required funding target relating to combined past and future service benefit accrual, including accrued asset share,
2) at the end of the determined time horizon,
3) with a sufficiently high likelihood, as set by the Fund's strategy for the category of employer.

The projections are carried out using an economic modeller (the "Economic Scenario Service") developed by the Fund's Actuary Hymans Robertson: this allows for a wide range of outcomes on key factors such as asset returns (based on the employer's investment strategy), inflation, and bond yields. The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (at the end of the time horizon) is equal to the required likelihood.

Actuarial Assumptions used to calculate employer contribution rates

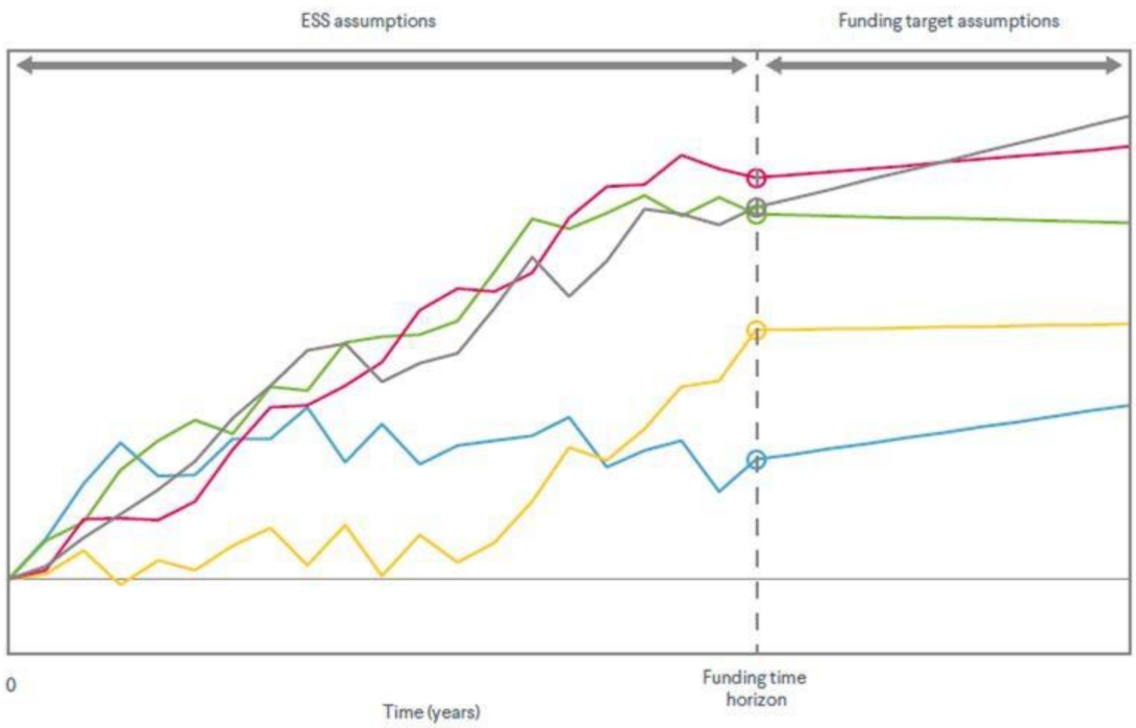
These are expectations of future experience used to place a value on future benefit payments ("the liabilities") and future asset values. Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants' benefits.

Changes in assumptions will affect the funding target and required contribution rate. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The Fund Actuary's approach to calculating employer contribution rates involves the projection of each employer's future benefit payments, contributions and investment returns into the future under 5,000 possible economic scenarios. Future inflation (and therefore benefit payments) and investment returns for each asset class (and therefore employer asset values) are variables in the projections. By projecting the evolution of an employer's assets and benefit payments 5,000 times, a contribution rate can be set that results in a sufficient number of these future projections (determined by the employer's required likelihood) being successful at the end of the employer's time horizon. In this context, a successful contribution rate is one which results in the employer having met its funding target at the end of the time horizon.

Setting employer contribution rates therefore requires two types of assumptions to be made about the future:

1) Assumptions to project the employer's assets, benefits and cashflows to the end of the funding time horizon. For this purpose, the Fund's Actuary uses Hymans Robertson's proprietary stochastic economic model - the Economic Scenario Service ("ESS")
2) Assumptions to assess whether, for a given projection, the funding target is satisfied at the end of the time horizon. For this purpose, the Fund has two different funding bases.



What assumptions are used in the ESS?

The Fund's Actuary uses Hymans Robertson's ESS model to project a range of possible outcomes for the future behaviour of asset returns and economic variables. With this type of modelling, there is no single figure for an assumption about future inflation or investment returns. Instead, there is a range of what future inflation or returns will be which leads to likelihoods of the assumption being higher or lower than a certain value.

The ESS is a complex model to reflect the interactions and correlations between different asset classes and wider economic variables. The table below shows the calibration of the model as at 31 March 2020. All returns are shown net of fees and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to the simulated yields at that time horizon.

		Annualised total returns									
		Cash	Index Linked Gilts (medium)	Fixed Interest Gilts (medium)	UK Equity	Overseas Equity	Property	CorpMedium A	Inflation	17 year real yield	17 year yield
5 years	16th %'ile	-0.6%	-3.0%	-2.9%	-5.3%	-5.2%	-3.7%	-2.1%	1.3%	-2.7%	0.2%
	50th %'ile	0.2%	0.0%	-0.3%	3.7%	3.9%	2.1%	1.3%	2.8%	-1.8%	1.3%
	84th %'ile	1.0%	3.0%	2.5%	13.6%	13.4%	8.7%	4.5%	4.3%	-0.9%	2.5%
10 years	16th %'ile	-0.4%	-2.5%	-2.0%	-2.1%	-2.1%	-1.8%	-1.1%	1.4%	-2.2%	0.6%
	50th %'ile	0.6%	-0.4%	-0.5%	4.3%	4.3%	2.5%	0.8%	2.9%	-0.9%	2.0%
	84th %'ile	1.7%	1.8%	1.0%	10.7%	10.5%	7.2%	2.6%	4.6%	0.3%	3.8%
20 years	16th %'ile	0.2%	-1.5%	-0.6%	0.6%	0.8%	0.2%	0.2%	1.4%	-1.6%	1.2%
	50th %'ile	1.6%	0.2%	0.2%	5.2%	5.3%	3.6%	1.3%	2.9%	0.1%	3.1%
	84th %'ile	3.3%	1.9%	1.0%	9.9%	10.0%	7.4%	2.4%	4.5%	1.9%	5.7%
	Volatility (Disp) (1 yr)	0%	7%	8%	27%	28%	14%	10%	1%		

What assumptions are used in the funding target?

At the end of an employer's funding time horizon, an assessment will be made – for each of the 5,000 projections – of how the assets held compare to the value of assets required to meet the future benefit payments (the funding target). Valuing the cost of future benefits requires the actuary to make assumptions about the following financial factors:

- Benefit increases and CARE revaluation
- Salary growth
- Investment returns (the "discount rate")

Each of the 5,000 projections represents a different prevailing economic environment at the end of the funding time horizon and so a single, fixed value for each assumption is unlikely to be appropriate for every projection. For example, a high assumed future investment return (discount rate) would not be prudent in projections with a weak outlook for economic growth. Therefore, instead of using a fixed value for each assumption, the actuary references economic indicators to ensure the assumptions remain appropriate for the prevailing economic environment in each projection. The economic indicators the actuary uses are: future inflation expectations and the prevailing risk-free rate of return (the yield on long term UK government bonds is used as a proxy for this rate).

The Fund has two funding bases which will apply to different employers depending on their type. Each funding basis has a different assumption for future investment returns when determining the employer's funding target.

Funding basis	Ongoing basis	Gilts cessation basis
Employer type	All employers except Community Admission Bodies that are closed to new entrants	Community Admission Bodies that are closed to new entrants
Investment return assumption underlying the employer's funding target (at the end of its time horizon)	Long term government bond yields plus an asset outperformance assumption (AOA) of 1.8% +p.a*	Long term government bond yields with no allowance for outperformance on the Fund's assets.

*For existing Transferee Admission Bodies, the ongoing investment return assumption at the end of the employer's time horizon is Long term government bond yields plus an asset outperformance assumption (AOA) of 1.5% +p.a

APPENDIX F: SALARY STRAIN RECHARGING MECHANISM

What is salary strain?

Prior to 1 April 2015, the Local Government Pension Scheme (LGPS) in Scotland was a 'final salary' scheme, so a member's pension accrued before 1 April 2015 is directly linked to their salary at retirement. This means that salary increases awarded to employees have a direct impact on total pension costs for employers. At each triennial valuation of the Fund, the Fund's Actuary makes an assumption about the level of future salary growth. At the next valuation, the Fund's Actuary assesses the difference between the increases awarded over the last three years compared to those assumed. If salary increases were higher than anticipated, this will lead to higher pension costs. This increase in costs is referred to as 'salary strain'.

Why is the Fund putting this mechanism in place?

At the 2020 valuation, the Fund discussed the appropriateness of the salary growth assumption, taking into account recent economic conditions and the outlook for future long term pay awards. The assumption agreed as part of the 2020 valuation discussions is significantly lower than that used at previous valuations and equivalent to a long-term rate of consumer price inflation ('CPI') plus 0.5% p.a. The valuation also includes an age-related allowance for promotional salary growth in addition to the inflationary element.

A lower salary growth assumption places a lower value on the liabilities and reduces future pension costs. All else being equal, employers therefore benefit via an improved funding position and lower contribution rate. However, assuming a lower level of future salary growth places a greater risk on the Fund of employers awarding larger than expected pay increases and not being able to meet the additional pension costs in the future. A salary strain recharging mechanism therefore controls this risk and allows the Fund to charge for salary strains if they occur.

How does the mechanism work?

The Fund will work with the actuary to monitor salary increases annually. Any salary growth strain arising will be billed immediately to the responsible employer.

Following each March year-end after the latest formal valuation, the Fund will provide an annual data cut of salary information to the Fund's Actuary for all employers in the Fund. The Fund's Actuary will then calculate whether any salary growth strain has occurred by comparing the employee's salary at the year-end against the expected salary for that same member (based on data from the previous formal valuation). The strain will then be totalled per employer. The actuary will also carry out an interim valuation of each employer's membership data at a recent date to provide an indicative funding for each employer. This will be considered alongside the results of the salary strain review and the following process will be applied:

- Where the employer has a funding level in excess of 130% the strain will be waived (although the employer can still pay), subject to the agreement of the scheme employer acting as guarantor (where applicable);
- Where the employer has a funding level between 115% and 130% a lower strain payment will be due, subject to the agreement of the scheme employer acting as guarantor (where applicable). The amount due will be capped at the amount that would allow a funding level of 130%; and

- Where the employer's funding level is less than 115% any salary strain identified will be recharged in full.

Where a strain applies the Fund will recharge the additional cost to employers via an invoice.

Assessing and managing salary strain on an annual basis avoids any unexpected deterioration in funding position resulting from pay awards at future valuations. The mechanism is a way to recognise the cost of salary strain at the point at which pay awards are granted, rather than letting the cost be met over a much longer time period. In the past, any salary strains have been met via higher ongoing pension contributions (as a higher salary growth assumption was used) or they have emerged at the next valuation resulting in a funding deficit, causing future contributions to rise

For members who have left during the period, the period-end salary will be at the date of leaving. Members who have joined during the inter-valuation period will be excluded from the analysis. However, if there are members who have joined the Fund and had a transfer in of final salary past service, any salary strain or gain in relation to these members would be allowed for at the next formal valuation of the Fund.

The salary growth assumption of CPI plus 0.5% at the 2020 valuation is a 'blended rate', made up of a short-term rate of 2% p.a until 2025 followed by CPI + 0.7% thereafter. For the purposes of the salary strain recharging mechanism, the blended rate of CPI plus 0/5% will be used as the expected salary increase assumption over the next 3 years until the next formal valuation of the Fund in 2023. The assumption will be reviewed as part of the next formal valuation and may change depending on the economic outlook at the time.

What if salary increases are less than expected?

If a salary gain is calculated in one year (i.e. the salary growth is less than that expected), then we would allow this to offset a strain occurring in any future year up to the next formal valuation date. If the overall impact of salary increases between valuations is a gain, then this will be credited to the employer's funding position at the next valuation and will help to reduce its contribution rate going forward (all other things being equal).

For the avoidance of doubt, salary strain is calculated on a member-by-member basis, with salary gains for members with pay awards that are lower than assumed being offset against strains for members with high pay awards. This means that is possible for an overall strain to arise even if the average pay award for any given employer is lower than the valuation assumption e.g. where an employer grants high pay awards to a few employees with long LGPS service and/or high salaries, and lower pay awards to the rest of its workforce.

This page is intentionally left blank

Pensions Committee

2.00pm, Tuesday, 19 June 2023

LPF Unaudited Annual Report (and Financial Statements) 2023

Item number 6.4

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 2023 for Lothian Pension Fund and Scottish Homes Pension Fund;

1.2 note that the unaudited Annual Report (and Financial Statements) for the year ended 31 March 2023 will be submitted to the auditor, Azets Audit Services Limited, by the due date of 30 June 2023;

1.3 note that, at the time of writing, final proof reading of the report, as appended, is still underway and therefore potential corrections and any minor amendments will be completed prior to release to the auditor and publication on the website.

David Vallery
Chief Executive Officer, Lothian Pension Fund

Contact: Jason Koumides, Financial Controller, Lothian Pension Fund

Susan Macfarlane, Head of Communications, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

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 2023 for Lothian Pension Fund and Scottish Homes Pension Fund.

2.2 A copy of the unaudited Pension Funds' Annual Report 2023 is attached as Appendix 1.

2.3 Despite volatile markets the Lothian Pension Fund has made a small positive return for the year. This results in Lothian Pension Fund (Group) net asset valuation as at 31 March 2023 being broadly inline with last year £9,700.6m (2022 - £9,605.2m).

2.4 Scottish Homes Pension Fund has a mature membership profile, with its investment objective to match the cash flow from gilt income and redemption payments as closely as possible with the expected liability payments of the Fund. Over the year the Fund's assets and liabilities have declined but funding level has remained consistent with last year.

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 arrangement 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 Service Director: Finance and Procurement serves as the Section 95 Officer for all of the City of Edinburgh Council's accounting arrangements, including those of the Pension funds. In previous years the Section 95 responsibility was delegated to Lothian Pension Funds' Chief Finance Officer, but due to this post being vacant this responsibility has fallen back to the Finance and Procurement Service Director.

The Local Authority Accounts (Scotland) Regulations 2014

3.2 These stipulate that "The Annual Accounts must be submitted to the auditor no later than 30 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.

Accounting and other guidance

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

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

a report about the management and financial performance during the year of each of the pension funds maintained by the authority;

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;

(a) a report of the arrangements made during the year for the administration of each of those funds;

(b) 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;

(c) the current version of the statement under regulation 53 (governance compliance statement);

(d) for each of the funds, the fund account and net asset statement with supporting notes and disclosures prepared in accordance with proper practices;

(e) 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); and

(ii) such other matters arising from a pension administration strategy as it considers appropriate;

(f) the current version of the statement referred to in regulation 56 (funding strategy statement);

(g) 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);

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

(i) any other material which the authority considers appropriate"

3.4 Local authorities are required to account for pension funds in accordance with the applicable Code of Practice in 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 approval accounting standards issued by the International Public Sector Accounting Standards Board and the UK Financial Reporting Council where these provide additional guidance. The Code now requires that preparers have regard to Chartered Institute of Public Finance and Accountancy (CIPFA) guidance "Accounting for Local Government Pension Scheme Management Costs".

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

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

3.7 With the, FCA regulated, investment services company, LPFI Limited, commencing trading on 28 February 2017, consolidated financial statement have again been prepared for Lothian Pension Find for the year 31 March 2023. 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 2023

4.1 A copy of the unaudited Annual Report (and Financial Statements) for the year to 31 March 2023 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 Despite volatile markets the Lothian Pension Fund has made a small positive return for the year. This has resulted in Lothian Pension Fund (Group) net asset valuation as at 31 March 2023 being broadly inline with last year £9,700.6m (2022 - £9,605.2m).

4.4 Scottish Homes Pension Fund has a mature membership profile, with its investment objective to match the cash flow from gilt income and redemption payments as closely as possible with the expected liability payments of the Fund. Over the year the Fund's assets and liabilities have declined but funding level has remained consistent with last year.

Governance

4.5 The Annual Report includes an Annual Government 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 issues 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.

4.8 The funds have separate Actuarial Statement, 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 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 – Unaudited Annual Report (and Financial Statements) 2023 for Lothian Pension Find and Scottish Homes Pension Fund

Appendix 2 – City of Edinburgh Council – Statement on the system of internal financial control by Service Director: Finance and Procurement

Appendix 3 – Lothian Pension Funds – Statement on the system of internal financial control by Service Director: Finance and Procurement

LOTHIAN
PENSION FUND

2022/23

ANNUAL REPORT
AND ACCOUNTS


TRAVEL
AIR TICKET
Hotel Booking
Name :
Lastname :
Date :
CREDIT CARD

CONTENTS

A MESSAGE FROM THE CONVENOR OF THE PENSIONS COMMITTEE

Our responsibility as an administering authority of the LGPS Pension Fund is to offer stability to our scheme members and employers. This year Lothian Pension Fund (LPF) has continued to improve and develop the organisation to ensure that it provides the pension services that its members and employers expect and deserve.

After the Council elections in May 2022, I was appointed Convenor of the Pensions Committee and LPF also welcomed two other new Pension Committee members, Councillor Nicolson and Councillor Doggart. Together with the continuing members, Councillor Ross, Councillor Burgess, Richard Lamont and John Anzani, the committee has continued the work of our predecessors, whilst bringing a fresh perspective, new ideas and constructive feedback to LPF.

In the pages that follow, the team will highlight the progress made in terms of LPF's pensions administration and investment activities, as well as the strategy and business plan. The report will also highlight the significant work undertaken on key projects, including further developing risk management and governance practices and the implementation of new legislation.

LPF is acutely aware of the difficult financial climate and in the coming year, LPF will continue to strengthen its governance, pensions administration, finance and investment arrangements with the aim of providing services that are efficient and effective.

I would like to extend my thanks to the Committee and Pension Board and all the Fund's employees for their continuing commitment to member-focussed change, which is vital for delivering services that meet or exceed the expectations of the scheme's members and employers. I hope you find the LPF annual report and accounts informative and useful.

Mandy Watt
Convenor of the Pensions Committee 2022/23
Lothian Pension Fund
21 June 2023

A REVIEW OF 2022/23

The financial year 2022/23 has seen the continuation of the conflict in Ukraine, and exacerbation of the cost-of-living crisis, with the latter leading to significant levels of industrial action, especially in the public sector with workers looking for significant pay increases to protect their earnings.

The passing of Queen Elizabeth II after 70 years on the throne and the subsequent coronation of King Charles III, illustrates both a commitment to service and the need for continuity alongside change.

It's within this context that I'm pleased to share some of our key highlights and achievements during 2022/23, demonstrating how colleagues at Lothian Pension Fund have continued to support our members, meet our commitments on responsible investing, and progress the priorities set out in our business plan.

Progress against our Strategy and Business Plan

We launched our new Strategy and Business Plan in early 2022. It's underpinned by four strategic goals:

- Develop and deliver a member and employer proposition for service excellence
- Earn an appropriate risk adjusted investment return as responsible investors
- Extend collaboration and services to existing partners and deepen where possible
- Achieve greatness in our people, teams and culture.

These goals are set by our Vision "to deliver outstanding pension and investment services for the benefit of members and employers". Despite the challenges of the current economic climate, we were able to make good progress towards delivering these goals and you can read more about our progress throughout this report.

Delivering for our members and their families

2022 got off to a great start as we welcomed our colleagues back into the office in February following the easing of lockdown restrictions. We were pleased to be able to re-introduce inbound calls from 1 February 2022 through our new and improved phone system. This was a great step forward for service excellence and member feedback has been very positive. Our new IT system has given us scope to do this more efficiently and effectively than before.

2022/23 was another year of success and progress for LPF. We continued to deliver for our members, paying out £196,061,842 to 35,632 members and welcoming 7,553 new members.

Providing excellent customer service to our members and employers is at the heart of what we do, so we were delighted to achieve Pensions Administration Standards Association (PASA) reaccreditation along with the Customer Service Excellence Award. We also scored 92.7% for overall customer satisfaction in our annual surveys.

A REVIEW OF 2022/23

Enhancing our digital proposition

We launched our new website in March 2022, where members and visitors can learn more about us, read our latest news and publications, access their pension, and view our vacancies in one, easy to navigate place. In addition, we issued our first ever electronic communication to members in the form of the Penfriend e-zine to our pensioners. This enables us to communicate more frequently with the large number of our members who have opted into electronic communications.

Our Digital strategy continued to progress and allowed for more on-line processing and self-service options for our members which has significantly reduced the timescales involved. We introduced on-line facial recognition software in August 2022 to make our 'Annual Proof of Existence' checks easier for our overseas members.

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 funding 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 March 2023 were £9,701m (March 2022 £9,607m).

Work has commenced on the new valuation as at 31 March 2023. The results of this should be reported on in next year's annual report.

WHAT OUR MEMBERS SAY:

"Very approachable staff, efficient and friendly professional service."

A REVIEW OF 2022/23

Investing in our people

During the year we recruited 26 new colleagues across a variety of roles within the Member Services, Finance, Legal, Risk & Compliance, Governance, Investment and IT teams. This includes Kerry Thirkell as Chief Risk Officer, who joins my Senior Leadership Team and the Board of LPFI, our regulated asset management company. Kerry brings extensive experience into this critical role and will help ensure our risk management framework and processes are robust and fit for purpose.

Hiring these colleagues will not only ensure that we remain adequately resourced to deliver what we need today but will enable us to continue to improve our capabilities and the services we deliver to our members and employers. You can read more about what we're doing to make LPF a great place to work on pages 59-64.

The LGPS in Scotland and Northern Ireland

LPFI continued to provide advisory services to the LGPS funds of Fife, Falkirk, Scottish Borders, and Northern Ireland, as well as managing assets for Falkirk (two sovereign bond portfolios and a global equity portfolio) and for Fife (two global equity portfolios and one sovereign bond portfolio). In September 2022, we were pleased to receive confirmation from the FCA that the asset cap restricting the funds under management of LPFI was removed. This enables us to increase the funds we can manage for the Falkirk and Fife funds.

We continued to explore a merger with Falkirk Council Pension Fund. Work to take the proposal forward will continue this year, subject to approval by both the City of Edinburgh and Falkirk Councils, and regulatory approval in both Scotland and the UK.

Maintaining momentum on responsible investment

Our focus and commitment to being a responsible investor continued. Our investment strategy currently seeks alignment with the Paris goals and uses the Transition Pathway Initiative to guide us in this regard. We intend to explore a net zero commitment in 2023 and would expect to introduce such a commitment and target date once we're confident about what such a commitment means for a fund and that we're capable of achieving it.

In March 2023, we were proud to be listed as a signatory to the UK Stewardship Code, following the publication of our Stewardship Report. Stewardship is the responsible oversight, management, and allocation of capital to create long-term value for clients and beneficiaries that lead to sustainable benefits for the economy, the environment and society. Our report demonstrates the nature of our commitment to stewardship for the benefit of our stakeholders and demonstrates how we're delivering against the 12 principles set out by the Financial Reporting Council.

A REVIEW OF 2022/23

We published Issues 5 and 6 of our ESG ezine, *ENGAGE,* which gives detailed information on LPF's approach to ESG and our responsible investment activities.

We continue to work with the Scottish Local Government Pension Scheme Advisory Board, who are considering enhanced climate change reporting, and advising Scottish Ministers following the Department for Levelling Up, Housing and Communities public consultation on the same subject for the Local Government Pensions Schemes (LGPS) in England and Wales.

McCloud and The Pensions Dashboard

The 'McCloud judgement' is a court ruling which found that the transitional protections for older workers provided in 2015, alongside the move of the Local Government Pension Scheme (LGPS) in Scotland from a final salary benefit structure to a career average scheme, were age discriminatory. Following this judgement, the government has been consulting on a revised scheme to extend similar protection to more workers and thereby rectify this prior discrimination on an equitable basis. Regulations are expected towards the end of 2023, and we remain ready to communicate with employers and members on the requirements and implications.

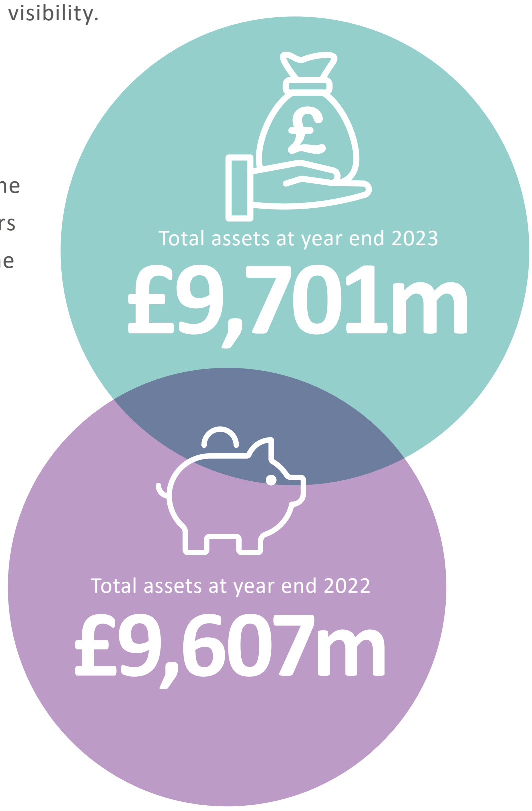
The Pensions Dashboard Regulations 2022 were laid and approved by the UK government and came into force on 12 December 2022. Between 2023 and 2025, pension schemes will be compelled to join the ecosystem by their staging deadline, which is 30 September 2024 for public service pensions. Pensions Dashboards will give increased transparency of expected pension benefits. The primary impact for LPF beyond supporting its introduction, is the likely increase in member queries from the increased visibility.

Affordability of pensions

During the year we assisted three employers with a managed exit from the Fund and we have a total of 19 funding agreements in place for employers who have previously exited in respect of satisfying their obligations to the Fund in regards to their employees. We amended our Funding Strategy Statement in line with regulatory amendments which allow greater flexibilities to help funds manage employer exits.

Oversight and governance of the Fund

The local elections in May 2022 resulted in changes to the composition of the Pensions Committee. Councillor Mandy Watt took over as convenor, with Councillors Doggart and Nicolson joining the



A REVIEW OF 2022/23

Committee. Councillors Rose, Child and Munn left the Council and Committee following the elections and I'd like to acknowledge their contribution to the effective governance of the Fund. With a comprehensive induction programme and continuity provided by the four remaining members of the Committee, good governance was maintained through the transition.

Throughout this report, there's comment from Mandy on behalf of the Pensions Committee, from Jim Anderson on behalf of the Board, Hugh Dunn on behalf of the LPFI and LPFE Boards and from Andy McKinnell as our Independent Professional Observer. Each of these roles and the bodies they represent perform 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.

David Vallery
Chief Executive Officer
Lothian Pension Fund
21 June 2023

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 £9.6 billion of assets at end March 2023 and were 106% funded at our last valuation in 2020, managing 93,716 records of 87,716 members and 63 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 1,349 deferred and pensioner members with £0.13 billion investments.

We manage over 85% of assets in-house investing in infrastructure, property and timberland in the private market portfolios as well as listed equity and bond portfolios.

LPF is unique within the Scottish LGPS sector in having our own FCA authorised asset management firm. 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 retained this accreditation along with 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, Pensions Administration Strategy and Pensions Discretions Policy.

COLLEAGUE PROFILE ANDREW DUFFY, DATA ANALYST

Andrew joined LPF in June of 2020 as a Trainee Pensions Administrator and started his current role as a Data Analyst in January of this year. Andrew helps to maintain and improve the quality of LPF's data as well as making sure the information we receive from employers every monthly is accurate.

"My role is challenging and interesting and I enjoy having the opportunity to explore improvements to our processes and data collection. I really like the people and culture at LPF. Having friendly and supportive colleagues make for a very pleasant working environment."

GOVERNANCE AND RISK

The Pensions Committee and Pensions Audit Sub-Committee

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

The Pensions Committee normally holds four meetings and the Audit Sub-Committee usually holds three meetings per year. LPF's governance structures continued to operate as designed, and meetings of the Committees and Pensions Board operate via a hybrid model with some members attending in person and others dialing in remotely via Teams.

The table below shows the Committee members for the year 2022/23:

COMMITTEE MEMBERS FROM 1 APRIL 2022 - 31 MARCH 2023

PENSIONS COMMITTEE	PENSIONS AUDIT SUB-COMMITTEE
Councillor Mandy Watt (Convenor) (from 30 June 2022)	
John Anzani (Member representative)	John Anzani (Member representative) (Convenor from 29 June 2022)
Councillor Phil Doggart (from 19 May 2022)	Councillor Phil Doggart (from 29 June 2022)
Councillor Neil Ross	Councillor Neil Ross
Councillor Steve Burgess	
Councillor Vicky Nicolson (from 25 August 2022)	
Richard Lamont (Employer representative, VisitScotland)	
Councillor Rob Munn (Convenor) (until 5 May 2022)	
Councillor Cameron Rose (until 5 May 2022)	Councillor Cameron Rose (Convenor) (until 5 May 2022)
Councillor Maureen Child (until 5 May 2022)	Councillor Maureen Child (until 5 May 2022)
Councillor Marco Biagi (from 19 May 2022 to 25 August 2022)	

GOVERNANCE AND RISK

The Pension Board

The Pension Board was established on 1 April 2015 as set out in 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 ten members, four representatives appointed from the employer bodies and five representatives appointed by trade unions for the membership of LPF. The Pension Board membership for 2022/23 is shown in the table below. There was one vacancy as of 31 March 2023.

MEMBER REPRESENTATIVES

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

EMPLOYER REPRESENTATIVES

Sharon Dalli	Police Scotland
Darren May	Scottish Water
Nick Chapman	Lothian Valuation Joint Board
Vacancy as of 31 March 2023	

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 investment strategy, governance and responsible investment.

Committee and Board representatives also attended external conferences virtually and in person, including the LGPS Seminar Scotland, as well as a variety of Local Authority Pension Fund Forum (LAPFF), Pensions and Lifetime Savings Association (PLSA) and Hymans Robertson webinars.

All the Pension Committee and Pension Board members achieved the required training hours during 2022/23 with the exception of one member. Pensions Committee members have collectively attended 179 hours of training as at 31 March 2023 and members of the Pension Board undertook 262 training hours.

GOVERNANCE AND RISK

Scheme Advisory Board (SAB)

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 seven representatives each from member and employers with a Joint Secretary to support each group, and included Councillor Cameron Rose until May 2022, and Councillor Mandy Watt from August 2022. Brian Robertson, one of the trade union representatives on LPF's Pension Board was the chair, then vice chair of the SAB during the year. There's more information on the Scheme Advisory Board at www.lgpsab.scot.

GOVERNANCE AND RISK

LPFE and LPFI Boards

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 City of Edinburgh's Service Director: Finance and Procurement and includes the Convenor of the Pensions Committee. Our team carry out certain activities through our Financial Conduct Authority authorised vehicle, LPFI Limited (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 Service Director: Finance and Procurement. Both the Boards of LPFI and LPFE comprise two independent Non-Executive Directors, Leslie Robb and Andy Marchant.

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, Information and Communication Technology (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.

MEMBERSHIP OF LPFI AND LPFE BOARD OF DIRECTORS IN 2022/23

LPFE Ltd	LPFI Ltd
Hugh Dunn, CEC, Service Director: Finance and Procurement	Hugh Dunn, CEC, Service Director: Finance and Procurement (Chair)
Leslie Robb, Non-Executive Director	Leslie Robb, Non-Executive Director
Andy Marchant, Non-Executive Director	Andy Marchant Non-Executive Director
Councillor Mandy Watt, Convenor of the Pensions Committee (from 30 August 2022)	John Burns, LPF, Chief Finance Officer
David Vallery, LPF Chief Executive Officer	Bruce Miller, LPF, Chief Investment Officer
Katy Miller, CEC, Head of HR (until 4 November 2022)	David Vallery, LPF, Chief Executive Officer
Councillor Rob Munn, Convenor of the Pensions Committee (until 5 May 2022)	Kerry Thirkell, LPF, Chief Risk Officer (from 16 September 2022)
Struan Fairbairn, LPF, Chief Risk Officer (Company Secretary) (until 15 September 2022)	Struan Fairbairn, LPF, Chief Risk Officer) (until 15 September 2022)

GOVERNANCE AND RISK

Joint Investment Strategy Panel

Investment strategy guidance is provided by the same Joint Investment Strategy Panel (JISP) that advises the Falkirk Council and Fife Council Pension Funds. The membership of the panel includes two senior investment professionals from LPFI including the Chief Investment Officer and two external independent advisers.

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

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

From 1 April 2022 to 31 March 2023 JISP met quarterly. The table below sets out the panel's membership.

JOINT INVESTMENT STRATEGY PANEL

Bruce Miller	Chief Investment Officer (LPFI)
Stewart Piotrowicz	Portfolio Manager (LPFI)
Kirstie MacGillivray	External Advisor
Stan Pearson	External Advisor

A nominated officer from Lothian Pension Fund, Falkirk Pension Fund and Fife Pension Fund attend each meeting of the panel.

GOVERNANCE AND RISK

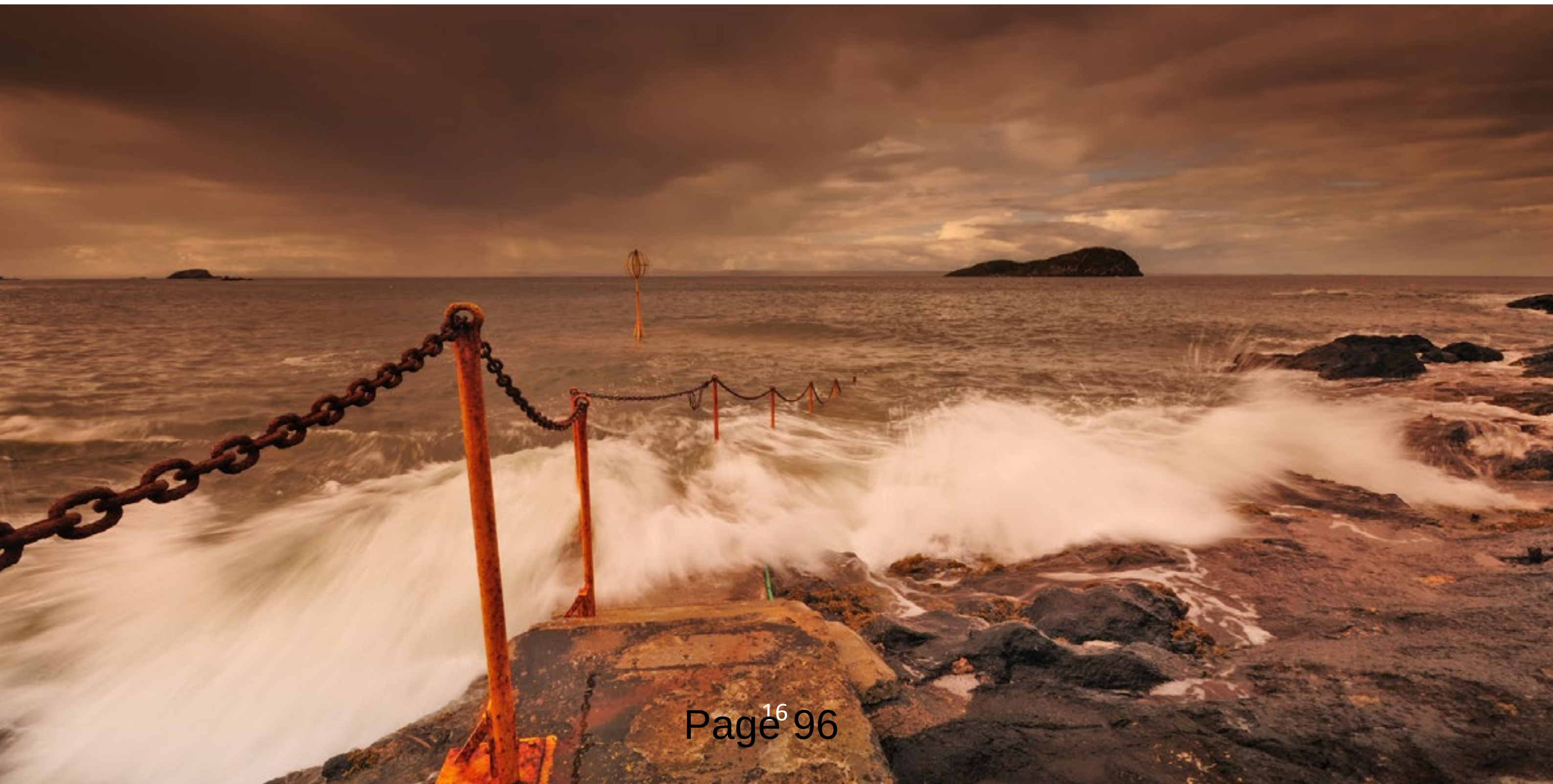
The Senior Leadership Team (SLT) of Lothian Pension Fund as at 31 March 2023 comprised:

- David Vallery, Chief Executive Officer
- Bruce Miller, Chief Investment Officer
- Kerry Thirkell, Chief Risk Officer
- John Burns, Chief Finance Officer
- Helen Honeyman, Chief People Officer
- Karlyn Sokoluk, Chief Operations Officer

Risk Management

LPF has a risk management framework in place across its business functions and group entities including a toolkit and methodology for identifying, assessing, evaluating, monitoring and reporting risks and controls. This helps to ensure that we're able to operate and demonstrate an appropriate and effective control environment which continues to facilitate and support LPF's forward looking business strategy and objectives.

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 oversees the implementation and ongoing effectiveness of LPF's risk management framework, and comprises senior officers of each function within the group, as well as the Senior Leadership Team (SLT).



GOVERNANCE AND RISK

Risk analysis and reporting is provided to the Pensions Committee and Audit Sub-Committee on a quarterly basis. In addition, the full risk register is circulated to the convenors of the Pensions Committee and Audit Sub-Committee, Chair of the Pension Board and Independent Professional Observer each quarter.

At the last Risk Management Group meeting held within the reporting period, the most significant risks, together with the key controls and mitigants managing the risk, are summarised below:

Regulatory Risk
The risk of being unable to meet regulatory obligations is managed through a combination of oversight activities, compliance procedures and policies, staff training, regulatory horizon scanning and continuous improvement.

Cyber Risk
The risk that cybersecurity protections and/or back-up are insufficient to prevent or minimise attacks and disruptions, is managed through a comprehensive suite of technical security controls, complimented by an ongoing programme of training and communications, and phishing tests.

Projects & Change
The risk that project and change activities aren't effectively managed and don't deliver expected objectives is managed through a project and change framework and supporting methodology, with regular governance and oversight through a formal senior management forum.

Governance
The risk that the group structure and governance arrangements aren't operating compliantly or effectively and with proper authority is managed through secretarial activities that include meeting and training scheduling for board and committee members, governance portal providing access to relevant material, provision of training to relevant stakeholders, appointment of Non Executive Directors on corporate boards, and documented delegations.

Third Party Suppliers
The risk that sub-optimal service delivery and oversight of third party suppliers leads to disruptions or errors is managed through a supplier management framework and procurement processes.

Resource
The risk that staff resource is insufficient to carry our core tasks is managed through regular review of headcount, structure and resource, with review and approval of organisational plans, succession plans and recruitment.

GOVERNANCE AND RISK

As LPFI is regulated by the FCA, it's subject to the requirements of the Investment Firm Prudential Regime ('IFPR'), and must ensure that it remains viable throughout the economic cycle, can address any harm from its ongoing activities, and that it can wind-down in an orderly manner. This means holding a minimum level of financial resources, and regularly assessing how much should be held. To facilitate this, an Internal Capital Adequacy and Risk Assessment (ICARA) process is required to be undertaken and regularly reviewed to ensure internal systems and controls are operating to monitor and reduce potential harms. The ICARA and the risk management framework need to be integrated to ensure all material relevant risks have been identified, articulated and assessed to ensure that risks of harm can be properly considered and accounted for. The LPFI board has oversight of this process.

3 Lines of Defence

A 3 Lines of Defence model helps underpin the integrity of the risk management framework:

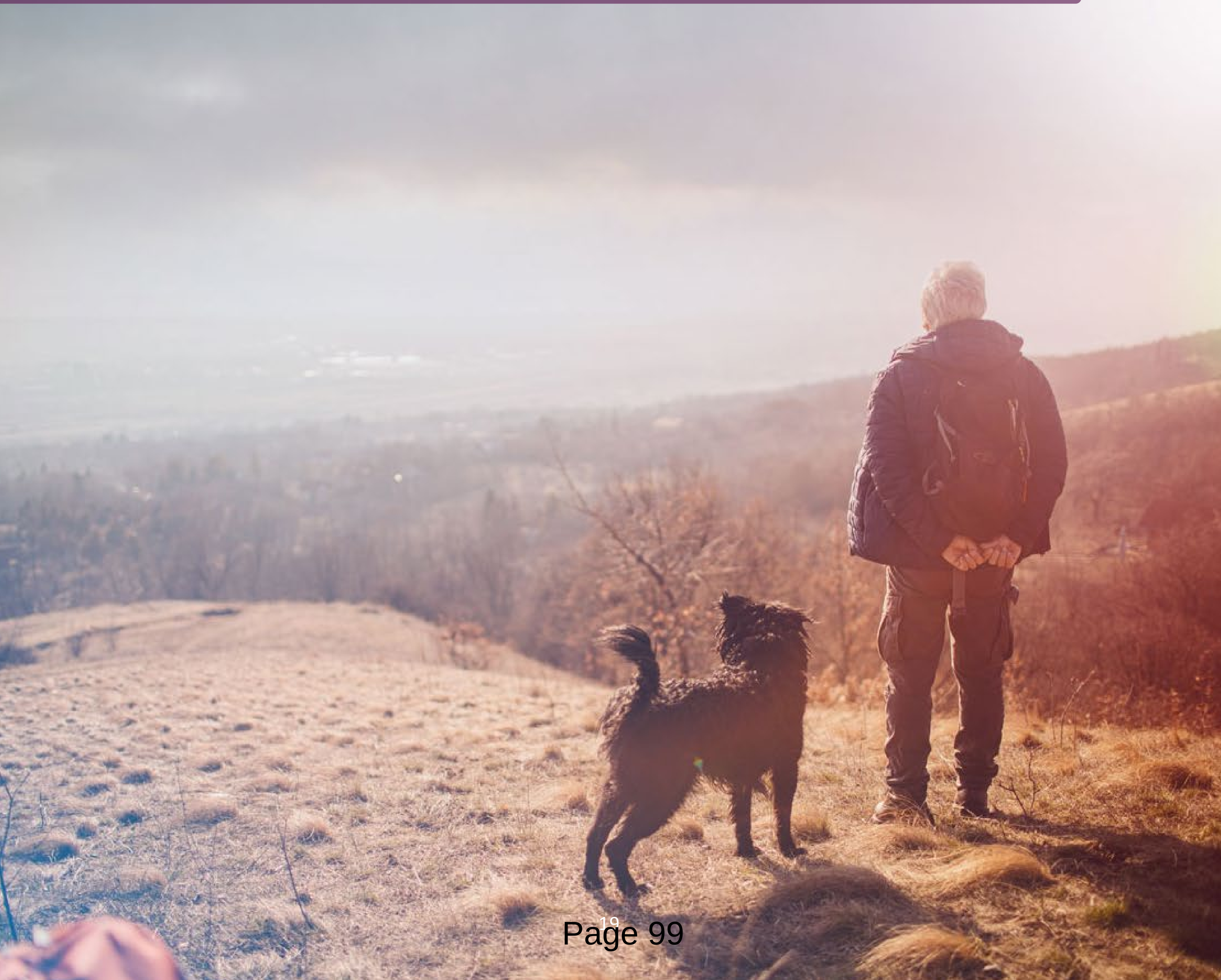
1. **Line 1:** business management responsible for identifying and managing risk and ensuring its activities are compliant with legal, regulatory, and organisational requirements

2. **Line 2:** Risk & Compliance function support the business in managing risks and achieving compliance, monitoring risk and compliance levels in the business and reporting on risk and compliance matters to management and governance forums

3. **Line 3:** independent oversight by Internal Audit providing independent assurance on the control framework and quality of implementation.

OUTSTANDING SERVICE

'Your care and consideration in helping me to transfer my father's pension helped us greatly at a difficult time.'



INVESTMENT

Investment markets

For the 12 months to 31 March 2023, global equities, as measured by the MSCI ACWI index, returned -1.4% in sterling terms (source: MSCI). However, the weaker pound masked a more pronounced decline of -7.4% in US dollar terms (source: MSCI). It was a year almost as extraordinary as 2020, when Covid emerged, and returns for most asset classes were curtailed by the challenging conditions.

Soaring inflation and central banks' policy responses dominated the backdrop for financial markets. The mounting pace of inflation was worsened by the supply shock brought about by the war in Ukraine, with UK consumer price inflation reaching 40-year highs. The reaction from most major central banks was to aggressively tighten monetary policy, marking a dramatic shift from the extremely low interest rates that had been in place since the financial crisis of 2008. This is an environment that many had become unaccustomed to and the unfamiliar conditions exposed frailties in the financial system, contributing in some part to the LDI crisis in the UK and the failure of two large US banks.

Government bond prices fell over the year, due to rising base rates and higher inflation, with the political crisis in the UK causing forced sales of long-dated gilts by some pension funds. 10-year gilt yields rose from 1.61% to 3.49% (reaching as high as 4.6%), giving an annual return of -10.9%. Although corporate bond credit spreads (the difference in yields between bonds of differing quality) widened over the year, it was the sharp rise in underlying government bond yields that caused most of the damage, with sterling investment grade credit returning -10.2% over the year. Commercial real estate returns were also strained by falling capital values as property owners, many of which are highly leveraged, contended with rising borrowing costs. However, some of the most eye-catching falls were among 'growth' stocks where valuations were severely marked down as sentiment for this part of the market soured.

JOHN ANZANI

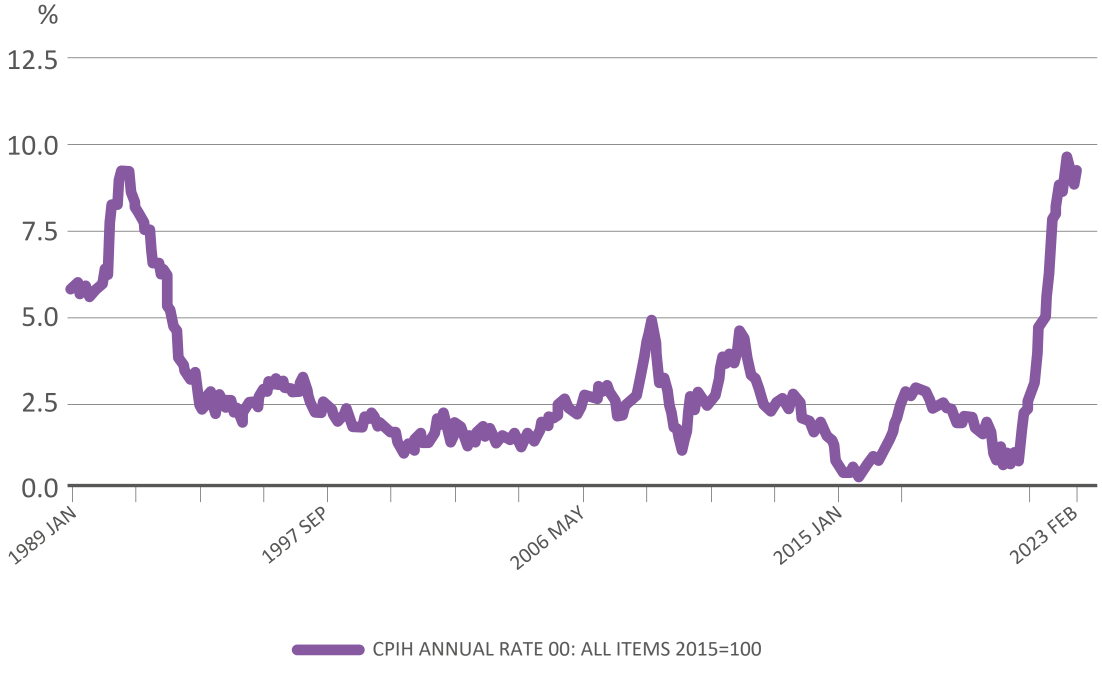
"This year the Audit Sub Committee has been engaged in assessing the effectiveness of LPFs audit, risk and compliance reporting. It has also taken steps to work closer with both the internal and external auditors. Effective oversight of internal and external auditors is key to the Audit Committee's ability do discharge its responsibilities in helping provide a clear understanding of the fund and ensuring that the internal audit plan is aligned to the key risks faced by the fund. The Committee reaffirmed its satisfaction that the fund operates within reasonable risk boundaries. It welcomes the evolving process that LPF's management team are implementing to ensure challenge and continuous improvement. In the future the Audit Sub Committee looks forward to working with LPF's auditors and management team to ensure that our risk and compliance monitoring programmes continue to meet the high expectations and standards of LPF."

Convenor of the Audit Sub Committee in 2022/23

INVESTMENT

Inflation's influence over investment markets appears set to continue with disinflation to pre-pandemic levels likely to take some time. However, there's cause to believe that inflation has already peaked amid moderating commodity prices and the cooling effect of monetary policy. With that, central banks appear to be nearing the peak of this tightening cycle which may signal a more favourable backdrop ahead for asset valuations. However, risk remains around whether inflation proves to be 'stickier' than hoped. Expectations for corporate earnings have held up well to date, though those forecasts may prove overly optimistic as economic growth deteriorates in the face of the tight monetary policy, declining real wages and heightened geopolitical tensions. Meanwhile, fiscal policy is handicapped by high debt burdens and costlier borrowing, as demonstrated by the rapid unwinding of the Truss government's plans. More positively, the recent reversal of China's 'zero-Covid' policy provides a welcome boost for growth. With several meaningful macroeconomic and geopolitical challenges to be navigated, it's hard to imagine that there won't be further significant financial market volatility in the coming years.

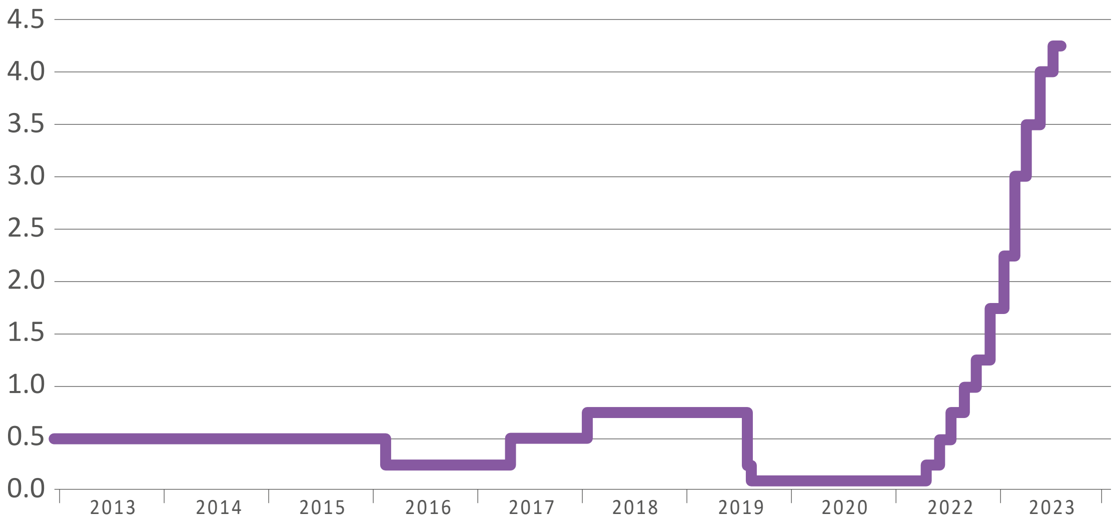
UK INFLATION (CPIH) - ANNUAL CHANGE



Source: https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/l55o/mm23

INVESTMENT

BANK OF ENGLAND OFFICIAL RATE



Source: https://www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp

HUGH DUNN

"Over the last year, LPFI Ltd and LPFE Ltd, continued to focus on delivering key strategic aims and service improvements to support LPF. LPFE and LPFI are key in LPF's success in supporting thousands of scheme members. LPFE enables us to recruit and retain the best possible colleagues. This year LPFE welcomed 26 new colleagues including a new Chief Risk Officer and appointed a Chief Operating Officer for the first time. They join our existing skilled and member focussed teams. Meanwhile, LPFI facilitates us to have an efficient and cost effective investment service which supports our collaboration with other local government pension schemes. This year, LPFI's investment management service increased its assets under management to £1.4billion over the course of the year.

I have announced my intention to retire in September 2023 and I'm delighted to have had the opportunity to contribute to LPFI and LPFE's development, seeing both companies flourish and evolve over the last 7 years. I would like to thank everyone for their commitment and work on behalf of members. It has been a pleasure to work with you all in support of the members and employers of LPF."

Chair of LPFI and LPFE Boards, and CEC Service Director: Finance and Procurement

RESPONSIBLE INVESTMENT

'We recently joined Advance, an initiative focussed on human rights and social issues for workers, communities and society.'

RESPONSIBLE INVESTMENT

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 in the interests of our beneficiaries and employers and our fiduciary duty requires us to act in a financially prudent manner, taking Environmental, Social and Governance (ESG) factors into consideration 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 to better understand the philosophy behind our overall approach to Responsible Investment, we publish our Statement of Responsible Investment Principles (SRIP). In this document, which is reviewed and updated annually, we set out how we undertake investment in a responsible manner, detailed on an asset class by asset class basis, to achieve our stewardship aims.

WHAT OUR MEMBERS SAY:

"Staff are very helpful on the phone as I am not confident using online."

RESPONSIBLE INVESTMENT

Responsible Investment (RI) and Stewardship Reporting

We produce an annual Stewardship Report which contains a wealth of detail and examples on the implementation of our RI policies. Our most recent Stewardship Report was published in October 2022 covering the year to 31 December 2021. It was assessed by the Financial Reporting Council, confirming our continued status as a signatory to the stringent UK Stewardship Code 2020.

Our Stewardship Report explains the core activities that we undertake, both individually as a fund, and collectively with like-minded organisations. These actions include voting on the resolutions of the companies in which we're invested and engaging with a high percentage of them, often through our engagement partners, to drive positive change in corporate behaviour and mitigate investment risk. We employ an engagement partner, currently Federated Hermes EOS, and work with other organisations, such as Climate Action 100+ and the PRI (Principles for Responsible Investment), to promote responsible investing.

As a provider of responsible capital, we believe LPF should be an agent for positive change. Our *ENGAGE* e-zine provides insight into our investment activities; from providing examples of where ESG considerations have impacted our investment decision-making, to celebrating award-winning environmental initiatives.

RESPONSIBLE INVESTMENT

'LPF is proud to continue working with Future Asset, who strive to provide an opportunity for girls to learn about investment.'

RESPONSIBLE INVESTMENT

Climate change

As of February 2023, 195 members of the United Nations Framework Convention on Climate Change are parties to the Paris Agreement. The three key aims of the Paris 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 attitude towards greenhouse gas emissions, the Financial Stability Board (FSB) of the Bank of England launched the Taskforce on Climate-Related Financial Disclosures (TCFD). TCFD aims to: "develop voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders." Further information is available at www.fsb-tcfd.org.

As asset owners, 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.

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.

We engage with companies to encourage them to improve their disclosure to support us in integrating climate change risk and opportunities into the risk management and governance at LPF. Over the last few years, we've undertaken substantial work on the issue, as detailed in our Stewardship Report.

RESPONSIBLE INVESTMENT

Climate change – governance

The Pensions Committee's approach to climate change risks is encapsulated in the Statement of Responsible Investment Principles.

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. The Pensions Committee is responsible for setting investment strategy and delegates implementation of strategy to officers taking advice from the Joint Investment Strategy Panel and working with investment managers. 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.

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 team also engages with company management on a regular basis as part of company meetings and investment conferences. Details on our engagement and voting activity is provided in our annual Stewardship Report.

In addition, we're a member of the Institutional Investors Group on Climate Change and of the Climate Action 100+ investor initiative. We actively participate as a co-lead in engagement with one of the 166 target companies in the initiative's 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.

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 to improve business practices. The selection and monitoring process for

RESPONSIBLE INVESTMENT

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 current investment in green energy is being undertaken by the incumbent energy providers (the diversification of carbon-extractive companies and carbon burning utilities).

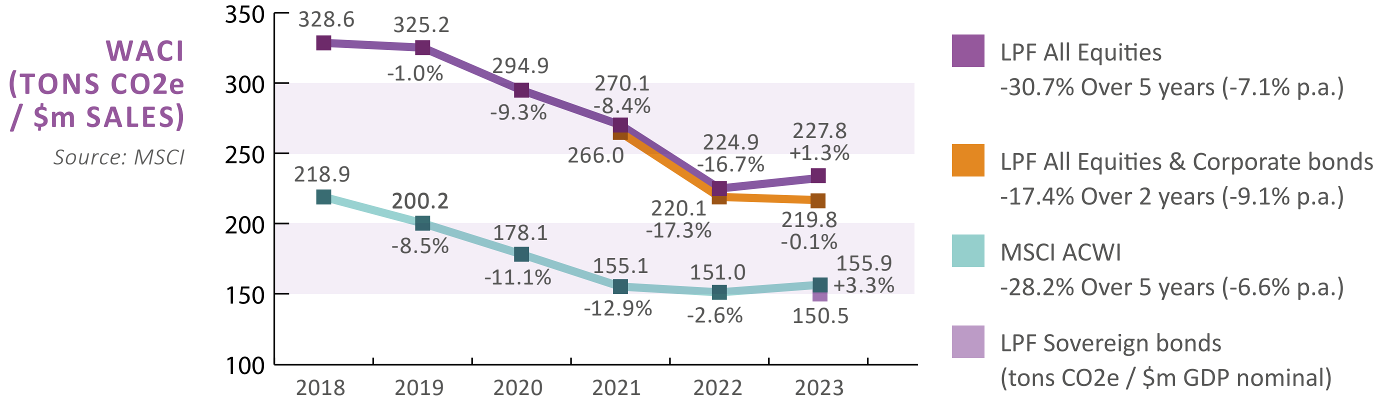
With a research budget specifically allocated to data services targeting ESG and climate-related risks and opportunities, we produce an annual carbon footprint for listed equities and corporate bonds. This measures the weighted average carbon intensity of the portfolio as a whole. More importantly, it 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've reported a measure of carbon efficiency since 2018: WACI is the Weighted Average Carbon Intensity, with units of tons CO2/$M sales. We use this 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 calculate the portfolio WACI by weighting these intensities according to the portfolio position sizes and adding 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

Under the Greenhouse Gas (GHG) Protocol:

- Scope 1 emissions are defined as direct GHG emissions that are controlled or owned by an organisation
- Scope 2 emissions are indirect GHG emissions that are the result of an organisation's energy use, such as electricity, steam, heat or cooling
- Scope 3 emissions are all other indirect emissions, such as from the production of purchased materials and fuels, supply-chain transport-related activities, outsourced activities, waste disposal, customers' emissions when using or accessing the organisation's products or services.

Our WACI figures are calculated based on Scope 1 and 2 carbon emissions. 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) have enabled us to present combined data for our equity and corporate bond holdings since 2021. This year we've been able to also calculate the WACI for our sovereign bond investments. However as the sovereign bond WACI is calculated in a different way, it's not meaningful to aggregate this with the corporate WACI calculated for our equity and corporate bond holdings. We have an ambition to keep expanding the coverage of our emissions reporting across all our assets as data becomes available (supported by external managers and using estimates if necessary) and present more granular emissions data by scope ahead of the deadline for enhanced TCFD reporting for the Scottish LGPS.

While we expect the average carbon intensity of our investments to decline over the longer term as the global economy decarbonises, this trend may be volatile year on year as we incorporate more emissions data and as the out performance of certain sectors can swing the annual snapshot in any one year.

LOTHIAN PENSION FUND

RESPONSIBLE INVESTMENT

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". Our reported portfolio level carbon intensity numbers 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.

We firmly believe that global decarbonisation will provide benefits to society and the environment, and we therefore support efforts to reduce carbon emissions in the real economy. We do this by engaging (either directly or in collaboration with other investors) with companies and policy makers to encourage businesses to pivot towards a lower carbon future.

Paris alignment

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

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 simply divesting or excluding all stocks in high exposure sectors. We'll continue to engage with our holdings rather than setting specific carbon intensity targets for our overall portfolio.

We're also engaging with our external managers to better understand their approach to aligning the investments they make on our behalf to a future net zero emissions world, and to encourage improved reporting of emissions data and other sustainability metrics.

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

RESPONSIBLE INVESTMENT

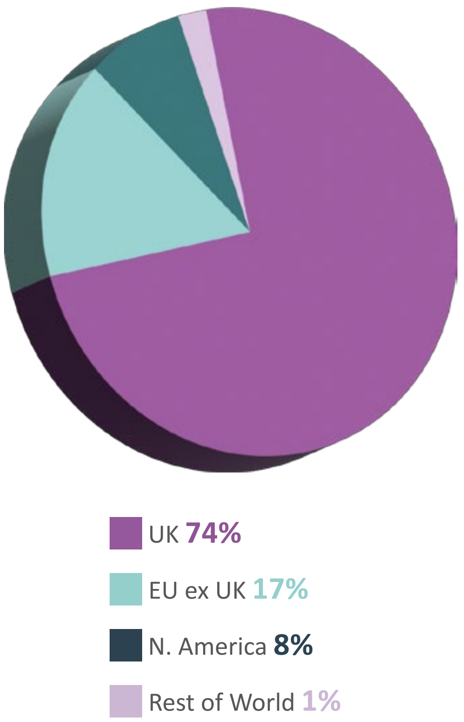
Climate solutions

We're also monitoring our investments in climate solutions. These are companies or assets that help the global economy achieve net zero. One of the clearest examples of climate solutions is our investments in renewable energy projects through our infrastructure portfolio.

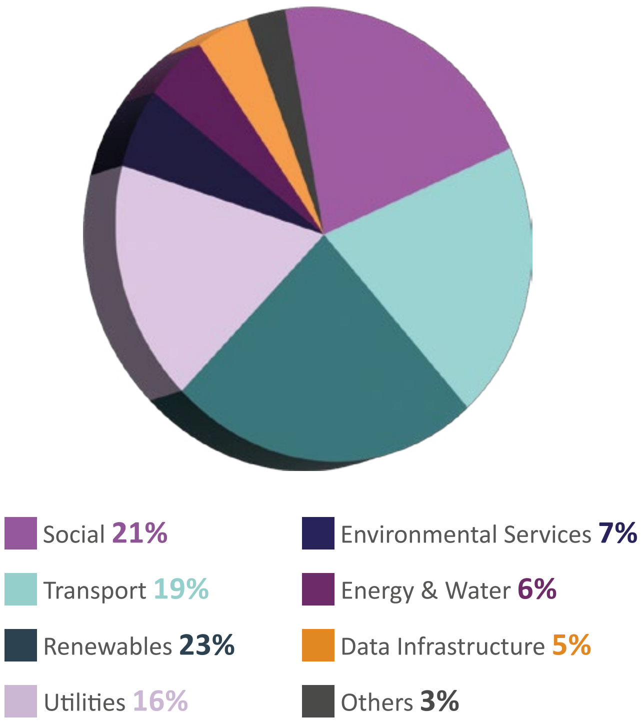
Infrastructure investments represented 13.4% of the value of Lothian Pension Fund assets at 31 March 2023, comprising one of the largest and most diversified allocations among UK LGPS funds. Of the total infrastructure portfolio, the majority is invested in the UK, and around a quarter of the portfolio is invested in renewables. During 2022/23, Lothian Pension Fund invested over £100m in renewable energy projects.

The geographic and sector diversification for Lothian Pension Fund infrastructure (as a percentage of infrastructure asset value of £1.3bn) is shown in the charts below.

GEOGRAPHY



SECTOR



FUNDING STRATEGY STATEMENT

The Funding Strategy Statement was fully revised at the 2020 Actuarial Valuation and reflects CIPFA guidance: "Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme 2016". Amendments were made in 2022 following amendments to scheme regulations.

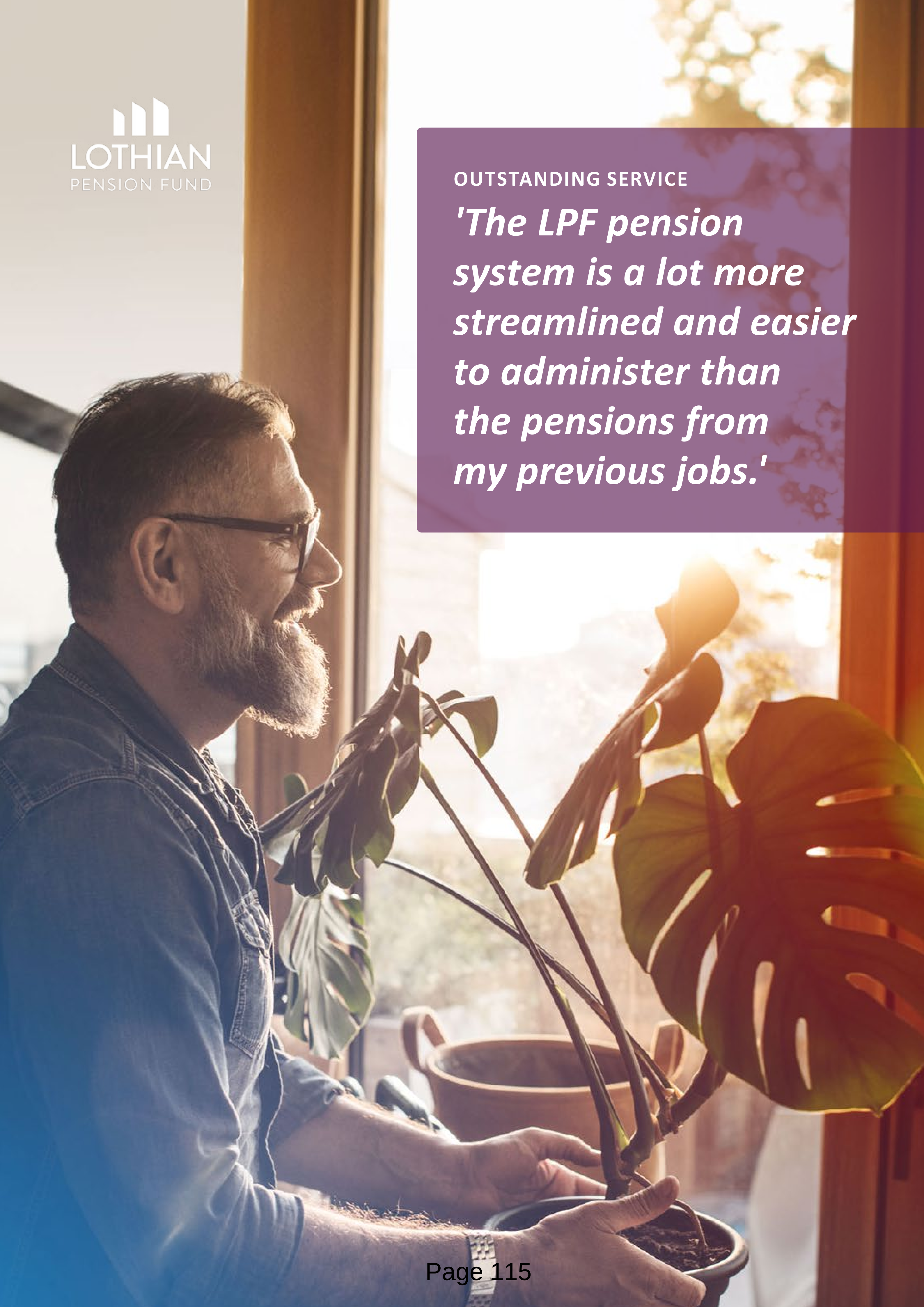
The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy), or asset returns (derived from the investment strategy). A formal review of the Fund's investment strategies is undertaken at least every three 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.

Full reviews of both the Funding Strategy Statement and the investment strategies will be carried out as part of this process.

WHAT OUR MEMBERS SAY:

"From start to finish you have been fabulous, as I have friends with terrible experiences. So, for me, I could not say how you could make anything better, so thanks."



LOTHIAN PENSION FUND

OUTSTANDING SERVICE

'The LPF pension system is a lot more streamlined and easier to administer than the pensions from my previous jobs.'

FINANCIAL PERFORMANCE

Administration expenses

A summary of the Fund's administrative expenditure for 2022/23, 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 £38,376k against the budget of £34,550k represented an overspend of £3,826k (11.1%) for the Fund.

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

- **Investment managers fees – Uninvoiced – £4,757k overspend.** The reason for the Funds overspend against budget is due to its uninvoiced investment management costs, a majority of which relates to its private market investments. One off refurbishment and transaction costs for the Funds in-house direct property mandate was the contributing factor to the variance against budget

- **Investment managers fees - Invoiced – £600k underspend.** Invoicing based for externally managed mandates based on market value. A £50m divestment from one of these mandates and below forecasted market values have resulted in an underspend for the year

- **Supplies and Services – £228k underspend.** Underspending occurred against budget for investment systems, in particular the delay in the scheduled upgrade to the Fund's front office system

- **Other third-party payments– £186k underspend.** Underspend occurred in a variety of areas including custody services, broken deal provision and project costs

- **Capital funding - depreciation– £29k overspend.** A decision was taken during the year to write off the Atria refurbishment costs over 2022/23-2023/24 financial year with potential office move taking place

- **Income – £258k under-recovery.** Income in relation to collaborative partners is based on a cost sharing mechanism. Due to underspend against budget, in particular staff costs, as well as the lower than expected deal flow in relation to collaborative investments, income was below budget.

FINANCIAL PERFORMANCE

	Approved budget	Actual outturn	Variance
	£000	£000	£000
Employees	7,126	6,930	(196)
Transport and premises	278	272	(6)
Supplies and services	2,396	2,168	(228)
Investment managers fees - invoiced*	4,000	3,400	(600)
Investment managers fees - uninvoiced*	20,725	25,482	4,757
Other third-party payments	1,727	1,541	(186)
Capital funding - depreciation	257	286	29
Direct Expenditure	**36,509**	**40,079**	**3,570**
Support costs	620	618	(2)
Income	(2,579)	(2,321)	258
Total net controllable cost to LPF	**34,550**	**38,376**	**3,826**

**Does not include performance element. In 2022/23, £9.1m 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	38,376
Securities lending revenue included in income above	536
Investment management fees deducted from capital – performance related element	9,062
IAS19 LPFE retirement benefits	(8,364)
LPFE deferred tax on retirement benefits	1,088
Corporation tax	38
Total cost to LPF (inclusive of full cost investment management fees)	**48,736**
Per Fund Accounts	
Lothian Pension Fund Group	40,683
Scottish Homes Pension Fund	53
Total	**40,736**

FINANCIAL PERFORMANCE

LOTHIAN PENSION FUND

Cashflow

Cashflow 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 23 March 2023, 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.

	2022/23 Projected	2022/23 Accruals basis	2022/23 Cash Basis
Income	**£000**	**£000**	**£000**
Contributions from employers	210,500	201,867	201,504
Contributions from employees	55,000	57,383	57,067
Transfers from other schemes	7,000	6,551	6,551
	272,500	**265,801**	**265,122**
Expenditure			
Pension payments	(206,000)	(206,225)	(206,225)
Lump sum retirement payments	(66,000)	(62,030)	(60,752)
Refunds to members leaving service	(830)	(845)	(845)
Transfers to other schemes	(13,000)	(11,689)	(11,689)
Administrative expenses	(3,000)	(3,202)	(3,202)
	(288,830)	**(283,911)**	**(282,713)**
Net additions/(deductions) from dealings with members	**(16,330)**	**(18,190)**	**(17,591)**

FINANCIAL PERFORMANCE

Cashflow (cont.)

Lothian Pension Fund	Actual	Cash flow forecast									
	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	2031 /2032 £m	2032 /2033 £m
Pensions income	265.8	278.7	291.7	305.3	319.6	334.6	350.3	366.7	383.9	401.9	420.9
Pensions expenditure	(284.0)	(315.3)	(327.3)	(339.9)	(353.1)	(366.9)	(381.4)	(396.6)	(412.6)	(429.4)	(447.0)
Net pensions cash flow	**(18.2)**	**(36.6)**	**(35.6)**	**(34.6)**	**(33.5)**	**(32.3)**	**(31.1)**	**(29.9)**	**(28.7)**	**(27.5)**	**(26.1)**
Net investment income	**339.1**	**352.7**	**366.8**	**381.5**	**396.8**	**412.7**	**429.2**	**446.4**	**464.3**	**482.9**	**502.2**

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 2022/23 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

	2022/23 Projected	2022/23 Accruals basis	2022/23 Cash Basis
Income	**£000**	**£000**	**£000**
Administration charge	90	90	90
Expenditure			
Pension payments	(6,500)	(6,258)	(6,258)
Lump sum retirement payments	(750)	(773)	(783)
Transfers to other schemes	(100)	(17)	(17)
Administrative expenses	(90)	(55)	(55)
	(7,440)	**(7,103)**	**(7,113)**
Net additions/(deductions) from dealings with members	**(7,350)**	**(7,013)**	**(7,023)**

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 £7.1 million which is broadly 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

Cashflow (cont.)

Scottish Homes Pension Fund	Actual	Cash flow forecast									
	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	2031 /2032 £m	2032 /2032 £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	(7.1)	(7.7)	(7.5)	(7.4)	(7.3)	(7.2)	(7.1)	(7.0)	(6.9)	(6.8)	(6.7)
Net pensions cash flow	**(7.1)**	**(7.7)**	**(7.5)**	**(7.4)**	**(7.3)**	**(7.2)**	**(7.1)**	**(7.0)**	**(6.9)**	**(6.8)**	**(6.7)**
Net investment income	**2.0**	**2.0**	**2.0**	**1.9**	**1.8**	**1.7**	**1.7**	**1.7**	**1.6**	**1.6**	**1.6**

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 became 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.

Work has commenced on the next triennial valuation for both funds which will be undertaken as at 31 March 2023. Results from this are expected in the final quarter of 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 Convenor’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”.

COLLEAGUE PROFILE RACHELLE WONG, MEMBER ADMINISTRATOR

Rachelle joined us in June 2020 as a trainee. Rachelle helps with the day-to-day processing in general tasks and most recently has updated the refund procedure to let members claim their refund of contributions online.

“The team is very approachable and you can always find an answer to a question with the depth of knowledge the pension admin team holds. I also love the diversity in the role in our everyday tasks.”

FINANCIAL PERFORMANCE

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.

COLLEAGUE PROFILE TOM COWIE, SENIOR FINANCE MANAGER

Tom joined us in May 2022 as a Senior Finance Manager. Tom supports the smooth running of the Finance team of the Fund, ensuring the delivery of accurate financial information so that our members are paid correctly and on time.

“From the very first day I started with LPF, I’ve been welcomed into a supportive and nurturing work environment. No day has been the same and the variety of projects and opportunities I’ve had to develop my career has been fantastic. I look forward to continually serving LPF to achieve the very best outcomes for our members!”

FINANCIAL PERFORMANCE

	Lothian Pension Fund		Scottish Homes Pension Fund	
	2021/22	2022/23	2021/22	2022/23
	£000	£000	£000	£000
Investment management expenses in compliance with CIPFA guidance	36,356	44,336	48	47
Investment management expenses per financial statements	37,183	44,942	98	88
Disclosure of management expenses in excess of CIPFA guidance	**827**	**606**	**50**	**41**

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. 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.

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 299 pension funds representing £8.8 trillion in assets. To provide a relevant 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 2022) showed that LPF's investment costs of 0.29% of average assets were significantly lower than CEM's benchmark cost of 0.50%, an equivalent annual saving of approximately £18.9m. This saving largely reflects the fact that the Fund manages a relatively high percentage of assets internally compared with other similar pension funds and that it has low exposure to fund-of-fund investment vehicles.

PERFORMANCE AND ADMINISTRATION

Key performance indicators 2022/23

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 focussed 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.

2021/2022		Target	2022/2023
Retained	Maintain Customer Service Excellence Standard (CSE) (Annual assessment)	Retain	Retained
Unqualified opinion	Audit of Annual Report and Accounts	Unqualified opinion	Unqualified opinion
100%	Proportion of members receiving a benefit statement by August	100%	100%
96.5%	Overall satisfaction of employers, active members and pensioners measured by surveys	90%	92.7%
99.8%	Percentage by value of pension contributions received within 19 days of end of month to which they relate	99%	99.91%
	Rolling 10-year fund return is >+5% pa unless the benchmark is <+5%pa, in which case, the relative return is positive	Meet benchmark monthly	Met
Met	Monthly pension payroll paid on time	Met	Met
2.5%	Level of sickness absence	4.0%	2.58%
100%	All colleagues complete at least two days training per year	100%	100%
76%	Colleague engagement index	Greater than 70%	79%

LOTHIAN
PENSION FUND

OUTSTANDING SERVICE

'I didn't realise it was so easy to upload documents to My Pension Online. I'll encourage my co-workers to do the same.'

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 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.

PERFORMANCE AND ADMINISTRATION

The outputs and analyses have served to supplement internal performance management information.

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 costs and quality of service and we've continued to participate since then.

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 LPF. CEM's benchmarking results categorised our pension administration service as "low cost; high service standard".

Interim results show that cost per member of £25.59 is lower than the adjusted average of £41.15, and a service score of 67 out of 100, which is higher than the peer median of 62. Reasons for the higher score compared to the peer group include:

- Paying retirement lump sums more quickly
- Providing assistance to vulnerable members, including offering specially formatted printed materials and including notifications on our website
- Carrying out targeted campaigns including encouragement to update beneficiary information.

WHAT OUR MEMBERS SAY:

"I found Lothian Pension Fund knowledgeable, friendly, and prepared even to anticipate steps beyond my limited questions and requests, and to offer very welcome and helpful possible alternatives."

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 2023 remains above the 90% target at 92%.

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 24,832 processes in 2022/23 and there were very few complaints made, less than 0.01 %. Complaints covered a broad range of issues including aggregating previous membership, late payment of retirement benefits and transferring pension benefits.

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 2022/23, there was one Stage 1 dispute for investigation. If a member remains dissatisfied with the Stage 1 decision, they have six months to take their appeal to Stage 2. In 2022/23 there was one Stage 2 dispute. These disputes are included in the statistics below.

Reason for dispute	Stage 1 outcome	Stage 2 outcome	On-going
Decision on who to pay a lump sum death grant to	0	dismissed	0
Non return of contributions on re-joining LGPS	0	dismissed	0
Awards, e.g. early payment of deferred pension on health grounds	1 ongoing	1 upheld	2

Further information about the IDRP and complaints procedure is available on our website at [Complaints and Appeals / LothianPensionFund].

PERFORMANCE AND ADMINISTRATION

Our data

We issued 100% of benefit statements by the statutory deadline of 31 August 2022.

We measure our pension record keeping standards against The Pensions 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 Pensions Regulator for the 2022 annual scheme return. Lothian Pension Fund and Scottish Homes Pension Fund scored 98.6% and 97.8% respectively for common data (2021 scores were 98.4% and 97.5% respectively) and 99.5% and 100% for conditional data (2021 scores were 99.5% and 99.9% respectively). The quality of data continues to be considered to be of a high standard.

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-focussed 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 16 years.

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 late February 2022, SPPA advised that "The Public Service Pensions and Judicial Offices Bill is currently working its way through the committee stage and is on track to get Royal Assent early in 2022. The Department for Levelling-up, Communities and Housing in England and Wales (DLUCH) has confirmed that it intends that the final McCloud remedy regulations will be made in Summer 2022. Scheme regulations will then be backdated to 1 April 2014. Scottish Ministers intend to mirror those regulations. It is intended that Scheme regulations will be made in the second quarter of 2022, coming into force on 1 April 2023. The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2022 will be backdated to 1 April 2015."

We're currently awaiting the government's response to the original consultation and implementation of the amendment regulations which was postponed to 1 October 2023. A further consultation is expected after the England and Wales May 2023 elections.

In preparation for rectification of member benefit entitlements, we've:

- Assigned a Project Manager
- Received data from employers with less than 100 active members
- Are in the process of issuing data requests to employers with over 100 active members
- Recruited new Trainee Pensions Administrators to ensure we have sufficient resources to deal with both remedy and current workloads
- Acquired a data validation tool to analyse employer responses
- Continued to receive updates to our pensions administration software in respect of calculations
- Ensured we're aware and alert to any emerging national guidance from the Local Government Association
- Continued engagement with the other Scottish LGPS administering authorities.

PERFORMANCE AND ADMINISTRATION

Member service

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. Our non-key procedure measure incorporates other pension administration measures, for example: aggregation (joining two periods of membership together); recalculation of pension benefits due to a backdated pay award; and updating member details (bank details, marital status) and so on. During the year we identified that our non-key workload was experiencing a backlog. As we were comfortable that our critical and key performance measures were in an overall stable position, the team continued to target non-key work. This allowed us to maintain overall levels of member satisfaction whilst keeping in mind the importance of maintaining our critical and key measures.

Despite the challenging environment, 97.88% of key procedures in 2022/23 were completed on target.

PERFORMANCE AND ADMINISTRATION

The table below shows performance against key procedures in 2022/23.

2021/22		Target	2022/23
97.4%	Proportion of critical pensions administration work completed within standards – individual performance within this indicator are shown below	Greater than 92%	97.9%
97.7%	Provide a maximum of one guaranteed Cash Equivalent Transfer Value (CETV) within 10 working days of receiving a request	91%	99.7%
98.7%	Pay lump sum retirement grant within seven working days of receiving all the information we need from the member	96%	98.3%
95.6%	Acknowledge of the notification of the death of a member to next of kin within five working days	96%	97.4%
100%	Respond in writing within 20 working days to formal complaints that have escalated from frontline resolution, or recorded directly as an investigation	96%	100%
94%	Notify early leavers entitled to deferred benefits of their rights and options within 10 days of being informed of end of pensionable service	91%	97.4%
79.1%	Proportion of non-key procedures completed within standard including Additional Regular Contributions, responding to member communications, updating nominations and maintaining the member database	75%	75.8%
93.5%	Notification of dependant benefits within five working days of receiving all necessary paperwork	96%	96.5%
98.8%	Payment of CETV within 20 working days of receiving all completed transfer out forms	96%	97.2%
93%	Provide transfer-in quote within 10 working days of receiving the Cash Equivalent Transfer Value (CETV) from member's previous pension provider	96%	98.1%
94%	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	85%	96.7%
99.2%	Pay a refund of contributions within seven working days of receiving the completed declaration and bank detail form	91%	98.5%
99.7%	Estimate requested by employer of retirement benefits within 10 working days	91%	100%
97.1%	Pay any lump sum death grant within seven working days of receipt of the appropriate documentation	96%	99.4%

PERFORMANCE AND ADMINISTRATION

Online services

We continue to encourage members to visit the website and access the online service. 51.4% of all members have registered for My Pension Online and for active members, this figure rises to 58.0% using the service.
To increase this, we've worked with employers to obtain email addresses where these aren't held.

We've made further enhancements to our online services in the last 12 months, giving members the option to complete their retirement online. This was initially introduced for active members retiring voluntarily and deferred members and we've been really encouraged by the uptake, with 74.4% of active members and 84.2% of deferred members requesting payment of their benefits online. We'll look to make further improvements during the coming year to allow active members retiring through redundancy or ill-health to complete the process online.

Members leaving after less than two years' membership can also now claim their refund of contributions online. Since this was launched in October 2022, 64% of members who received payment of a refund requested this through the online service.

In addition to these improvements, we have also partnered with Crown Agents Bank to provide our overseas pensioners with a digital means to carry out the annual existence check exercise. The existing process required members to attend a Western Union bureau with photographic ID or complete a Proof of Life Certificate and have it countersigned by an appropriate person. The new process allows members to complete the process from home, using digital facial authentication, by uploading a photo of themselves and of their photographic ID. The option to use a Proof of Life Certificate is still available.

Following a successful trial with a small group of members, we rolled out the process to all overseas members in October 2022. In total, 381 members completed the exercise, and of those, 335 (or 88%) did so using the digital method.

Our current website went live in March 2022 and provides a single integrated platform, which allows development of further online services. We continually review and update the website to ensure information is accurate and provide information on changes we've made to our processes, as a result of complaints, as well as our service and performance standards.

Our employers also use a variety of digital services including providing monthly contribution returns via a secure transfer portal and allowing data to be automatically uploaded to the pension software system. This has significantly improved the provision of employer data, allowed automation of tasks, and considerably simplified the year end processes. We now receive member specific documents through i-Connect rather than Go Anywhere. This reduces risk as the document is automatically uploaded onto the member's record.

PERFORMANCE AND ADMINISTRATION

Protecting members from transfer scams

The Pensions Act 2021 introduced two new conditions to be satisfied before a member's pension could be transferred to another scheme.

The first is that the scheme receiving the transfer must either be a Public Sector pension scheme or a Master Trust or Collective Money Purchase scheme named on The Pension Regulator's (TPR's) approved list. If this condition isn't met, the transferring scheme has to check for any red or amber flags before we can proceed with the transfer. Where red flags are present, the transfer must be cancelled, while the member should be referred to MoneyHelper if there are any amber flags.

Red flags include that the member requested the transfer as a result of unsolicited contact or was offered an incentive to transfer. Amber flags include where the member couldn't provide evidence of a link to the new pension scheme (e.g. that they work for an employer that is part of the scheme) or where the new scheme's charges or investment structure are unclear.

We've now reviewed all our transfer procedures to make sure that we identify any of these flags and refer the member to MoneyHelper, when needed, to protect our members from pension scams.

AVC "Nudge"

New regulations introduced in June 2022 mean that members over the age of 50 who've been paying Additional Voluntary Contributions (AVCs) need to take additional steps before they can do anything with their AVC fund. This is known as a 'Stronger Nudge to Pensions Guidance' and provides further protection to members by helping them make an informed decision about what to do with their AVC fund.

We've now updated our processes and relevant documents. When a member applies to take payment of their AVCs alongside their main pension, or transfer them to access through another Defined Contribution scheme, they need to either take guidance from Pension Wise to ensure they make an informed decision or tell us that are opting out of taking this guidance. Members can make an appointment with Pension Wise themselves or ask us to do it for them, but they need to provide evidence that they have received guidance, or confirm in writing that they've opted out.

COLLEAGUE PROFILE MARK DOBBIE, PORTFOLIO MANAGER

Mark joined LPF in August 2022 as a Portfolio Manager in the equities team. He's responsible for managing one of our in-house global equity strategies and supporting the implementation of the Fund's wider equities investment strategy. Mark says:

"I'm proud to be part of an organisation that has such a clear focus on delivering positive outcomes for our many members. Working alongside a friendly, talented and dedicated team makes this all the more rewarding."

LOTHIAN PENSION FUND

PERFORMANCE AND ADMINISTRATION

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.

WHAT OUR MEMBERS SAY:

"I didn't realise it was so easy to upload documents to my pension online i.e., forms and passport. I will encourage my co-workers to do the same. Everyone on the phones were helpful."

PERFORMANCE AND ADMINISTRATION

Since the strategy was introduced, provision of early leaver and retiral information from employers has been well below the expected standard. During 2022/23, 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 2022/23 is shown below, with 2021/22 shown for comparison purposes.

		2021/22			2022/23		
Case type	**Target (working days)**	**Number received**	**Number within target**	**% within target**	**Number received**	**Number within target**	**% within target**
New members	20	6,099	5,335	87%	7,553	6,979	92%
Leavers	20	3,529	2,074	59%	4,575	2,609	57%
Retirements	20	1,425	544	38%	1,450	517	36%
Deaths in Service	10	32	20	63%	15	5	33%

PERFORMANCE AND ADMINISTRATION

All 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 has improved, a high percentage are still being received out of target. One of our largest employers identified a high amount of historical cases and this has impacted the Fund result negatively. We continue to provide missing leaver queries to employers on a monthly basis, and our year end process helps identify historical cases to employers which require urgent attention.

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 over 40% are received after the member's retirement date.

Employer	Number of late payments	Employer	Number of late payments
Scotland's Learning Partnership	6	Bellrock	1
Dacoll	1	Edinburgh Leisure	1
Edinburgh Development Group	1	Heriot-Watt University Students Association	1
Pilton Equalities Project	1	Scottish Futures Trust	1
TOTAL			**13**

Contributions by value paid on time

99.8% of contributions by value were paid on time. Of the 777 payments made, 13 were paid late and these are shown in the table. The option to levy interest on overdue contributions was not exercised in 2022/23 as late contributions weren't received significantly later than the 19th day.

OUR COLLEAGUES

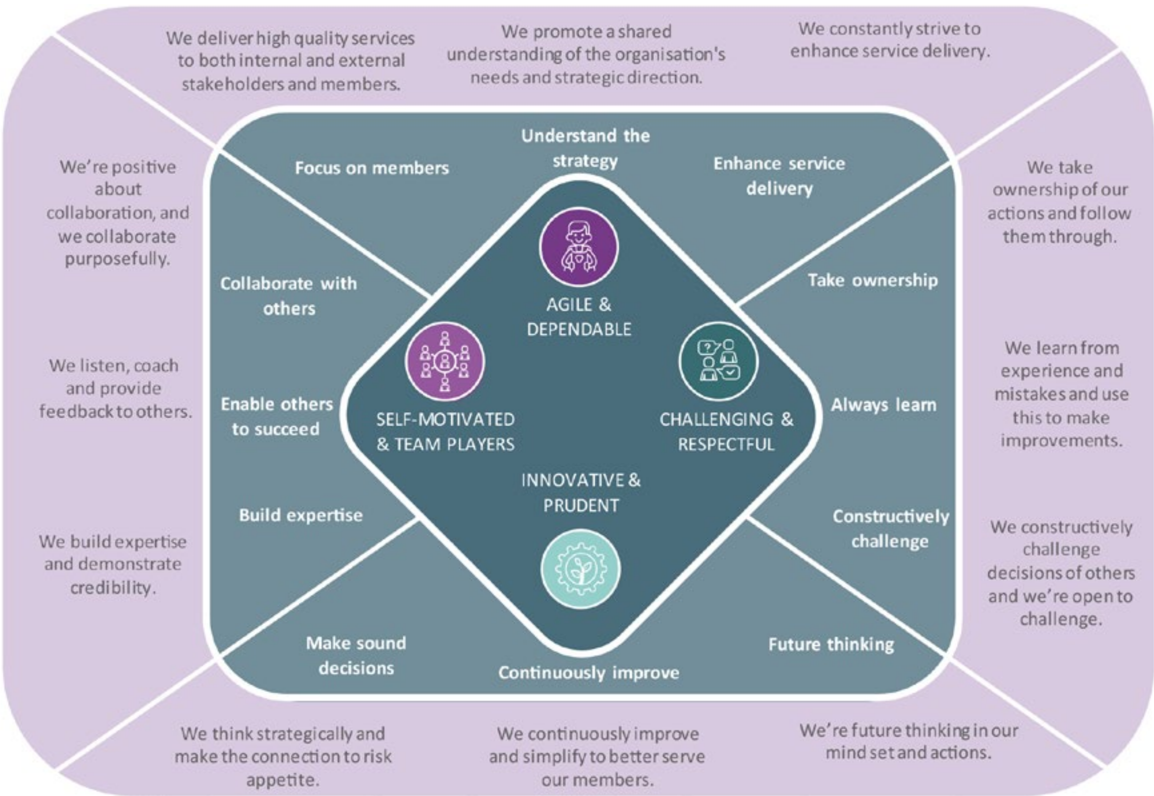
Our colleagues

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.

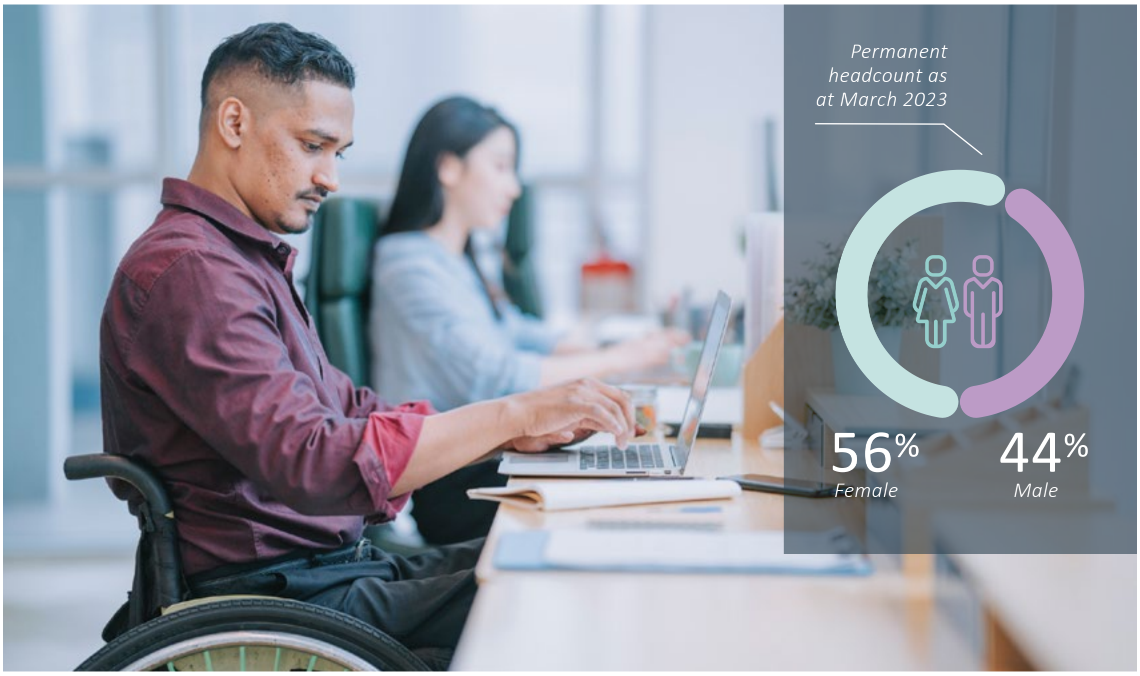
Our core values

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.



OUR COLLEAGUES



Inclusivity

We're one team, but we represent many ideas, experiences and backgrounds. We value everyone's contributions and believe that our colleagues 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 2023 our permanent headcount was 56% female and 44% male.

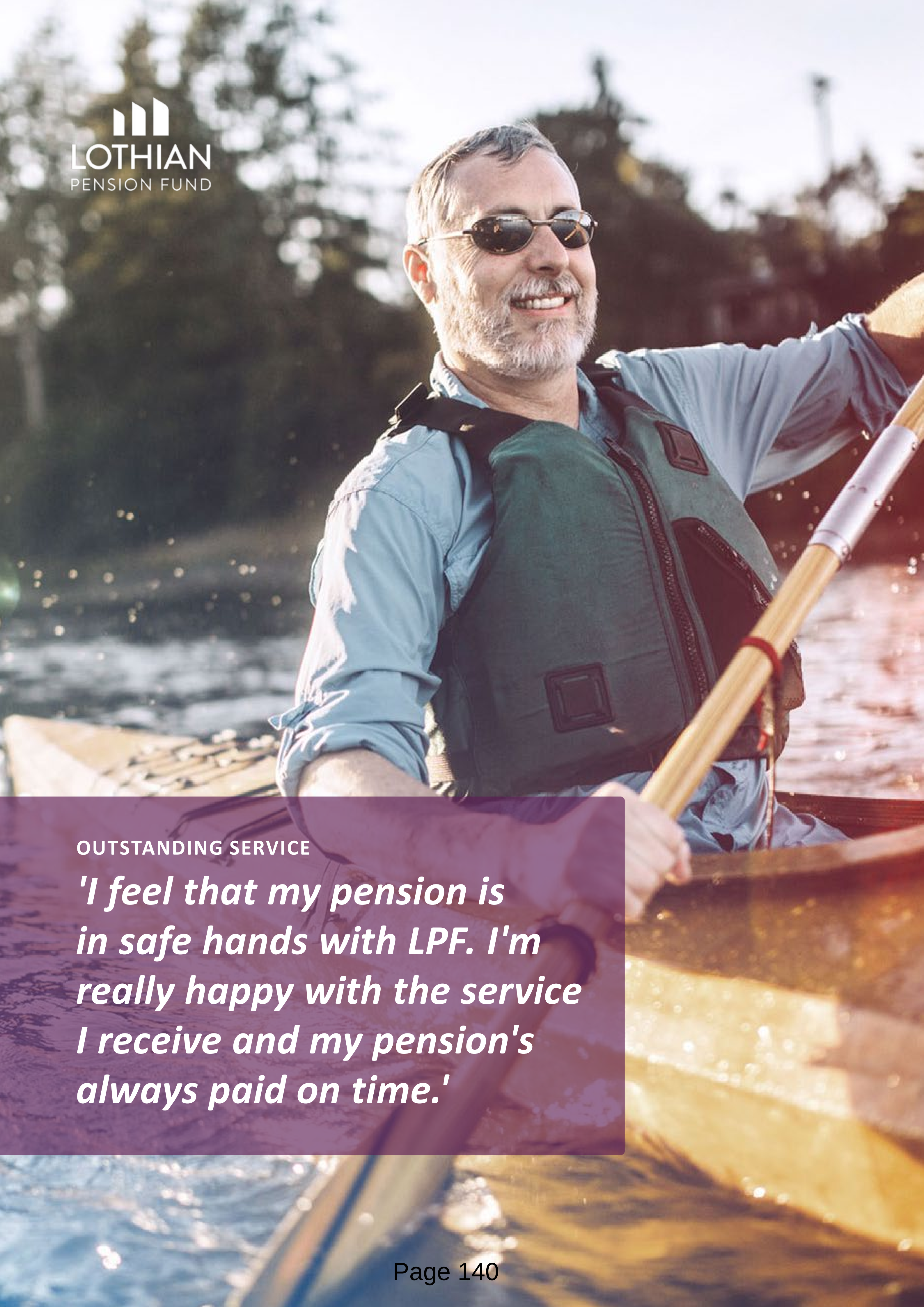
We recognise the many strengths and talents our diverse colleagues bring to the workplace so we're taking steps to make sure that LPF is as inclusive as possible for both our colleagues and members:

- 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 first 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 focussed 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.

disability confident

FUTURE ASSET

DIVERSITY PROJECT
BUILDING INCLUSION IN INVESTMENTS & SAVINGS



OUTSTANDING SERVICE

'I feel that my pension is in safe hands with LPF. I'm really happy with the service I receive and my pension's always paid on time.'

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 2023 we have, on aggregate, 58% women in our top three leadership layers and across the whole company, 56% of our workforce are women
- Our mean gender pay gap is 20.6%
- 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
- In 2022/23 we recruited 26 colleagues; 58% of these were women.

Performance and reward

Our approach to performance management provides clarity for our colleagues about how their contribution and performance links to our vision and values. We're 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 monthly all colleague calls and biannual events. More information on our remuneration policies and employee share plans can be found later in this document.

In October 2022 we awarded a large proportion of our colleagues with a £1,500 (pro rata) salary increase. This out of cycle increase was in addition to the usual annual pay review and was to support them with the cost-of-living crisis.

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.

OUR COLLEAGUES

The Scottish Government and Scottish Funding Council launched the Flexible Workforce Development Fund in 2017. The academic year 2020-21 was the first year that the funding was made available to small and medium sized enterprises to support with the upskilling and reskilling of workforces, address skills gaps and contribute to recovery from the Covid-19 pandemic. We worked closely with Edinburgh College to create a bespoke management training programme devised to upskill our management population. We secured the funding again in 2022 and were able to roll out the same programme to our new managers to ensure everyone had the same opportunities and skills to successfully perform in their roles. The programme was rolled out over a series of half day sessions for our management population and focussed on performance management, difficult conversations, assertiveness skills, effective leadership and leading and motivating teams.

In September 2022 customer service and complaint handling training was delivered to our customer facing colleagues. The customer service training helped develop colleagues' awareness of the personal skills, attitudes and behaviours that influence the customer experience. The complaint handing training helped individuals take personal responsibility for customer service and allows them to handle customer complaints effectively.

In December 2022 our managers and senior administrators attended training on coaching for performance. The aim of this training was to: provide them with the tools and techniques required to carry out different styles of coaching; be able to undertake effective coaching conversations and coaching sessions; and coach colleagues to improve performance.

Investing in colleagues

In 2022 we procured a new human resource information system (HRIS) which would integrate our people, learning and payroll system into one application and improve our efficiencies and data analysis. The new HR system was implemented on 9 January 2023 and our upgraded learning management system went live on 16 January. We now have an online performance management process and all colleagues have recorded their 2023 performance goals.

The new systems have been well received by our colleagues, so we'll continue to build on the functionality of both systems over the coming months to make sure our colleague experience remains positive.

Our digital e-learning platform, Compliance Serve, gives our colleagues the opportunity to expand their own development as well as complete our quarterly core learning. This 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. As at 31 March 2023, 100% of our colleagues had completed their 20 hours of annual CPD.

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 continue to develop our suite of Moments that Matter documents focusing on mental health, physical health, financial health, relationships, 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. They're also available to our members on our new website www.lpf.org.uk.

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

OUR COLLEAGUES

Throughout 2022 we held various sessions focusing on wellbeing. During Mental Health Awareness Week, we planned daily activities to promote metal health and we invited an external speaker to talk about building personal resilience and taking care of our mental health during challenging times.

During Pride month we raised awareness of the current issues facing the LGBTQA+ community by sharing key messages with the team and suggesting ways for everyone to get involved. We sponsored the Edinburgh Pride march in Edinburgh on its 25th anniversary and the first since 2019.

On Mental Health Day, we welcomed Therapet dogs into the office to show the benefits of having pets as companions and they talked about the good work they do in education.

Charity days

During 2022 several teams across the organisation completed various charity days to help support our local communities. The teams carried out a variety of activities including painting and gardening to support the local community as well as sorting and packing clothes for Kids Love Clothes.

Management commentary approved by:

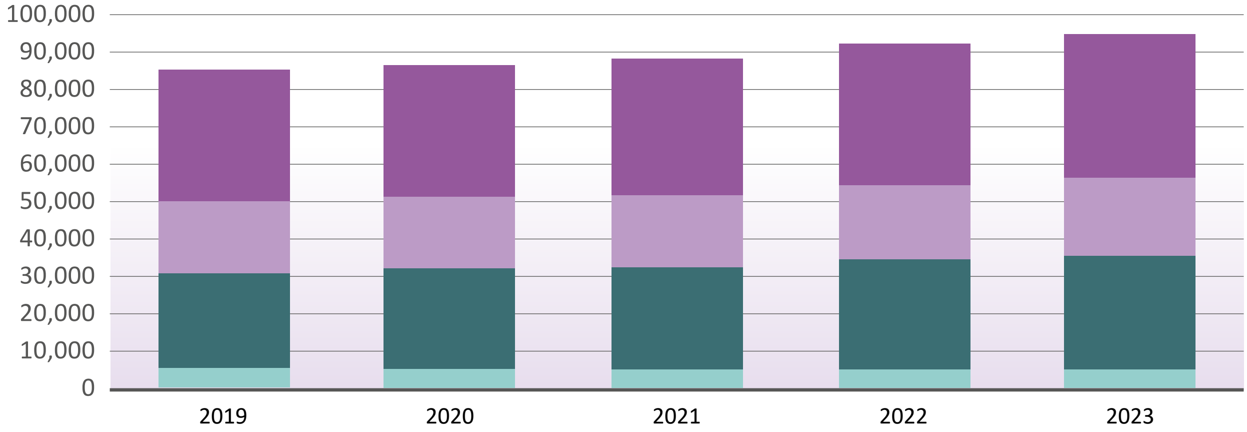
Andrew Kerr
Chief Executive Officer
The City of Edinburgh Council
21 June 2023

David Vallery
Chief Executive Officer
Lothian Pension Fund
21 June 2023

Hugh Dunn
Service Director: Finance and Procurement
The City of Edinburgh Council
21 June 2023

LOTHIAN PENSION FUND INVESTMENT STRATEGY

LOTHIAN PENSION FUND MEMBERSHIP DATA



	2019	2020	2021	2022	2023
Active	35,014	35,874	36,149	37,207	37,614
Deferred	19,094	19,098	19,049	19,832	20,427
Pensioner	25,627	27,091	27,843	28,870	29,800
Dependant	4,199	4,229	4,173	4,161	4,155

Investment strategy

The Fund's current investment strategy was approved by the Pensions Committee in June 2021.

The objective of the Fund's investment strategy is the achievement of the discount rate, the return that the actuary prudently assumes will pay pensions as they fall due and will also be consistent with affordable and stable employer contribution rates.

The Fund's investment strategy reflects the duration of its liabilities, the pensions it will pay in the future. For most employers, these liabilities stretch decades into the future. Consequently, the strategy allocates a substantial portion of the Fund to assets that are expected to grow in real terms over the long term, such as equities. However, given that these types of assets are volatile, and that the future is uncertain, the strategy includes other asset types to diversify risk. The macroeconomic backdrop also influences the formation of the investment strategy and its implementation and, given the more inflationary environment than that of recent years, this supports the emphasis on real assets that have a history of protecting investors from the worst effects of inflation.

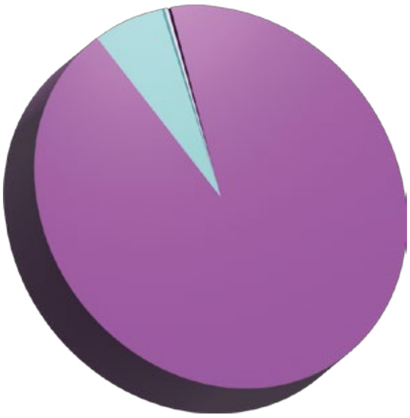
There were no changes to fund strategy over the year to end March 2023. The Total Fund Strategy percentages shown below are a weighted average of the employer strategies. Movements in the relative size of these strategies has resulted in modest changes to the Total Fund Strategy weightings.

LOTHIAN PENSION FUND INVESTMENT STRATEGY

Employer strategies

Lothian Pension Fund is a multi-employer pension scheme and not all employers are alike. To address their differing funding requirements the Fund operates four distinct 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.

EMPLOYER GROUP STRATEGIES 31 MARCH 2023



Main Strategy **94.1%** (£9,075m)
Buses Strategy **5.3%** (£513m)
50/50 Strategy **0.4%** (£37m)
Mature Employer Strategy **0.1%** (£15m)

TOTAL WEIGHT 100%
TOTAL ASSETS 9,701 (£m)

Most employer liabilities are funded under the Main Strategy, which adopts a long-term investment strategy, aiming to generate an investment return that will minimise the cost to the employer within reasonable and considered risk parameters. 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 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 0.2% 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 0.4% of total liabilities.

The Buses Strategy, which was created when the assets and liabilities of Lothian Buses Pension Fund were consolidated into the Lothian Pension Fund on 31 January 2019, is a 55/45 mix of the Main Strategy and the Mature Employer Strategy. The liabilities funded by the Buses strategy represent approximately 5.4% of total liabilities.

LOTHIAN PENSION FUND INVESTMENT STRATEGY

Policy groups

The investment strategies are described in terms of allocations to broad asset classes, or policy groups, which are the key determinants of risk and return. These policy groups are Equities, Real Assets, Non-Gilt Debt, LDI (Gilts) and Cash. 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.

The table below presents the policy group target allocations of the four investment strategies at end March 2023 along with the total Fund strategy, which is the weighted average of the four employer strategies.

LOTHIAN PENSION FUND 31 March 2023	Main strategy	Mature Employer strategy	50/50 strategy	Buses strategy	Total Fund Strategy
Equities	60.0%	0.0%	30.0%	33.0%	58.3%
Real Assets	20.0%	0.0%	10.0%	11.0%	19.4%
Non-Gilt Debt	10.0%	0.0%	5.0%	5.5%	9.7%
LDI (Gilts)	10.0%	100.0%	55.0%	50.5%	12.5%
Cash	0.0%	0.0%	0.0%	0.0%	0.0%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Note: Numbers may not sum due to rounding

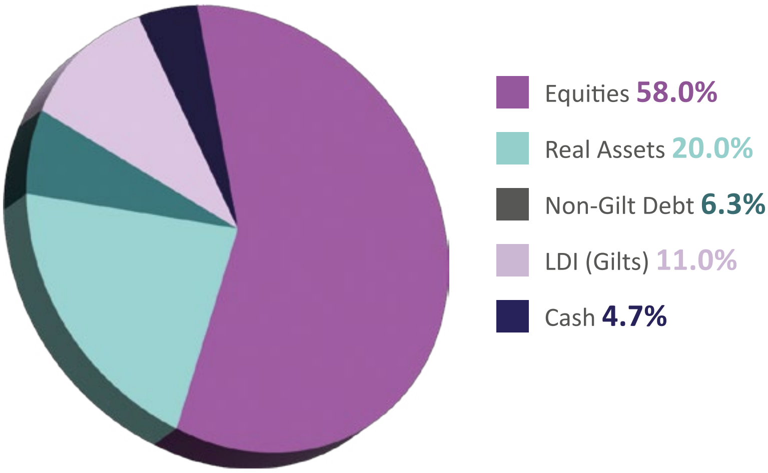
The LDI policy group comprises index-linked and nominal gilts. It does not use financial leverage, which caused some pension funds to become forced sellers of assets in the autumn of 2022. This is the lowest risk, lowest expected return policy group as it’s possible to match the cash flows of gilts with the pension payments that the Fund expects to pay in the future. The purpose of the other policy groups is to generate a return in excess of the gilt return to make the Fund affordable to employers. The other policy groups, therefore, are expected to generate higher returns over the long term – the actuary models 20 years into the future. These higher returns come at the cost of higher risk or volatility.

Strategy implementation

The Pensions Committee delegates implementation of investment strategy to the Fund’s officers, who are tasked with investing each policy group within specified ranges. These are laid out in the Statement of Investment Principles. The actual allocation at end March 2023 is presented in the pie chart below. The largest deviation from strategy is the overweight position in cash (+4.7%), which reflects continuing caution about the valuation of other assets, though is considerably lower than last year following recent opportunities to increase allocation to Real Assets and LDI at more favourable prices. Offsetting underweight positions are in LDI (or gilts) and Non-Gilt Debt. The Fund’s exposure to Equity and Real Assets, which should help protect against inflation, is broadly in-line with target. The Fund has operated comfortably within the prescribed ranges over the year.

LOTHIAN PENSION FUND INVESTMENT STRATEGY

ACTUAL ASSET ALLOCATION TOTAL FUND 31 MARCH 2023



Within policy groups, the Fund pays careful attention to risk taken to achieve returns and the cost of implementation. Within Equities, for example, the strategy typically avoids higher risk securities, meaning that its portfolio is lower risk than the benchmark. This has been the case for the last several years. One of the benefits of this approach is that it helps to maintain a low cost of implementation as turnover is generally quite low. Also contributing to a low cost of implementation is the internal management of just under 90% of equity assets.

The Real Assets policy group allocation has grown substantially over the last several years. The investments in this diverse category are comprised of (very largely UK) property, a wide range of infrastructure assets, including a variety of renewables, regulated utilities and other essential assets and timberlands. Again, there is a wide range of expected risk and expected returns associated with these types of private market assets. The Fund seeks long term, defensive investments with inflation protection or correlation, and expects returns and risk to be somewhat lower than those from the Equity policy group and for the assets to provide some diversification benefits.

The Non-Gilt Debt policy group comprises investments in various non-gilt debt securities. However, as its purpose in the Fund is to diversify equity risk, it eschews most high yield debt instruments, which are riskier and strongly correlated with equities. The Fund also invests in overseas sovereign bonds, which are included in this policy group.

LOTHIAN PENSION FUND INVESTMENT STRATEGY

Investment portfolio changes

The table below shows the changes to asset allocation over the year. They were relatively small and reflect both market movements and investment activity.

POLICY GROUP	Actual Allocation 31 March 2022	Actual Allocation 31 March 2023	Change %
Equities	58.5%	58.0%	-0.5%
Real Assets	17.3%	20.0%	+2.7%
Non-Gilt Debt	7.6%	6.3%	-1.3%
Gilts	8.5%	11.1%	+2.6%
Cash	8.1%	4.7%	-3.4%
Total	**100%**	**100%**	

Note: Numbers may not sum due to rounding

The Equity allocation is broadly unchanged over the last twelve months.

The Real Assets allocation increased during the year, primarily due to net new investment activity. In particular, new infrastructure investments were made throughout the year which offset distributions of income and capital for existing private market investments. The Fund continued to source new investments to achieve the target Real Asset allocation, and the real asset policy group was a net investor during the year.

The allocation to Non-Gilt Debt fell modestly over the year, mainly as a result of weak relative returns. In contrast, the exposure to LDI (or gilts) increased, despite weak returns. Having been underweight LDI for some time, the Fund took the opportunity to accelerate its hitherto gradual purchases of UK government bonds during the Truss government-induced market weakness in September/ October 2022.

The net result of the changes was a reduction in cash. The cash position twelve months ago was highlighted to be a temporary, defensive position which was supported by the Fund’s advisers. Some of this cash was utilised during the market dislocation in gilts referenced above, to purchase gilts at more attractive yields and move the Fund closer to the strategic target allocation.

There were no changes to investment strategy during the period; changes to Total Fund Strategy allocation weightings over the year were solely a result of movements in the relative size of the underlying strategies. The changes to actual asset mix, while more significant, were also relatively minor. The largest actual change was the reduction in cash which was used to increase the allocation to Real Assets and LDI.

LOTHIAN PENSION FUND INVESTMENT STRATEGY

Investment performance

The investment objective of the Fund is to achieve a return on assets sufficient to meet the funding objectives over the long term 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.

This aim is translated into a strategic benchmark comprising a mix of assets, whose future returns are expected to approximate the required returns over the long term. The Fund is not expected to track the benchmark from year to year, but it does target a return broadly in line with its strategic benchmark allocation over the long term, with a lower-than-benchmark level of risk.

There are two main reasons why returns will deviate from the benchmark, particularly over shorter timeframes: portfolios aren't constructed to track listed market benchmarks, and private market benchmarks aren't readily available nor assets well suited to short term measurement.

The Fund's performance over the last year and over longer-term timeframes is presented in the table below, both relative to the asset benchmark and with other relevant economic metrics. UK CPI and Average Weekly Earnings are both measures of inflation and Fund liabilities are, of course, linked to long term inflation. Both had grown at low and relatively stable rates for many years until recently.

Annualised returns to 31 March 2023 (% per year)	1 year	5 years	10 years
Lothian Pension Fund	0.3	6.3	8.3
Benchmark*	-14.6	4.5	6.9
Average Weekly Earnings (AWE)	4.9	4.3	3.5
Consumer Price Index (CPIH All Items)	8.9	3.8	2.6

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

COLLEAGUE PROFILE ABIGAIL FORTUNE, GRADUATE TRAINEE ACCOUNT

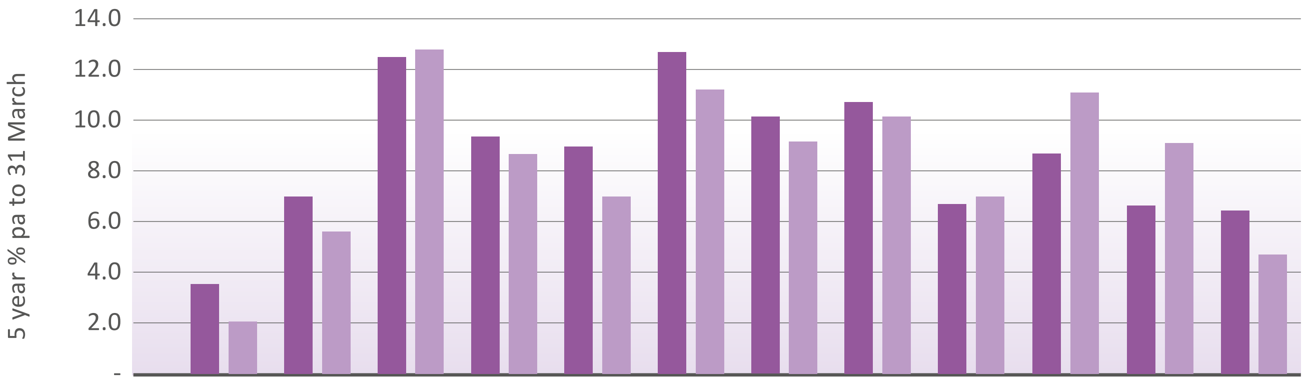
Abby joined us as a graduate trainee accountant in June 2019. Abby's role involves carrying out a wide variety of financial analysis and control tasks across the Fund, while also working towards her professional accountancy qualification.

"As a graduate trainee accountant with LPF, I've valued the freedom to work across a wide variety of areas, which is something I likely wouldn't have had in larger companies. I am currently working on the testing for our new finance system, the implementation of which will increase the finance team's efficiency and improve workflows across the company."

LOTHIAN PENSION FUND INVESTMENT STRATEGY

The following bar chart presents the underlying performance data in a long-term context. It shows rolling 5-year returns for the Fund, its asset-based benchmark, and the relative return. The historical record highlights that these numbers fluctuate meaningfully over time, and so caution is required when interpreting individual data points. It is important to remember that the objective of the Fund is to balance both risk and return. While the chart below looks solely at the return component, the table with policy group components (below the bar chart) adds the perspective of the risk taken to achieve those returns.

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



	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Fund	3.6	7.1	12.7	9.5	9.1	12.9	10.3	10.9	6.8	8.5	6.5	6.3
Benchmark	2.1	5.7	13.0	8.8	7.1	11.4	9.3	10.1	7.1	11.8	8.6	4.5
Relative	+1.5	+1.4	-0.3	+0.7	+1.9	+1.5	+1.0	+0.8	-0.3	-3.2	-2.1	+1.7

While the chart above looks solely at the return component, the policy group table below adds the perspective of the risk taken to achieve those returns. It presents the Fund's risk and return over 1 and 5 years as calculated by its independent performance measurement provider. It breaks down the performance by policy group where available. Due to changes to the structure of the Fund, there are no meaningful 10-year numbers for the individual policy groups.

LOTHIAN PENSION FUND INVESTMENT STRATEGY

The following table presents the Fund's risk and return over 1, 5 and 10 years as calculated by its independent performance measurement provider. It breaks down the performance by policy group where available. Due to changes to the structure of the Fund, only one policy group has meaningful 10-year data.

TO END MARCH 2023

POLICY GROUP	1 year (%)		5 year (% pa)		10 year (% pa)	
	Fund	Benchmark	Fund	Benchmark	Fund	Benchmark
Equities	4.3	-1.4	8.4	9.7		
Real Assets	7.9	-36.6	7.5	-3.8		
Non-Gilt Debt	-3.7	-10.0	1.9	-0.5		
LDI (Gilts)	-38.6	-39.1	-6.7	-6.7	0.9	1.3
Total Fund Return	**0.3**	**-14.6**	**6.3**	**4.5**	**8.3**	**6.9**
Total Fund Risk*	**8.3**	**10.8**	**7.0**	**11.2**	**6.8**	**9.3**

**1 year predicted; 5 years ex-post (source: Portfolio Evaluation)*

The Fund produced an absolute return of +0.3% over the twelve months to end March 2023, which was notably ahead of the benchmark return of -14.6%. With risk below benchmark, it outperformed its long-term objective over the short 1-year timeframe.

Reasonable returns were achieved within Equities and Real Assets. The Fund's Equities gained 4.3% over the year, comfortably ahead of the global index (MSCI ACWI in GBP) return of -1.4%. Within the Real Assets category, the return of +7.9% was led by strength in both unlisted infrastructure (+19.6%) and timber & agriculture (+12.0%) investments.

Five-year returns were above benchmark at +6.3%pa vs +4.5%pa and over ten years the comparison was +8.3%pa vs +6.9%pa. In summary, over each of these time periods, Fund returns have been above benchmark.

On the risk side of the equation, the Fund has achieved its returns with notably lower levels of volatility than its benchmark (approximately 63% of benchmark risk over five years and 73% over ten years), so from a risk / return perspective the outcomes were notably better than expected over the 1, 5 and 10-year timeframes.

LOTHIAN
PENSION FUND

OUTSTANDING SERVICE

'I'm not tech savvy, but the colleague I spoke to over the phone was very helpful and guided me through the online process. I'm very grateful for their help.'

LOTHIAN PENSION FUND

LOTHIAN PENSION FUND ACCOUNT FOR YEAR ENDED 31 MARCH 2023

Financial statements

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

Lothian Pension Fund				Lothian Pension Fund	
Parent	Group			Parent	Group
2021/22	2021/22			2022/23	2022/23
£000	£000		Note	£000	£000
		Income			
198,944	198,944	Contributions from employers	4	201,867	201,867
53,201	53,201	Contributions from members	5	57,383	57,383
5,130	5,130	Transfers from other schemes	6	6,551	6,551
257,275	**257,275**			**265,801**	**265,801**
		Less: expenditure			
195,116	195,116	Pension payments including increases	7	206,225	206,225
51,043	51,043	Lump sum retirement payments	8	52,541	52,541
7,662	7,662	Lump sum death benefits	9	9,489	9,489
531	531	Refunds to members leaving service		845	845
-	-	Premiums to State Scheme		-	-
5,874	5,874	Transfers to other schemes	10	11,689	11,689
2,820	2,439	Administrative expenses	11a	3,202	1,088
263,046	**262,665**			**283,991**	**281,877**
(5,771)	**(5,390)**	**Net (withdrawals)/additions from dealing with members**		**(18,190)**	**(16,076)**
		Returns on investments			
276,010	276,010	Investment income	12	339,114	339,114
676,468	676,468	Change in market value of investments	14, 19b	(188,055)	(188,055)
(37,183)	(35,534)	Investment management expenses	11b	(44,942)	(39,595)
915,295	**916,944**	**Net returns on investments**		**106,117**	**111,464**
909,524	**911,554**	**Net increase in the fund during the year**		**87,927**	**95,388**
8,697,762	**8,693,689**	**Net assets of the fund at 1 April 2022**		**9,607,286**	**9,605,243**
9,607,286	**9,605,243**	**Net assets of the fund at 31 March 2023**		**9,695,213**	**9,700,631**

LOTHIAN PENSION FUND
NET ASSETS AS AT 31 MARCH 2023

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 2022	31 March 2022			31 March 2023	31 March 2023
£000	£000		Note	£000	£000
		Investments			
9,528,867	9,528,867	Assets		9,650,374	9,650,374
(4,466)	(4,466)	Liabilities		(9,386)	(9,386)
9,524,401	**9,524,401**	**Net investment assets**	**13**	**9,640,988**	**9,640,988**
		Non current assets			
13,061	13,061	Debtors	23	10,688	10,688
719	719	Computer systems		486	486
690	-	Share Capital		690	-
-	-	Retirement benefit obligation	29	-	4,866
-	875	Deferred tax	28a	-	-
14,470	**14,655**			**11,864**	**16,040**
		Current assets			
3,870	3,870	The City of Edinburgh Council	27	2,311	2,311
68,241	69,098	Cash balances	20, 27	44,224	45,703
20,042	20,473	Debtors	24	21,221	21,891
92,153	**93,441**			**67,756**	**69,905**
		Non current liabilities			
-	(3,498)	Retirement benefit obligation	29	-	-
-	-	Deferred tax	28a	-	(213)
-	(14)	Creditors		-	(16)
-	**(3,512)**			**-**	**(229)**
		Current liabilities			
(23,738)	(23,742)	Creditors	25	(25,395)	(26,073)
(23,738)	**(23,742)**			**(25,395)**	**(26,073)**
9,607,286	**9,605,243**	**Net assets for the fund**		**9,695,213**	**9,700,631**

LOTHIAN PENSION FUND ACCOUNTS

The unaudited accounts were issued on 21 June 2023.

Hugh Dunn
Service Director: Finance and Procurement
The City of Edinburgh Council
21 June 2023

Notes to the net asset statement

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

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 147.

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 are identified as either “Parent “ or “Group”.

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

The consolidation of the group accounts was prepared prior to the approval by the Boards of LPFE Limited and LPFI Limited their respective audited financial statements for 2022/23. 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

There have been no events since 31 March 2023, and up to the date when these Financial Statements were authorised, that require any adjustments to these Financial Statements.

4 Contributions from employers

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

	2021/22	2022/23
By category	**£000**	**£000**
Primary Contribution (future service)	180,554	195,628
Secondary Contribution (past service deficit)	5,433	5,399
Strain costs	3,209	705
Cessation Contributions	9,748	135
	198,944	**201,867**

	2021/22	2022/23
By employer type	**£000**	**£000**
Administering Authority	71,515	75,947
Other Scheduled Bodies	95,937	104,123
Community Admission Bodies	30,123	20,190
Transferee Admission Bodies	1,369	1,607
	198,944	**201,867**

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

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

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	2021/22 £000	2022/23 £000
Administering Authority	18,969	20,488
Other Scheduled Bodies	27,596	29,886
Community Admission Bodies	6,212	6,521
Transferee Admission Bodies	424	488
	53,201	57,383

6 Transfers in from other pension schemes

	2021/22 £000	2022/23 £000
Group transfers	1,649	6,551
Individual transfers	3,481	-
	5,130	6,551

7 Pensions payable

By employer type	2021/22 £000	2022/23 £000
Administering Authority	84,339	87,871
Other Scheduled Bodies	91,909	98,401
Community Admission Bodies	18,537	19,537
Transferee Admission Bodies	331	416
	195,116	206,225

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. The use of a Fund bank account for these "unfunded transfer payments" is prohibited. Accordingly, for reasons of efficiency and simplicity, the pension payroll is combined and both funded and unfunded pension payments are made through a general fund bank account of the administering authority, City of Edinburgh Council. For the funded LGPS payments, the Fund transfers money from its own bank account to that of the City of Edinburgh Council's to cover the value of these benefits. For the unfunded payments, these are recharged to the employer body (or successor) which originally granted the discretionary benefits.

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

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

8 Lump sum retirement benefits payable

	2021/22	2022/23
By employer type	**£000**	**£000**
Administering Authority	17,553	19,160
Other Scheduled Bodies	28,214	29,727
Community Admission Bodies	4,905	3,221
Transferee Admission Bodies	371	433
	51,043	**52,541**

9 Lump sum death benefits payable

	2021/22	2022/23
By employer type	**£000**	**£000**
Administering Authority	2,985	3,421
Other Scheduled Bodies	4,294	5,351
Community Admission Bodies	382	708
Transferee Admission Bodies	1	9
	7,662	**9,489**

10 Transfers out to other pension schemes

	2021/22	2022/23
	£000	**£000**
Group transfers	-	-
Individual transfers	5,874	11,689
	5,874	**11,689**

LOTHIAN PENSION FUND

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

11a Administrative expenses

	LPF Parent 2021/22	LPF Group 2021/22	LPF Parent 2022/23	LPF Group 2022/23
	£000	£000	£000	£000
Employee costs	1,775	2,042	1,937	2,263
System costs	462	467	508	514
Actuarial fees	96	96	248	248
External/Internal audit fees	74	79	84	88
Legal fees	24	24	22	23
Printing and postage	158	158	119	119
Depreciation	81	81	108	108
Office costs	85	85	97	97
Sundry costs less sundry income	65	93	79	88
IAS19 retirement benefit adjustments - see note 29	-	(762)	-	(2,839)
Deferred tax on retirement benefit obligation - see note 28	-	65	-	369
Corporation tax	-	11	-	10
	2,820	**2,439**	**3,202**	**1,088**

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.

COLLEAGUE PROFILE EMMA BURNS, GOVERNANCE OFFICER

Emma joined LPF in September 2022 as Governance Officer. Emma assists with the Governance of the scheme and helps to run the Pension Board and Committee. Emma says:

"From the very first day of joining the organisation I have received such a warm welcome and really appreciated the effort from colleagues in making me feel included and part of the team. The role is very busy, varied and interesting, with lots of opportunity to build knowledge and new skills."

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

11b Investment management expenses

	LPF Parent 2021/22	LPF Group 2021/22	LPF Parent 2022/23	LPF Group 2022/23
	£000	£000	£000	£000
External management fees:				
invoiced	3,213	3,213	3,175	3,175
deducted from capital (direct investment)	23,772	23,772	24,525	24,525
deducted from capital (indirect investment)	827	827	606	606
Securities lending fees	81	81	107	107
Transaction costs - Equities	1,624	1,624	2,249	2,249
Property operational costs	1,770	1,770	7,164	7,164
Third party - Invest property service charge expense	5,964	5,964	8,266	8,266
Third party - Invest property service charge income	(5,964)	(5,964)	(8,266)	(8,266)
Employee costs	2,938	3,477	3,876	4,589
Custody fees	426	426	366	366
Engagement and voting fees	112	112	89	89
Performance measurement fees	98	98	117	117
Consultancy fees	110	110	86	86
Research fees	442	442	503	503
System costs	909	918	1,123	1,136
Legal fees	275	358	337	447
Depreciation	170	170	172	172
Office costs	127	127	153	153
Sundry costs less sundry income	289	(866)	294	(1,111)
IAS19 retirement benefit adjustments - see note 30	-	(1,253)	-	(5,525)
Deferred tax on retirement benefit obligation - see note 29	-	108	-	719
Corporation tax	-	-	-	-
Corporation tax gains utilised by CEC group	-	20	-	28
	37,183	35,534	44,942	39,595

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

11b Investment management expenses (cont.)

	Total	Management /Expense fees	Performance related fee	Transaction costs
2022/2023	**£000**	**£000**	**£000**	**£000**
Bonds	109	109	-	-
Equities	5,321	3,079	(7)	2,249
Pooled investment vehicles	25,167	16,073	9,062	32
Property	7,164	7,164	-	-
Cash and FX contacts	65	65	-	-

	Total	Management /Expense fees	Performance related fee	Transaction costs
2021/2022	**£000**	**£000**	**£000**	**£000**
Bonds	109	109	-	-
Equities	5,249	3,506	119	1,624
Pooled investment vehicles	24,114	15,234	8,848	32
Property	1,770	1,770	-	-
Cash and FX contacts	45	45	-	-

Investment costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to both 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 £9.1m (£9.1m direct) in respect of performance-related fees compared to £9m in 2021/22 (£8.9m 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 1 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 £0.6m in costs (2022 £0.8m).

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 2021/22	LPF Group 2021/22	LPF Parent 2022/23	LPF Group 2022/23
	£000	£000	£000	£000
Administrative costs	2,534	2,032	2,687	703
Investment management expenses	34,514	34,185	41,447	38,332
Oversight and governance costs	2,953	1,756	4,010	1,648
	40,001	**37,973**	**48,144**	**40,683**

JIM ANDERSON

"Having once again become chair of the Pension Board I wish to thank the Board members for their continuing support. The Board are key to providing 'oversight and assurance' and have been reassured by the efforts of the Fund. The Board has supported the Committee in its consideration of the investment strategy, governance, administration, communications, Project Forth and LGPS regulation changes. In addition, the Board reviewed operational improvements including the 'Members Self Service' [website] facility. The Board has worked tirelessly in its members interests in what was yet another challenging year."

Chair of the Pension Board

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

12 Investment income

	2021/22	2022/23
	£000	£000
Income from bonds	4,586	7,645
Dividends from equities	168,743	192,831
Unquoted private equity and infrastructure	85,598	118,735
Income from pooled investment vehicles	2,805	2,507
Gross rents from properties	22,500	25,983
Interest on cash deposits	57	4,968
Stock lending and sundries	407	536
	284,696	**353,205**
Irrecoverable withholding tax	(8,686)	(14,091)
	276,010	**339,114**

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's assumed that the Fund will make full recovery of these reclaims. For the period of 2022/23 £8,041k of the stated income relates to tax yet to be received. At 31 March 2023 £29,014k (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.

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

13 Net investment assets

	31 March 2022	31 March 2023
Investment assets	**£000**	**£000**
Bonds		
Public sector fixed interest	157,498	243,549
Public sector index linked gilts quoted	957,545	1,198,067
	1,115,043	**1,441,616**
Equities		
Quoted	5,434,373	5,469,139
	5,434,373	**5,469,139**
Pooled investment vehicles		
Private equity, infrastructure, private debt & timber	1,344,172	1,711,625
Property	116,925	82,890
Other	203,941	177,904
	1,665,038	**1,972,419**
Properties		
Direct property	431,303	365,745
	431,303	**365,745**
Derivatives		
Derivatives - forward foreign exchange	-	2,549
	-	**2,549**
Cash deposits		
Deposits	837,138	341,424
	837,138	**341,424**
Other investment assets		
Due from broker	1,417	908
Dividends and other income due	44,555	56,574
	45,972	**57,482**
Total investment assets	**9,528,867**	**9,650,374**
Investment liabilities		
Derivatives		
Derivatives - forward foreign exchange	(2,375)	-
	(2,375)	**-**
Other financial liabilities		
Due to broker	(2,091)	(9,386)
	(2,091)	**(9,386)**
Total investment liabilities	**(4,466)**	**(9,386)**
Net investment assets	**9,524,401**	**9,640,988**

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

14a Reconciliation of movement in investments and derivatives

	Market value at 31 March 2022*	Purchase at cost & derivative payments	Sale & derivative receipts	Change in market value	Market value at 31 March 2023
	£000	£000	£000	£000	£000
Bonds	1,115,043	1,487,342	(882,212)	(278,557)	1,441,616
Equities	5,434,373	980,072	(985,504)	40,198	5,469,139
Pooled investment vehicles	1,665,038	392,099	(185,094)	100,376	1,972,419
Property	431,303	17,016	(6,437)	(76,137)	365,745
Derivatives - futures	-	-	-	-	-
Derivatives - forward foreign exchange	(2,375)	7,468	(2,061)	(483)	2,549
	8,643,382	**2,883,997**	**(2,061,308)**	**(214,603)**	**9,251,468**
Other financial assets / liabilities					
Cash deposits*	837,138			26,512	341,424
Broker balances*	(674)			36	(8,478)
Investment income due*	44,555			-	56,574
	881,019			**26,548**	**389,520**
Net financial assets	**9,524,401**			**(188,055)**	**9,640,988**

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

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.

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

14a Reconciliation of movement in investments and derivatives (cont.)

	Market value at 31 March 2021*	Purchase at cost & derivative payments	Sale & derivative receipts	Change in market value	Market value at 31 March 2022
	£000	£000	£000	£000	£000
Bonds	689,792	638,774	(228,844)	15,320	1,115,043
Equities	5,044,875	1,014,338	(1,127,432)	502,592	5,434,373
Pooled investment vehicles	1,615,521	240,695	(274,517)	83,339	1,665,038
Property	366,125	380	(7,982)	72,780	431,303
Derivatives - futures	-	-	-	-	-
Derivatives - forward foreign exchange	625	24	(1,790)	(1,234)	(2,375)
	7,716,938	**1,894,211**	**(1,640,565)**	**672,797**	**8,643,382**
Other financial assets / liabilities					
Cash deposits*	933,452			3,717	837,138
Broker balances*	(87,278)			(46)	(674)
Investment income due*	33,602			-	44,555
	879,776			**3,671**	**881,019**
Net financial assets	**8,596,714**			**676,468**	**9,524,401**

** 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 2022	Level 3 transfers		Purchases at cost & derivative payments	Sale & derivative receipts	Unrealised gains / (losses)	Realised gains / (losses)	Market value at 31 March 2023
Pooled investments	£000	in	out	£000	£000	£000	£000	£000
Infrastructure	932,043	-	-	317,032	(94,671)	118,858	25,455	1,298,717
Property	66,667	-	-	12,152	(36,883)	(27,131)	29,035	43,840
Private equity	43,835	-	-	(8)	(13,552)	(6,216)	8,606	32,665
Timber	107,614	-	-	27,910	(2,495)	(19,966)	(2,005)	111,058
Private debt	260,680	-	-	32,229	(32,508)	18,192	(9,409)	269,184
Freehold property	431,303	-	-	17,016	(6,437)	(76,137)	-	365,745
	1,842,141	**-**	**-**	**406,331**	**(186,546)**	**7,600**	**51,682**	**2,121,209**

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 NOTES TO THE FINANCIAL STATEMENTS

15 Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2023.

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	53,113	93,335	2,549	-
One to six months	CHF	USD	-	-	-	-
One to six months	USD	CHF	-	-	-	-
Open forward currency contracts at 31 March 2023					**2,549**	**-**
Net forward currency contracts at 31 March 2023						**2,549**
Prior year comparative						
Open forward currency contracts at 31 March 2022					**-**	**(2,375)**
Net forward currency contracts at 31 March 2022						**(2,375)**

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

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.

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

16 Investment managers and mandates

Manager	Mandate	Market value at 31 March 2022 £000	% of total 31 March 2022 %	Market value at 31 March 2023 £000	% of total 31 March 2023 %
In-house	UK all cap equities	265,832	2.8	295,441	3.1
In-house	UK mid cap equities	110,344	1.2	99,315	1.0
Total UK equities		**376,176**	**4.0**	**394,756**	**4.1**
In-house	European ex UK equities	250,266	2.6	202,168	2.1
In-house	US equities	359,548	3.8	372,923	3.9
Total regional overseas equities		**609,814**	**6.4**	**575,091**	**6.0**
In-house	Global high dividend	1,289,083	13.5	1,342,866	13.9
In-house	Global low volatility	1,285,006	13.5	1,272,317	13.2
In-house	Global multi factor value	1,177,932	12.4	1,196,232	12.4
In-house	Global quality	-	-	63,719	0.7
Harris	Global equities	132,500	1.4	138,204	1.4
Nordea	Global equities	351,784	3.7	329,513	3.4
Baillie Gifford	Global equities	178,332	1.9	170,952	1.8
Total global equities		**4,414,637**	**46.4**	**4,513,803**	**46.8**
In-house	Currency hedge	(2,374)	-	2,549	-
Total currency overlay		**(2,374)**	**-**	**2,549**	**-**
Total listed equities		**5,398,253**	**56.8**	**5,486,199**	**56.9**
In-house	Private equity unquoted	43,946	0.5	32,744	0.3
In-house	Private equity quoted	123,673	1.3	75,720	0.8
Total private equity		**167,619**	**1.8**	**108,464**	**1.1**
Total equity		**5,565,872**	**58.6**	**5,594,663**	**58.0**
In-house	Index linked gilts	497,000	5.2	756,003	7.8
In-house	Normal gilts	-	-	51,285	0.5
In-house	Mature employer gilts	316,605	3.3	262,748	2.7
Total inflation linked assets		**813,605**	**8.5**	**1,070,036**	**11.0**
In-house	Indirect property	116,925	1.2	82,890	0.9
In-house	Property	459,147	4.8	405,137	4.2
In-house	Infrastructure unquoted	932,043	9.8	1,298,717	13.5
In-house	Infrastructure quoted	28,666	0.3	24,845	0.3
In-house	Timber	107,614	1.1	111,058	1.2
Total real assets		**1,644,395**	**17.2**	**1,922,647**	**20.1**
Baillie Gifford	Corporate bonds	33,412	0.4	29,683	0.3
In-house	Private debt	260,680	2.7	269,185	2.8
In-house	Sovereign bonds	298,857	3.1	184,978	1.9
In-house	Investment Grade Credit	134,640	1.4	121,334	1.3
Total debt assets		**727,589**	**7.6**	**605,180**	**6.3**

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

16 Investment managers and mandates (cont)

		Market value at 31 March 2022	% of total 31 March 2022	Market value at 31 March 2023	% of total 31 March 2023
Manager	**Mandate**	**£000**	**%**	**£000**	**%**
In-house	Cash	772,033	8.1	448,096	4.6
In-house	Transitions	907	0.0	366	0.0
Total cash and sundries		**772,940**	**8.1**	**448,462**	**4.6**
Net financial assets		**9,524,401**	**100.0**	**9,640,988**	**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 2023, £92.5m (2022 £167.6m) of securities were released to third parties. Collateral valued at 105.1% (2022 107.3%) of the market value of the securities on loan was held at that date.

18 Property holdings

	2021/22	2022/23
	£000	**£000**
Opening balance	366,125	431,303
Additions	380	17,016
Disposals	(7,982)	(6,437)
Net change in market value	72,780	(76,137)
Closing balance	**431,303**	**365,745**

As at 31 March 2023, there were no restrictions on the realisability of the property or the remittance of income or sale proceeds. As at 31 March 2023, the Fund had no contractual obligation for any further construction costs.

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

	2021/22	2022/23
	£000	**£000**
Within one year	19,702	20,158
Between one and five years	65,976	67,636
Later than five years	102,119	106,764
	187,797	**194,558**

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

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 2022			31 March 2023		
	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	1,115,043	-	-	1,441,616	-	-
Equities	5,434,373	-	-	5,469,139	-	-
Pooled investments	1,665,038	-	-	1,972,419	-	-
Property leases	-	-	-	-	-	-
Derivative contracts	-	-	-	2,549	-	-
Margin balances	-	-	-	-	-	-
Cash	-	837,138	-	-	341,424	-
Other balances	-	44,555	-	-	57,482	-
	8,214,454	**881,693**	**-**	**8,885,723**	**398,906**	**-**
Other assets						
City of Edinburgh Council	-	3,870	-	-	2,311	-
Cash	-	68,241	-	-	44,224	-
Share Capital	-	690	-	-	690	-
Debtors - current	-	20,042	-	-	21,221	-
Debtors - non-current	-	13,061	-	-	10,688	-
	-	**105,904**	**-**	**-**	**79,134**	**-**
Assets total	**8,214,454**	**987,597**	**-**	**8,885,723**	**478,040**	**-**

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

Classification of financial instruments - parent (cont)	31 March 2022			31 March 2023		
	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	(2,375)	-	-	-	-	-
Other investment balances	-	(674)	-	-	(9,386)	-
	(2,375)	**(674)**	**-**	**-**	**(9,386)**	**-**
Other liabilities						
Creditors	-	-	(23,738)	-	-	(25,395)
Liabilities total	**(2,375)**	**(674)**	**(23,738)**	**-**	**(9,386)**	**(25,395)**
Total net assets	**8,212,079**	**986,923**	**(23,738)**	**8,885,723**	**468,654**	**(25,395)**

	31 March 2022	31 March 2023
Total net financial instruments	**9,175,264**	**9,328,982**
Amounts not classified as financial instruments	432,022	366,231
Total net assets - parent	**9,607,286**	**9,695,213**

ANDY MCKINNELL

"Over the last five years I have provided guidance to the Pensions Committee and Pension Board in the exercise of their duties. The Independent Professional Observer role is an important one for LPF, as it strengthens LPF's oversight and governance arrangements, ensuring that its committee and pension board have access to independent expertise within a complex industry. It has been a pleasure to support both the Pension Committee and Pension Board to ensure that the best interests of LPF's members and employers remain the key driver for all the Fund's decision making. I will leave my role in September 2023 and wish LPF success going forward."

Lothian Pension Fund's Independent Professional Observer

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

19a Classification of financial instruments (cont)

Classification of financial instruments - adjustments to parent to arrive at group	31 March 2022			31 March 2023		
	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	-	857	-	-	1,479	-
Share capital	-	(690)	-	-	(690)	-
Debtors - current	-	430	-	-	772	-
Debtors - non-current	-	875	-	-	-	-
Debtors - non-current Retire. benefit obligation	-	-	-	-	4,866	-
	-	1,472	-	-	6,427	-
Assets total	-	1,472	-	-	6,427	-
-Other liabilities-						
Retire. benefit obligation	-	-	(3,498)	-	-	-
Creditors	-	-	(3)	-	(678)	-
Creditors - non current	-	-	(14)	-	(331)	-
Liabilities total	-	-	(3,515)	-	(1,009)	-
Total net assets	-	1,472	(3,515)	-	5,418	-

	31 March 2022	31 March 2023
Total adjustments to net financial instruments	(2,043)	5,418
Total net assets - group	9,605,243	9,700,631

19b Net gains and losses on financial instruments

	2021/22	2022/23
	£000	£000
Designated as fair value through Fund Account	997,105	(138,466)
Loans and receivables	(11,464)	26,548
Financial liabilities at amortised cost	-	-
Total	**985,641**	**(111,918)**
Gains and losses on directly held freehold property	(16,405)	(76,137)
Change in market value of investments per fund account	**969,236**	**(188,055)**

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

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 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.

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.

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

19C fair value hierarchy (cont)

	31 March 2023			
	Level 1	Level 2	Level 3	Total
Investment assets at fair value through Fund Account	**£000**	**£000**	**£000**	**£000**
Bonds	-	1,441,616	-	1,441,616
Equities	5,469,139	-	-	5,469,139
Pooled investment vehicles	27,093	189,861	1,755,465	1,972,419
Derivatives	2,549	-	-	2,549
Cash deposits	341,424	-	-	341,424
Investment income due	57,482	-	-	57,482
Non-financial assets at fair value through profit and loss				
Property	-	-	365,745	365,745
Total investment assets	**5,897,687**	**-**	**2,121,210**	**9,650,374**
Investment liabilities at fair value through Fund Account	**(9,386)**	**-**	**-**	**(9,386)**
Total investment liabilities	**(9,386)**	**-**	**-**	**(9,386)**
Net investment assets	**5,888,301**	**-**	**2,121,210**	**9,640,988**

	31 March 2022			
	Level 1	Level 2	Level 3	Total
Investment assets at fair value through Fund Account	**£000**	**£000**	**£000**	**£000**
Bonds	-	1,115,043	-	1,115,043
Equities	5,434,373	-	-	5,434,373
Pooled investment vehicles	36,078	218,122	1,410,838	1,665,038
Derivatives	-	-	-	-
Cash deposits	837,138	-	-	837,138
Investment income due	44,555	-	-	44,555
Non-financial assets at fair value through profit and loss				
Property	-	-	431,303	431,303
Total investment assets	**6,352,144**	**1,333,165**	**1,842,141**	**9,527,450**
Investment liabilities at fair value through Fund Account	**(3,049)**	**-**	**-**	**(3,049)**
Total investment liabilities	**(3,049)**	**-**	**-**	**(3,049)**
Net investment assets	**6,349,095**	**1,333,165**	**1,842,141**	**9,524,401**

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

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're 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.

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 type	Potential price movement (+ or -)
Equities - Developed Markets	20.5%
Equities - Emerging Markets	28.0%
Private equity	26.0%
Timber and gold	18.0%
Secured loans	10.5%
Fixed interest Gilts	11.2%
Index-linked Gilts	11.8%
Infrastructure	12.0%
Property	13.0%
Cash	1.5%

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.

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

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

	Value at 31 March 2023	% of fund	Potential Change +/-	Value on increase	Value on decrease
	£m	%	%	£m	£m
Equities - Developed Markets	4,968	51.5	20.5%	5,986.5	3,949.6
Equities - Emerging Markets	516	5.3	28.0%	660.0	371.3
Private equity	108	1.1	26.0%	136.7	80.3
Timber and gold	111	1.2	18.0%	131.0	91.1
Secured loan	420	4.4	10.5%	464.3	376.1
Fixed interest Gilts	51	0.5	11.2%	57.0	45.5
Index-linked Gilts	1,201	12.5	11.8%	1,342.9	1,059.5
Infrastructure	1,324	13.7	12.0%	1,482.9	1,165.1
Property	488	5.1	13.0%	551.1	424.3
Cash and forward foreign exchange	454	4.6	1.5%	460.3	446.7
Total [1]	**9,641**	**100.0**	**16.9%**	**11,272.8**	**8,009.4**
Total [2]			**13.0%**	**10,897.3**	**8,384.9**
Total [3]			**14.0%**	**10,992.0**	**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 isn't 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 isn't reflected in market prices.

Cash deposits

At 31 March 2023, cash deposits represented £380m, 3.92% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2023	Balances at 31 March 2022	Balances at 31 March 2023
Held for investment purposes		**£000**	**£000**
Northern Trust Global Investment Limited - liquidity funds	A2	9,439	9,673
Northern Trust Company - cash deposits	A2	494,418	54,715
UK Short-Term Bills and Notes	Aa3	160,901	130,016
The City of Edinburgh Council - treasury management	See below	162,690	139,838
Total investment cash		**827,448**	**334,242**
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	68,241	44,224
JLL in-house property cash (Barclays)	A1	9,688	7,182
Total cash - parent		**895,689**	**378,466**
Cash held by LPFE/LPFI Limited			
Royal Bank of Scotland	A1	857	1,478
Total cash - group		**896,546**	**379,944**

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 2023	Balances at 31 March 2022	Balances at 31 March 2023
Money market funds		**£000**	**£000**
Deutsche Bank AG, London	Aaa-mf	8,625	25,862
Goldman Sachs	Aaa-mf	6,034	859
Aberdeen Standard Sterling Liquidity Fund	Aaa-mf	18,614	6,644
Bank call accounts			
Bank of Scotland	A1	23,016	13
Royal Bank of Scotland	A1	1,045	6,851
Santander UK	A1	23	24
Barclays Bank	A1	12	13
Svenska Handelsbanken		13	8,467
HSBC Bank PLC	A1	2,590	8
Notice accounts			
HSBC Bank PLC	A1	20,422	4
UK Government			
Gilts & T-Bills and UK Government Debt	Aa3	103,035	27,636
Supranational Commerical Paper			
European Investment Bank	Aaa	17,758	-
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa3	29,744	107,681
		230,931	**184,062**

[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 2023 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 doesn't 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 in note 17 (p90). The Fund is potentially exposed to credit risk in the event of the borrower of securities defaulting. This 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 2023, the Fund was owed £2,549k 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 isn't bound by any obligation to replenish its investments so isn't 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.

The majority (estimated to be approximately 78% (2022 81%)) 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 £6,971m (2022 £10,049m). 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's not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

	31 March 2022	31 March 2023
	% p.a.	% p.a.
Inflation / pensions increase rate	3.2	3.0
Salary increase rate	3.7	3.5
Discount rate	2.7	4.8

Longevity assumptions

Life expectancy is based on the Fund's VitaCurves with improvements in line with the CMI 2021 model, with a 10% weighting of 2021 (and 2020) data, standard smoothing (Sk7), initial adjustment of 0.25% 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 2022		31 March 2023	
	Male	Female	Male	Female
Current pensioners	20.3 years	23.1 years	19.9 years	22.9 years
Future pensioners (assumed to be currently 45)	21.6 years	25.0 years	21.2 years	24.7 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 2022	LPF Group 31 March 2022	LPF Parent 31 March 2023	LPF Group 31 March 2023
	£000	£000	£000	£000
Contributions due - employers' cessation	13,061	13,061	10,688	10,688
	13,061	13,061	10,688	10,688

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 2022	LPF Group 31 March 2022	LPF Parent 31 March 2023	LPF Group 31 March 2023
	£000	£000	£000	£000
Contributions due - employers	15,222	15,222	16,211	16,211
Contributions due - members	4,091	4,091	4,407	4,407
Benefits paid in advance or recoverable	166	166	-	-
Sundry debtors	158	628	248	1,003
Prepayments	363	366	253	270
LPFE & LPFI Limited Loan facility - see note 28	42	-	102	-
	20,042	20,473	21,221	21,891

25 Creditors	LPF Parent 31 March 2022	LPF Group 31 March 2022	LPF Parent 31 March 2023	LPF Group 31 March 2023
	£000	£000	£000	£000
Benefits payable	9,386	9,538	10,498	10,498
VAT, PAYE and State Scheme premiums	934	1,064	906	1,575
Contributions in advance	11,193	11,193	11,819	11,819
Miscellaneous creditors and accrued expenses	1,679	1,763	1,850	2,014
Office - operating lease	152	152	129	129
Corporation tax losses utilised from CEC group	-	-	-	38
Intra group creditor - see note 28	394	-	193	-
	23,738	23,710	25,395	26,073

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

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 aren't included in the pension fund financial statements.

	2021/22	2022/23
Total contributions during year for Lothian Pension fund	**£000**	**£000**
Standard Life	294	254
Prudential*	1,346	2,544
	1,640	**2,798**

	31 March 2022	31 March 2023
Total value at year end for Lothian Pension Fund	**£000**	**£000**
Standard Life	4,572	3,997
Prudential*	9,674	10,383
	14,246	**14,380**

**Figures provided are unaudited*

Prudential has been unable to supply contributions received data to the Fund for 2022/23, therefore total Prudential contributions shown above reflect the monthly contribution information provided by the Fund employers.

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 2022	31 March 2023
	£000	£000
Year-end balance of holding account	3,870	2,311
	3,870	**2,311**

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 2023, the fund had an average investment balance of £197.9m (2021/22 £222.9m). Interest earned was £3,857k (2021/22 £253k).

Year end balance on treasury management account

	31 March 2022	31 March 2023
	£000	£000
Held for investment purposes	162,691	139,838
Held for other purposes	68,241	44,224
	230,932	**184,062**

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 120. The employer contributions for the ten largest scheme employers are as follows:

	31 March 2022	31 March 2023
	£000	£000
City of Edinburgh Council	71,515	75,947
West Lothian Council	29,898	32,549
East Lothian Council	18,253	20,607
Midlothian Council	16,441	18,027
Scottish Water	10,543	11,419
Scottish Police Authority	6,781	7,010
Edinburgh Napier University	6,080	6,650
Heriot-Watt University	3,402	3,720
Audit Scotland	2,792	2,886
Edinburgh College	2,748	2,877
Weslo Housing Management	5,405	-
Hanover Housing Association	2,868	-

Governance

As at 31 March 2023, all members of the Pensions Committee and the Pension Board were members of the Lothian Pension Fund, with the exception of Richard Lamont and Tony Beecher. One member of both the Pensions Committee and the Pension Board is 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 2022 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 2022	31 March 2023
	£000	£000
Short-term employee benefits	909	1,281
Post-employment benefits - employer pension contributions	111	119

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

27 Related parties (cont)

Key management personnel employed by LPFE had accrued pensions totalling £148,034 (1 April 2022: £134,724) and lump sums totalling £147,429 (1 April 2022: £131,304) at the end of the period. Further details on senior management remuneration can be found within the remuneration report on page 174.

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

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

LPFE Limited & LPFI Limited – loan facility

LPFE & LPFI Limited are wholly owned by the City of Edinburgh Council as administrating authority of Lothian Pension Fund, and have entered into a shareholder agreement with the Council to address governance matters. The companies have a loan facility agreement with the City of Edinburgh Council for the purpose of the provision of short-term working capital. The current agreement covers the period to 1 May 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 £3,313 of which £1,872 was due at the year end and for LPFI Limited their interest payable for the year was £1,913 of which £1,442 was due at the year end. At 31 March 2023, there was a zero balance on the loan facilities for LPFE Limited, and a £100,000 balance on the loan facilities for 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 2023, the Fund was invoiced £6,076k (2022 £5,003k) 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 2021/22	LPF Group 2022/23
	£000	£000
Opening balance	1,047	875
Credit for year to Fund Account	(172)	(1,088)
Closing balance	**875**	**(213)**

Elements of closing deferred tax asset

	LPF Group 31 March 2022	LPF Group 31 March 2023
	£000	£000
Pension liability	875	(213)
	875	**(213)**

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

	31 March 2022	31 March 2023
	£	£
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	690,378	690,378
	690,379	**690,379**

**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.*

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 2022	% of total 31 March 2022	Fair value at 31 March 2023	% of total 31 March 2023
Asset		**£000**	**%**	**£000**	**%**
Equity securities:	Consumer	2,016	12.0	2,195	12.0
	Manufacturing	2,168	13.0	2,468	14.0
	Energy and utilities	905	6.0	1,080	6.0
	Financial institutions	944	6.0	1,077	6.0
	Health and care	1,135	7.0	1,315	7.0
	Information technology	744	5.0	744	4.0
	Other	1,221	7.0	1,223	7.0
Debt securities:	Corporate Bonds	308	2.0	279	2.0
	UK Government	1,433	9.0	2,076	12.0
	Other	-	0.0	374	2.0
Private equity:	All	77	0.0	70	0.0
Real property:	UK property	866	5.0	806	5.0
	Overseas property	5	0.0	29	0.0
Investment funds and unit trusts:	Equities	294	2.0	252	1.0
	Bonds	767	5.0	518	3.0
	Infrastructure	1,661	10.0	2,552	14.0
Derivatives:	Foreign Exchange	1	0.0	1	0.0
Cash and cash equivalents	All	1,841	11.0	845	5.0
		16,385	**100.0**	**17,904**	**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 2022	LPF Group 31 March 2023
	£000	£000
Fair value of Fund assets	16,385	17,904
Present value of Fund liabilities	(19,883)	(13,038)
	(3,498)	**4,866**

Movement in the defined benefit obligation during the period

	LPF Group 2021/22	LPF Group 2022/23
	£000	£000
Brought forward	19,361	19,883
Current service cost	1,813	1,930
Past service cost	59	-
Interest cost on obligation	418	576
Fund participants contributions	279	343
Benefits paid	(67)	(124)
Actuarial losses arising from changes in financial assumptions	(1,894)	(10,309)
Actuarial losses arising from changes in demographic assumptions	(119)	(119)
Other actuarial losses	33	858
Balance at year end	**19,883**	**13,038**

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 2021/22	LPF Group 2022/23
	£000	£000
Brought forward	13,848	16,385
Benefits paid	(67)	(124)
Interest income on Fund assets	293	464
Contributions by employer	716	814
Contributions by member	279	343
Other gains / (losses)	-	-
Return on assets excluding amounts included in net interest	1,316	22
Balance at year end	**16,385**	**17,904**

Amounts recognised in the Fund Account

	LPF Group 2021/22	LPF Group 2022/23
	£000	£000
Interest received on Fund assets	(293)	(464)
Interest cost on Fund liabilities	418	576
Current service costs	1,813	1,930
Past service costs	59	-
Employer contributions	(716)	(814)
Actuarial gain/(loss) due to re-measurement of defined benefit obligation	(1,980)	(9,570)
Return on Fund assets (excluding interest above)	(1,316)	(22)
Net cost recognised in Fund Account	**(2,015)**	**(8,364)**

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

29 Retirement benefits obligation - group (cont)

Principal actuarial assumptions used in this valuation	31 March 2022	31 March 2023
	% p.a.	% p.a.
Inflation / pensions increase rate	3.2	3.0
Salary increase rate	3.7	3.5
Discount rate	**2.8**	**4.8**

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's 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's 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 2021 model, with a 10% weighting of 2021 (and 2020) data, standard smoothing (Sk7), initial adjustment of 0.25% 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 2022		31 March 2023	
	Male	Female	Male	Female
Current pensioners	20.3 years	23.1 years	19.9 years	22.9 years
Future pensioners	21.6 years	25.0 years	21.2 years	24.7 years

Expected employer contributions to the defined benefit plan for the year ended 31 March 2024 are £814k, based on a pensionable payroll cost of £4,499k.

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 2022	31 March 2023
	£000	£000
Outstanding investment commitment	262,578	294,486
	262,578	**294,486**

Office accommodation - 144 Morrison Street, Edinburgh

The Fund is committed to making the following future payments.

	31 March 2022	31 March 2023
	£000	£000
Within one year	118	118
Between one and five years	355	355
After five years	311	193
	784	**666**
Recognised as an expense during the year	**95**	**95**

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

31 Contingent assets and liabilities

Contribution refunds

At 31st March 2023, Lothian Pension Fund had £1,878k (2022: £1,659k) in unclaimed refunds due to members.

Co-investment deal abort costs

At 31 March 2023 the Fund had entered into negotiations for a private debt investment which it is exposed to the potential risk of investment abort costs. Lothian Pension Fund's exposure to this is approximately £2k.

Employer cessations

As stated in note 23, "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 2023, such contingent assets of the Fund totalled £3,622k and the fund has secured first ranking security over two employer property assets and second ranking security over a further 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. Claims with a value of £4.9m related to Manufactured Overseas Dividends have been removed from the outstanding claims. The remaining claims relate to "Fokus Bank". 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 £5.4m. To date, the amount of tax recovered exceeds the cost of pursuing claims. Legal costs are shared across a pool of claimants and the Fund has the right to cease participation without incurring further costs. An annual progress report is provided to Pensions Audit Sub-Committee.

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 staff to receive an assessed percentage of their salary as an additional variable pay award if they meet certain objectives during the year. The assessment year runs from 1 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 2022/23 year, payment two for the 2021/22 year and payment three for the 2020/21 year were made in January 2023. A liability has been raised at 31 March 2023 for the two months of service for the second and third instalment of 2022/23 and third instalment of 2021/22 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 2022 remain in the company's employment there's a contingent liability of £511,423 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'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 the consultation

It's anticipated that rectification regulations should come into force from the start of October 2023.

The Fund's IAS26 reporting from its actuary, as disclosed in Note 22, takes into account the appeal decision and the proposed remedy.

LOTHIAN PENSION FUND NOTES TO THE FINANCIAL STATEMENTS

Guaranteed Minimum Pension (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 between 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 the Fund is awaiting further guidance before taking any further action.

Contingent Value Right (CVR)

Following the take-over and delisting of one of the Fund's holdings in Abiomed by Johnson & Johnson in 2022 the Fund received a cash payment and one CVR with the entitlement of up to $35 per share if certain commercial and clinical milestones are achieved in the future. The CVR is unlisted and non-tradeable.

The CVR is held at a valuation of zero within the portfolio and the Fund would receive £166.7k if the milestones are achieved.

32 Impairment losses

	2021/22	2022/23
	£000	£000
Bad Debt provision	370	361

During the year the Fund recognised impairment losses in respect of cessation contributions for a specific employer (Freespace).

Freespace voluntarily exited the Fund on 31 March 2020. An exit debt of £390,000 was identified by the actuary. Discussions took place with the company on repayment of exit debt and it was agreed that an initial payment of £75,000 would be made by Freespace. This was paid in September 2020, however a balance of £315,000 remains unpaid as the company entered liquidation on 22 October 2020.

The Fund submitted a claim to the liquidators (SKSi Limited) and adjudication on claims submitted by creditors was confirmed on 11 April 2023. Dividends to unsecured creditors (including the Fund) were calculated as 19.2p in the pound and therefore the Fund expects to receive £60.4k.

LOTHIAN PENSION FUND ("THE FUND") ACTUARIAL STATEMENT FOR 2022/23

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 September 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;
- to maximise the returns from investments within reasonable and considered risk parameters, and hence minimise the cost to the employer;
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment;
- to help employers manage their pension liabilities; and
- where practical and cost effective, to make allowance for the different characteristics of different employers and groups of employers.

The FSS sets out how the Administering Authority seeks to 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 over 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 2022/23

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 continued to be disrupted by the ongoing war in Ukraine and inflationary pressures, impacting on investment returns achieved by the Fund's assets. High levels of inflation in the UK (compared to recent experience) have resulted in a higher than expected LGPS benefit increase of 10.1% in April 2023. Despite this, the funding level of the Fund is likely to be higher than reported at the previous formal valuation at 31 March 2020 due to the significant rise in interest rates which reduces the value placed on the Fund's liabilities.

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
2 May 2023

LOTHIAN PENSION FUND
LIST OF ACTIVE EMPLOYERS AT 31 MARCH 2023

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	VisitScotland
Midlothian Council	West Lothian College
Scotland's Rural College (SRUC)	West Lothian Council

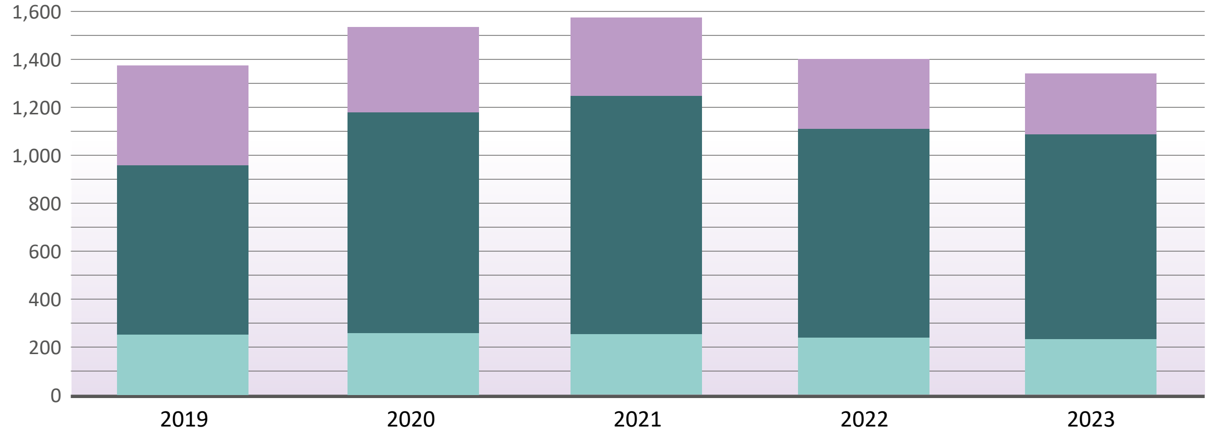
Admitted Bodies	
Audit Scotland	Convention of Scottish Local Authorities
Baxter Storey	Improvement Service (The)
BEAR Scotland	Lothian Buses
Bellrock Property and Facilities Management	LPFE Limited
Canongate Youth Project	Melville Housing Association
Capital City Partnership	Mitie PFI
CGI UK Ltd	Morrison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

LOTHIAN PENSION FUND
LIST OF ACTIVE EMPLOYERS AT 31 MARCH 2023

Admitted Bodies	
Dacoll Limited	Pilton Equalities Project
Edinburgh Development Group	Queen Margaret University
Edinburgh Leisure	Royal Edinburgh Military Tattoo
Edinburgh Napier University	Royal Society of Edinburgh
ELCAP	Scotland's Learning Partnership
Enjoy East Lothian	Scottish Adoption Agency
Family Advice and Information Resource	Scottish Futures Trust
First Step	Scottish Schools Education Research Centre (SSERC)
Forth and Oban Ltd	Skanska UK
Handicabs (Lothian) Ltd	Sodexo Ltd
Health in Mind	St Andrew's Children's Society Limited
Heriot Watt University Students Association	Stepping Out Project
Homes for Life Housing Partnership	University of Edinburgh (Edinburgh College of Art)
Lothian Buses	West Lothian Leisure

SCOTTISH HOMES PENSION FUND INVESTMENT STRATEGY

SCOTTISH HOMES PENSION FUND MEMBERSHIP DATA



	2019	2020	2021	2022	2023
Active	-	-	-	-	-
Deferred	404	360	320	295	262
Pensioner	906	911	898	870	861
Dependant	263	262	252	238	228

Investment strategy

The Fund's last triennial actuarial valuation was dated 31 March 2020, at which point the actuary estimated Scottish Homes Pension Fund’s funding level to be 117.7%, whilst the Fund’s actuary, Hymans Robertson, reported a funding level of 118% in their funding update at 31 March. The Fund continues to have achieved its full funding objective ahead of the timeline originally agreed by the Scottish Government and the City of Edinburgh Council.

As the Fund is closed to new entrants and relatively mature, its objective is to minimise investment shortfall risk of assets relative to liabilities, in line with Scottish Government guidance. The Pensions Committee reaffirmed the following investment objective in June 2021: "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 2023, 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 2022 and 2023 financial years are shown in the table above.

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 inflation-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. The higher allocation to cash is due to the fully funded status of the Fund. As bonds redeem, the cash is reinvested in short-dated bonds, so that this has no impact on the duration matching with the liabilities.

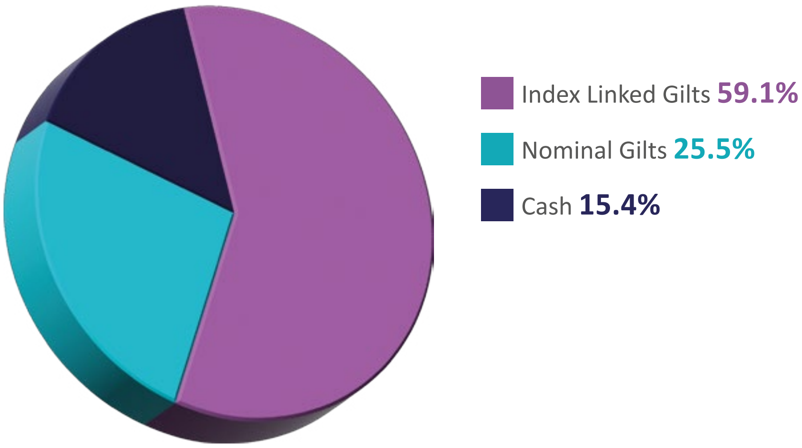
SCOTTISH HOMES PENSION FUND INVESTMENT STRATEGY

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. Hymans Robertson, the Fund's actuary, have stated that the funding level at end March 2023 (the next triennial valuation) is "likely to be fairly similar to that reported at the previous formal valuation".

Following the confirmation of the March 2023 valuation results, the portfolio holdings will be reviewed and rebalanced as required to ensure that they continue to cash flow and duration match the expected liabilities.

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

ACTUAL ASSET ALLOCATION 31 MARCH 2023



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. The cash balance at end March 2023 was equivalent to slightly more than two and a half years' pension payments, an increase on the prior year due to the run-off of maturing bonds.

The fund's assets have declined in value over the year, from £152.0 to £124.6m, due to higher discount rates as the BOE raised rates significantly to address high inflation. Secondly, £7.2m was paid out in pensions over the year. Adjusted for cash flow movements, the underlying assets decreased in value by -13.8% over the year.

As gilts are generally held to maturity and matched with liability payments, short term fluctuations in asset values don't impact the overall strategy. Liability values rise and fall, as they did this year, with asset values.

SCOTTISH HOMES PENSION FUND ACCOUNT FOR YEAR ENDED 31 MARCH 2023

Financial statements

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

2021/22			2022/23
£000		Note	£000
	Income		-
-	Contributions from the Scottish Government	3	-
-	Transfers from other schemes		-
-			
	Less: expenditure		
6,360	Pension payments including increases		6,258
506	Lump sum retirement payments		769
8	Lump sum death benefits		14
-	Transfers to other schemes		17
(38)	Administrative expenses	4b	(35)
6,836			**7,023**
(6,836)	**Net withdrawals from dealing with members**		**(7,023)**
	Returns on investments		
1,923	Investment income	5	1,981
1,683	Change in market value of investments	6, 9b	(22,640)
(98)	Investment management expenses	4c	(88)
3,508	**Net returns on investments**		**(20,747)**
(3,328)	**Net increase/(decrease) in the Fund during the year**		**(27,770)**
157,542	Net assets of the Fund at 1 April 2022		154,214
154,214	**Net assets of the Fund at 31 March 2023**	**9**	**126,444**

SCOTTISH HOMES PENSION FUND
NET ASSETS STATEMENT AS AT 31 MARCH 2023

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

31 March 2022			31 March 2023
£000		Note	£000
	Investment Assets		
139,732	Bonds - UK		104,882
12,291	Cash Deposits		19,273
471	Other investment assets		447
152,494			**124,602**
	Investment Liabilities		
-	Other investment liabilities		-
-			-
152,494	**Net investment assets**	**7**	**124,602**
	Current assets		
183	The City of Edinburgh Council	17	265
1,551	Cash balances	10,15	1,597
1	Debtors	13	7
1,735			**1,869**
	Current liabilities		
(15)	Creditors	14	(27)
(15)			**(27)**
1,720	**Net current assets**		**1,842**
154,214	**Net assets of the Fund**	**9**	**126,444**

The unaudited accounts were issued on 21 June 2023.

Hugh Dunn

Service Director: Finance and Procurement

The City of Edinburgh Council

21 June 2023

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

1 Statement of accounting policies

The statement of accounting policies for all Funds can be found on page 147.

2 Events after the reporting date

There have been no events since 31 March 2023, 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 £24.9million 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 £90,000 per annum for years 31 March 2021 to 31 March 2024. Investment expenses are being met directly from the Fund’s surplus.

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

4a Total management expenses

	2021/22	2022/23
	£000	£000
Administrative costs	(45)	(48)
Investment management expenses	48	47
Oversight and governance costs	59	54
	62	53

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 4b and c and splits out the costs to include a third heading covering oversight and governance expenditure.

4b Administrative expenses

	2021/22	2022/23
	£000	£000
Employee costs	29	29
System costs	11	12
Actuarial fees	1	3
External audit fees	1	1
Printing and postage	3	2
Depreciation	1	2
Office costs	1	1
Sundry costs less sundry income	5	5
	52	55
Administration fee received	(90)	(90)
	(38)	(35)

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, costs that are common to the two Funds are allocated on a defined basis.

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

4c Investment management expenses

	2021/22	2022/23
	£000	£000
Transaction costs	-	-
Employee costs	47	49
Custody fees	4	5
Engagement and voting fees	2	1
Performance measurement fees	-	-
Consultancy fees	10	1
System costs	13	15
Legal fees	2	2
Office costs	2	2
Sundry costs less sundry income	18	13
	98	**88**

The Fund has not incurred any performance-related investment management fees in 2022/23 or 2021/22.

5 Investment income

	2021/22	2022/23
	£000	£000
Income from fixed interest securities	1,921	1,919
Interest on cash deposits and sundries	2	62
	1,923	**1,981**
Irrecoverable withholding tax	-	-
	1,923	**1,981**

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

6 Reconciliation of movement in investments

	Market value at 31 March 2022	Purchases at cost	Sales & proceeds	Change in market value	Market value at 31 March 2023
	£000	£000	£000	£000	£000
Bonds	139,732	27,913	(39,979)	(22,784)	104,882
	139,732	27,913	(39,979)	(22,784)	104,882
Other financial assets / (liabilities)					
Cash deposits*	12,291			144	19,273
Investment income due/amounts payable*	471			-	477
	12,762			144	19,720
Net financial assets	152,494			(22,640)	124,602

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

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

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

	Market value at 31 March 2021	Purchases at cost	Sales & proceeds	Change in market value	Market value at 31 March 2022
	£000	£000	£000	£000	£000
Bonds	140,723	-	(2,670)	1,679	139,732
	140,723	-	(2,670)	1,679	139,732
Other financial assets / (liabilities)					
Cash deposits*	14,906			4	12,291
Investment income due/amounts payable*	461			-	471
	15,367			4	12,762
Net financial assets	156,090			1,683	152,494

** 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

7 Investment managers and mandates

		Market value at 31 March 2022	% of total 31 March 2022	Market value at 31 March 2023	% of total 31 March 2023
Manager	**Mandate**	**£000**	**%**	**£000**	**%**
In-house	Ex-Equity	12	0.01	12	0.01
Total ex-equities		**12**	**0.01**	**12**	**0.01**
In-house	UK Index Linked Gilts	152,482	99.99	124,567	99.97
Total fixed interest and inflation linked bonds		**152,482**	**99.99**	**124,567**	**99.97**
In-house	Cash	-	-	23	0.02
Total cash		**-**	**-**	**23**	**0.02**
Net financial assets		**152,494**	**100.0**	**124,602**	**100.0**

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

	Market value at 31 March 2022	% of total 31 March 2022	Market value at 31 March 2023	% of total 31 March 2023
	£000	**%**	**£000**	**%**
UK Gov 0% T-BILL 26/06/2023	-	N/A	9,903	7.8
UK Gov 2.5% Index Linked 17/07/24	9,253	6.0	9,284	7.3
UK Gov 1.25% Index Linked 22/11/27	9,501	6.2	9,024	7.1
UK Gov 4.125% Index Linked 22/07/30	9,338	6.1	8,456	6.7
UK Gov 4.25% 07/06/32	8,535	5.5	7,309	5.8
UK Gov 0% T-BILL 11/09/2023	-	N/A	6,867	5.4
UK Gov 0.625% Index Linked 22/11/42	8,336	5.4	5,886	4.7
UK Gov 1.875% Index Linked 22/11/21	8,470	5.5	-	N/A

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

9 Financial instruments

9a 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's no difference between the carrying value and fair value.

	31 March 2022			31 March 2023		
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	139,732	-	-	104,882	-	-
Cash	-	12,291	-	-	19,273	-
Other balances	-	471	-	-	447	-
	139,732	**12,762**	**-**	**104,882**	**19,720**	**-**
Other assets						
City of Edinburgh Council	-	183	-	-	265	-
Cash	-	1,551	-	-	1,597	-
Debtors	-	1	-	-	7	-
	-	**1,735**	**-**	**-**	**1,869**	**-**
Assets total	**139,732**	**14,497**	**-**	**104,882**	**21,589**	**-**
Financial liabilities						
Other liabilities						
Creditors	-	-	(15)	-	-	(27)
Liabilities total	**-**	**-**	**(15)**	**-**	**-**	**(27)**
Total net assets	**139,732**	**14,497**	**(15)**	**104,882**	**21,589**	**(27)**
Total net financial instruments			**154,214**			**126,444**

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

9b Net gains and losses on financial instruments

	2021/22	2022/23
	£000	£000
Designated as fair value through Fund Account	1,679	(22,784)
Loans and receivables	4	144
Financial liabilities at amortised cost	-	-
Total	**1,683**	**(22,640)**

9c 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.

Level 3

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

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

9c Valuation of financial instruments carried at fair value cont

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 2023
	Level 1	Level 2	Level 3	Total
Investment assets	**£000**	**£000**	**£000**	**£000**
Bonds	-	104,882	-	104,882
Cash deposits	19,273	-	-	19,273
Investment income due/amounts payable	447	-	-	447
Total financial assets	**19,720**	**104,882**	**-**	**124,602**
Investment liabilities				
Payable for investment purchases	-	-	-	-
Total investment liabilities	**-**	**-**	**-**	**-**
Net investment assets	**19,720**	**104,882**	**-**	**124,602**

				31 March 2022
	Level 1	Level 2	Level 3	Total
Investment assets	**£000**	**£000**	**£000**	**£000**
Bonds	-	139,732	-	139,732
Cash deposits	12,291	-	-	12,291
Investment income due/amounts payable	471	-	-	471
Total financial assets	**12,762**	**139,732**	**-**	**152,494**
Investment liabilities				
Payable for investment purchases	-	-	-	-
Total investment liabilities	**-**	**-**	**-**	**-**
Net investment assets	**12,762**	**139,732**	**-**	**152,494**

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

10 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 2020 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 2023 triennial valuation, rebalancing is scheduled to take place early in the new financial year.

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 below sets out the long-term volatility assumptions used by the Fund's investment adviser Isio:

Asset type	Potential price movement (+ or -)
Index-Linked Gilts	11.8%
Fixed Interest Gilts	11.2%
Cash	1.5%

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

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

	Value at 31 March 2023	% of fund	Potential Change +/-	Value on increase	Value on decrease
	£m	%	%	£m	£m
Index-Linked Gilts	73	58.4	11.8%	82	64
Fixed Interest Gilts	32	25.6	11.2%	36	28
Cash	20	16.0	1.5%	20	20
Total [1]	**125**	**100.0**	**12.5%**	**138**	**112**
Total [2]			**9.1%**	**136**	**114**
Total [3]			**1.7%**	**127**	**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

10 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 2023, cash deposits represented £20.9m, 16.5% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2023	Balances at 31 March 2022	Balances at 31 March 2023
Held for investment purposes		**£000**	**£000**
Northern Trust Company - cash deposits	A2	8,935	16,771
UK Short-Term Bills and Notes	Aa3	3,356	2,502
		12,291	**19,273**
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	1,551	1,597
Total cash		**13,842**	**20,870**

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

10 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 2023	Balances at 31 March 2022	Balances at 31 March 2023
Money market funds	**£000**	**£000**	**£000**
Deutsche Bank AG, London	Aaa-mf	58	224
Goldman Sachs	Aaa-mf	41	7
Aberdeen Standard Sterling Liquidity Fund	Aaa-mf	125	58
Bank call accounts			
Bank of Scotland	A1	155	1
Royal Bank of Scotland	A1	7	59
Svenska Handelsbanken	A1	-	73
Notice accounts			
HSBC Bank PLC	A1	155	1
UK Government			
Gilts & T-Bills and UK Government Debt	Aa3	691	240
Supranational Commercial Paper			
European Investment Bank	Aaa	119	-
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa3	200	934
		1,551	**1,597**

[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 2023 was 'Aa3').

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.

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

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

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 isn't 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.

11 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

12 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 £95m (2022 £116m). 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's not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

	31 March 2022	31 March 2023
	% p.a.	% p.a.
Inflation/pensions increase rate	3.20%	2.95%
Discount rate	2.70%	4.75%

Longevity assumptions

The longevity assumptions have changed since the previous IAS26 disclosure for the Fund.

Life expectancy is based on the Fund's VitaCurves with improvements in line with the CMI 2021 model, with a 10% weighting of 2021 (and 2020) data, standard smoothing (Sk7), initial adjustment of 0.5% 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 summarised below:

	31 March 2022		31 March 2023	
	Male	Female	Male	Female
Current pensioners	20.3 years	23.1 years	20.4 years	23.1 years
Future pensioners (assumed to be currently 45)	21.6 years	25.0 years	20.4 years	25.8 years

Commutation assumption

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

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

13 Debtors

	31 March 2022	31 March 2023
	£000	£000
Sundry debtors	1	7
	1	**7**

14 Creditors

	31 March 2022	31 March 2023
	£000	£000
Benefits payable	15	25
Miscellaneous creditors and accrued expenses	0	2
	15	**27**

15 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'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. 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, 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 2022	31 March 2023
	£000	£000
Year end balance of holding account	183	265
	183	**265**

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 2023, the fund had an average investment balance of £1.4m (2022 £1.7m). Interest earned was £31k (2022 £2k).

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

15 Related party transactions cont

	31 March 2022	31 March 2023
Year end balance on treasury management account	**£000**	**£000**
Held for investment purposes	-	-
Held for other purposes	1,551	1,597
	1,551	**1,597**

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 3 (page 126) 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 2023, the Fund was recharged £78k (2022 £76k) for the services of LPFE Limited staff.

Governance

As at 31 March 2023, all members of the Pensions Committee and the Pension Board were members of the Lothian Pension Fund, with the exception of Richard Lamont and Tony Beecher. One member of both the Pensions Committee and the Pension Board is 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

15 Related party transactions cont

During the period from 1 April 2022 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 2022	31 March 2023
	£000	£000
Short-term employee benefits	909	1,281
Post-employment benefits - employer pension contributions	111	119

Key management personnel employed by LPFE had accrued pensions totalling £148,034 (1 April 2022: £134,724) and lump sums totalling £147,429 (1 April 2022: £131,304) at the end of the period. Further details on senior management remuneration can be found within the remuneration report on page 174.

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.

16 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 hadn't 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 hasn't yet published its formal response to its consultation.

SCOTTISH HOMES PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS

It's anticipated that rectification regulations should come into force from the start of October 2023.

The Fund's IAS26 reporting from its actuary, as disclosed in Note 12, takes into account the appeal decision and the proposed remedy.

Guaranteed Minimum Pension (GMP) Equalisation - Lloyds ruling on historic transfers

On 20 November 2022 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 isn't obvious within the judgement that there's to be any blanket exception on the application of this ruling to public sector schemes.

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

17 Contractual commitments

The Fund had no contractual commitments at the year end.

18 Impairment losses

No impairment losses have been identified during the year.

SCOTTISH HOMES PENSION FUND ("THE FUND") ACTUARIAL STATEMENT FOR 2022/23

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 September 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 8 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 set out in its FSS.

SCOTTISH HOMES PENSION FUND ("THE FUND") ACTUARIAL STATEMENT FOR 2022/23

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 inflation (RPI) curve less 0.9% p.a.

SCOTTISH HOMES PENSION FUND ("THE FUND") ACTUARIAL STATEMENT FOR 2022/23

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 risen, reducing the value of the liabilities and the assets held by the Fund. As a result, the funding level of the Fund as at 31 March 2023 is likely to be fairly similar to 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 2023

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 2022/23 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 2022/23 financial year and report on the net assets available to pay pension benefits as at 31 March 2023. 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.

The Financial Statements are prepared on the going concern basis, which provides that the Funds will continue in operational existence for the foreseeable future. The basis is on the grounds that there's sufficient funding available to the Funds to support the anticipated continuation of the provision of services.

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.

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.

ACCOUNTING POLICIES AND GENERAL NOTES

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 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.

ACCOUNTING POLICIES AND GENERAL NOTES

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 IFRS 16, lease incentives are recognised as a reduction in the lease expense over the term of the lease on a straight-line basis.

Net Assets Statement

j) Financial assets

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

The values of investments as shown in the Net Assets Statement have been determined at fair value in accordance with the Fund's Investment Valuation Policy. The Policy is designed to provide a framework for LPF's investment valuation process as determined by the Investment Valuation Group, which has been given delegated authority from the Chief Executive Officer of the Fund.

The Fund's Investment Valuation Group reviews the valuation process for all investments on an annual basis, including the application of appropriate valuation standards, based on the input of LPF's Investment Management team. Group members consist of the Fund's Portfolio Managers, Finance Managers, and Risk Managers.

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.

LOTHIAN
PENSION FUND

OUTSTANDING SERVICE

'I was nervous about deferring my pension, but everyone I spoke to was very patient and understanding and talked me through the process. Thank you for your support."

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 -	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 /	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 CBRE Ltd in accordance with RICS Red Book Global Valuation Standards (introduced with effect from 31 January 2022).	Existing lease terms and rentals. Independent market research.	Not required
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 in consultation 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 2023.

Lothian Pension Fund	Assessed Valuation range (+ or -)	Value at 31 March 2023	Value on increase	Value on decrease
Unquoted		**£m**	**£m**	**£m**
Private Equity	26.0%	108	137	80
Infrastructure	12.0%	1,324	1,483	1,165
Timber	18.0%	111	131	91
Private Secured Loans	10.5%	420	464	376
Property	13.0%	488	551	424
		2,451	**2,766**	**2,136**

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

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

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

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

n) Actuarial present value of promised retirement benefits
The actuarial present value of promised retirement benefits of each of the Fund is assessed on an annual

ACCOUNTING POLICIES AND GENERAL NOTES

basis by the Scheme Actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

As permitted under IAS26, the Fund has 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 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 aren't 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 isn't 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 aren't recognised in the Net Assets Statement but are disclosed by way of narrative in the notes.

q) Employee benefits

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

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

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

ACCOUNTING POLICIES AND GENERAL NOTES

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 2022/23 Code:

The Code requires implementation from 1 April 2023 and there is therefore no impact on the 2022/23 financial statements.

- IAS 8 Definition of Accounting Estimates
- IAS 1 and IFRS Practice Statement 2 Disclosure of Accounting Policies
- IAS 12 Deferred Tax related to Assets and Liabilities arising from a Single Transaction
- IFRS 13 Reference to the Conceptual Framework

The amendments are generally minor or principally providing clarification. Overall, these new or amended standards aren't 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 (IPEV) 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 2023 was £1,712m (2022 £1,344m).

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 2023 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 as follows:

Change in assumptions – year ended 31 March 2023	Approx Increase in liabilities %	Approx monetary amount £m
0.1% p.a. decrease in the Discount Rate	2%	131
1 year increase in member life expectancy	4%	279
0.1% p.a. increase in Salary Increase Rate	0%	13
0.1% p.a. increase in Pensions Increase Rate (CPI)	2%	120

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

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

Change in assumptions – year ended 31 March 2023	Approx Increase in liabilities %	Approx monetary amount £m
0.1% p.a. decrease in the Discount Rate	1%	1
1 year increase in member life expectancy	4%	4
0.1% p.a. increase in Pensions Increase Rate (CPI)	1%	1

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 won't change the reported net change in the Fund for the year.

STATEMENT OF RESPONSIBILITIES FOR THE ANNUAL ACCOUNTS

The responsibilities of the Administering Authority

The Administering Authority's responsibilities 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.

I confirm that these Unaudited Annual Accounts were approved for signature by the Lothian Pension Fund Committee at its meeting on 21 June 2023.

Hugh Dunn
Service Director: Finance and Procurement
The City of Edinburgh Council
21 June 2023

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 2022/23 (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 2023.

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 legislation and the Local Authority Accounting Code (in so far as it is compatible with legislation)

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.

I certify that the financial statements give a true and fair view of the financial position of the Pension Fund as at 31 March 2023 and the transactions of the Pension Fund for year ended 31 March 2023.

Hugh Dunn
Service Director: Finance and Procurement
The City of Edinburgh Council
21 June 2023

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 (Administering Authority). This responsibility is for two separate Funds: the Lothian Pension Fund and Scottish Homes Pension Fund (the Fund). Responsibility for the oversight and management of those funds is delegated to a governance structure in order to satisfy the requirements of relevant pensions and investment legislation and to ensure best practice.

Oversight bodies: 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 Fund's governance structure must also adhere to the Local Government Pension Scheme (Governance)(Scotland) Regulations 2015. The oversight of the Funds is therefore carried out via:

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

Corporate group: The Lothian Pension Fund group comprises the investment and pensions team employed by LPFE Limited (LPFE) and LPFI Limited (LPFI), the Group's regulated investment vehicle (together the LPF Group). Both companies are wholly owned by the Administering Authority.

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.

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 focussed 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 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 has a few remaining services on which it relies from the Administering Authority. 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 overall assurance stack. However, the Fund also seeks specialist external input in order to provide effective assurance around its financial services, investments and pensions specific business.

The LPF Group also currently 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.

Following the establishment of the wholly-owned subsidiary companies, LPFE and LPFI, the Administering Authority continues to have appropriate assurance processes and procedures around the administration of those companies and the wider LPF Group administering the Fund.

ANNUAL GOVERNANCE STATEMENT

Review of affectiveness

The Local Code of Governance details the Administering Authority's arrangements for monitoring each element of the framework and providing evidence of compliance.

The Chief Internal Auditor provides an annual assurance statement on the effectiveness of the system of internal control. The internal audit represents only one aspect of the LPF Group's oversight and assurance arrangements, which also includes work undertaken by LPF's Risk & Compliance team as well as other external assurance providers to support and complement existing internal activities. These assurance activities cover oversight of the group's systems and controls, including FCA regulated compliance and other regulatory frameworks. In addition, the Chief Finance Officer of the LPF Group provides a statement of the effectiveness of the internal financial control system for the year ended 31 March 2023 for the Fund.

These forms of monitoring and oversight continue to provide the Pensions Committee, Pension Board and boards of LPFE and LPFI with good levels of assurance and broad coverage of the group's activities. Where these activities have identified any weaknesses and enhancements, appropriate action plans have been agreed to make improvements where required.

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 2022 to 31 March 2023 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
- **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
- **Third line:** to review the structure and effectiveness of its internal audit assurance
- **Data security:** we achieved Cyber Essentials and Cyber Essentials+ accreditation in April 2023. Cyber Essentials is a UK Government backed scheme, overseen by the National Cyber Security Centre, designed to show that an organisation has a good level of protection in cyber security
- **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 from the Administering Authority is supported in a manner consistent with those duties.

The LPF Group will continue to ensure that these are treated as a priority and that progress towards implementation will be reviewed through the governance structures and processes established for the LPF Group and summarised herein.

ANNUAL GOVERNANCE STATEMENT

David Vallery
Chief Executive Officer
Lothian Pension Fund
21 June 2023

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 2023 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. **with the exception of consideration of a proposed merger with LPF and Falkirk Council Pension 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 currently delegated from the Pensions Committee to the Service Director: Finance and Procurement, 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 one 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).	✔	Our current Independent Professional Observer (IPO) was appointed in August 2018. The appointment was extended in August 2021 for a further two years. The IPO helps Committee scrutinise advice.

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 February 2017 and LPFE on March 2018, being reappointed in January 2021, with a further two-year reappointment being approved in March 2023 to both LPFE and LPFI Boards. A further non-executive director was appointed to the board of LPFI on January 2021 and LPFE on February 2021 with a two-year reappointment being approved in March 2023 to both LPFE and LPFI Boards. 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) is 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.
	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. From 2023 the LPFE and LPFI boards meet at least four times a year (in February, June, September and December).
	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. From June 2023 the papers and minutes will be available on the Council's website via a link to the LPF website. 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.

David Vallery

Chief Executive Officer

Lothian Pension Fund

21 June 2023

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 2023 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 2023 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	2021/22	2022/23	Remuneration Bands	2021/22	2022/23
£50,000 - £54,999	1	3	£140,000 - £144,999	2	-
£55,000 - £59,999	-	4	£145,000 - £149,999	1	-
£60,000 - £64,999	1	1	£150,000 - £154,999	-	2
£65,000 - £69,999	2	4	£155,000 - £159,999	-	2
£70,000 - £74,999	-	-	£160,000 - £164,999	3	1
£75,000 - £79,999	2	1	£165,000 - £169,999	-	3
£80,000 - £84,999	1	2	£170,000 - £174,999	-	-
£85,000 - £89,999	-	-	£175,000 - £179,000	1	-
£90,000 - £94,999	-	1	£180,000 - £184,999	-	-
£95,000 - £99,999	-	-	£185,000 - £189,999	-	-
£100,000 - £104,999	1	1	£190,000 - £194,999	-	-
£105,000 - £109,999	-	1	£195,000 - £199,999	-	-
£110,000 - £114,999	2	-	£200,000 - £204,999	-	-
£115,000 - £119,999	1	1	£205,000 - £209,999	-	-
£120,000 - £124,999	-	-	£210,000 - £214,999	-	1
£125,000 - £129,999	-	-	£215,000 - £219,999	-	-
£130,000 - £134,999	1	-	£220,000 - £224,999	-	-
£135,000 - £139,999	2	-	£225,000 - £229,000	-	1
			Total No. of Employees	**21**	**29**

REMUNERATION REPORT

EMPLOYEES REMUNERATION

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

	Total Remuneration 2021/22	Salary, Fees and Allowances	Variable Remuneration	Total Remuneration 2022/23
Name and Post Title	**£000**	**£000**	**£000**	**£000**
David Vallery, Chief Executive Officer (from June 2021)	114	181	47	228
Bruce Miller, Chief Investment Officer	176	154	60	214
Struan Fairbairn, Chief Risk Officer (to September 2022)	138	57	-	57
Kerry Thirkell, Chief Risk Officer (from August 2022)	-	91	13	104
John Burns, Chief Finance Officer (resigned May 2023)	132	117	45	162
Karlynn Sokoluk, Chief Operating Officer (from November 2022)*	-	106	9	115
Helen Honeyman, Chief People Officer	112	114	44	158
Total	**719**	**820**	**218**	**1,038**

**Karlynn Sokoluk was employed as Head of Services from April 2022 to November 2022*

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 2022/23 along with the Senior Management variable remuneration for 2022/23 and vested payment for the previous two assessment years. This is split as follows:

	Company Variable Remuneration 2022/23	Senior Management Variable Remuneration			Total Variable Remuneration 2022/23
		2021 Payment 3	2022 Payment 2	2023 Payment 1	
Name and Post Title	**£000**	**£000**	**£000**	**£000**	**£000**
David Vallery, Chief Executive Officer	15	-	11	21	47
Bruce Miller, Chief Investment Officer	13	14	16	17	60
Kerry Thirkell, Chief Risk Officer (from August 2022)	5	-	-	8	13
John Burns, Chief Finance Officer (resigned May 2023)	8	11	12	14	45
Karlynn Sokoluk, Chief Operating Officer (from November 2022)	8	-	-	1	9
Helen Honeyman, Chief People Officer	10	9	11	14	44
Total	**59**	**34**	**50**	**75**	**218**

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

	Total Remuneration 2021/22	Salary, Fees and Allowances	Variable Remuneration	Total Remuneration 2022/23
Name and Post Title	**£000**	**£000**	**£000**	**£000**
Andrew Imrie, Portfolio Manager	164	116	51	167
Stewart Piotrowicz, Portfolio Manager	162	114	52	166
Ian Wagstaff, Portfolio Manager	164	116	51	167
Albert Chen, Portfolio Manager	143	106	47	153
Ross Crawford, Portfolio Manager	145	104	47	151
Nicola Barrett, Portfolio Manager	150	107	51	158
Total	**928**	**663**	**299**	**962**

REMUNERATION REPORT

The variable remuneration shown on the previous page includes the Company variable remuneration for 2022/23 along with the Portfolio Manager variable remuneration for 2022/23 and vested payment for the previous two assessment years. This is split as follows:

	Company Variable Remuneration 2022/23	Portfolio Manager Variable Remuneration			Total Variable Remuneration 2022/23
		2021 Payment 3	2022 Payment 2	2023 Payment 1	
Name and Post Title	**£000**	**£000**	**£000**	**£000**	**£000**
Andrew Imrie, Portfolio Manager	9	13	15	14	51
Stewart Piotrowicz, Portfolio Manager	9	13	15	15	52
Ian Wagstaff, Portfolio Manager	9	13	15	14	51
Albert Chen, Portfolio Manager	10	11	13	13	47
Ross Crawford, Portfolio Manager	10	11	13	13	47
Nicola Barrett, Portfolio Manager	11	12	14	14	51
Total	**58**	**73**	**85**	**83**	**299**

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 2023 remain in the company's employment is as follows:

	Payable January 2024		Payable January 2025
	2022 Payment 3	2023 Payment 2	2023 Payment 3
	£000	**£000**	**£000**
Senior Employee Variable Remuneration	46	71	71
Portfolio Manager Variable Remuneration	104	112	112
Employer National Insurance Contribution	21	25	25
Total	**171**	**208**	**208**

The amounts payable for senior employee variable remuneration over the next two years exclude amounts previously calculated for Struan Fairbairn in respect of performance in 2020/21 and 2021/22 following his resignation from LPFE in March 2022, and subsequent foregoing of vested variable pay.

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 2022/23 were as follows:

Pensionable Pay (2022/23)	Rate (%)
On earnings up to and including £23,000 (2021/2022 £22,300)	5.5%
On earnings above £23,001 and up to £28,100 (2021/2022 £22,300 to £27,300)	7.25%
On earnings above £28,101 and up to £38,600 (2021/2022 £27,300 to £37,400)	8.5%
On earnings above £38,601 and up to £51,400 (2021/2022 £37,400 to £49,900)	9.5%
On earnings of £51,401 and above (2021/2022 £49,900)	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	
	2021/22	2022/23		As at 31 March 2023	Increase from 31 March 2022
Name and Post Title	**£000**	**£000**		**£000**	**£000**
David Vallery, Chief Executive Officer (from June 2021)	12	14	Pension	-	-
			Lump Sum	-	-
Bruce Miller, Chief Investment Officer	24	4	Pension	38	1
			Lump Sum	33	-
Struan Fairbairn, Chief Risk Officer (to September 2022)	19	10	Pension	18	2
			Lump Sum	-	-
Kerry Thirkell, Chief Risk Officer (from August 2022)	-	16	Pension	-	-
			Lump Sum	-	-
John Burns, Chief Finance Officer (resigned May 2023)	18	15	Pension	58	11
			Lump Sum	99	15
Karlynn Sokoluk, Chief Operating Officer (from November 2022)	-	21	Pension	-	-
			Lump Sum	-	-
Helen Honeyman, Chief People Officer	16	22	Pension	7	3
			Lump Sum	-	-
Total	**89**	**102**		**253**	**32**

REMUNERATION REPORT

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	
	2021/22	2022/23		As at 31 March 2023	Increase from 31 March 2022
Name and Post Title	£000	£000		£000	£000
Andrew Imrie, Portfolio Manager	22	23	Pension	36	6
			Lump Sum	17	-
Stewart Piotrowicz, Portfolio Manager	22	23	Pension	29	5
			Lump Sum	-	-
Ian Wagstaff, Portfolio Manager	22	23	Pension	27	4
			Lump Sum	-	-
Albert Chen, Portfolio Manager	20	21	Pension	13	3
				-	-
Ross Crawford, Portfolio Manager	20	21	Pension	11	3
				-	-
Nicola Barrett, Portfolio Manager	21	22	Pension	9	3
				-	-
Total	**127**	**133**		**142**	**24**

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 2022/23 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
- Statement of Responsible Investment Principles
- Communications Strategy
- Funding Strategy Statement
- Strategy and Business Plan 2022/23
- Training and Attendance policy

Fund advisers

Actuaries:	Hymans Robertson LLP, Exchange Place 1, Semple Street, Edinburgh, EH3 8BL
Auditors	Azets, Exchange Place 3, Semple Street, Edinburgh, EH3 8BL
Bankers:	Royal Bank of Scotland, 36 St Andrew Square, Edinburgh, EH2 2YB
Strategic advisers:	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 M&G Corporate Services Limited, 10 Fenchurch Avenue, London EC3M 5AG.
Property valuations:	CBRE Ltd Valuation & Advisory Services, Henrietta House, 8 Henrietta Place, London W1G 0NB
Property Management and Property Fund Accounting:	Jones Lang LaSalle Limited: 30 Warwick Street, London, W1B 5NH
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 audio CD, in Braille and large print if you ask us. Please contact Interpretation and Translation Service (ITS) on its@edinburgh.gov.uk and quote reference number XXXX. 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

PO Box 24158,
Edinburgh EH3 1GY

Phone: 0333 996 1900
Email: pensions@lpf.org.uk
Web: www.lpf.org.uk

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 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 Team (CLT) agendas, with progress in implementation also regularly reported to the Governance, Risk and Best Value Committee. Progress in implementation of recommendations resulting from the external audit process is likewise reported to elected members.

3. In view of successive years' staffing reductions and various resulting changes in responsibilities, previous self-attestation exercises undertaken have been helpful in assessing the extent to which improvements have 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 Corporate Services Directorate (where the majority of finance-related controls lie), by quarterly Service Performance and Assurance meetings and discussion at the Corporate Services Management Team 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 October 2022 (as part of the Council's Annual Audit). This assessment did not result in the identification of any significant weaknesses in these systems, albeit scope for improvement in the Council's payroll processes and controls was highlighted.

5. As with other systems across the Council, some aspects of the financial control framework have had to be adapted to a continuing home-working environment but with the emphasis consistently being on obtaining assurance in a different way rather than compromising or relaxing existing controls. Specific contingency plans had previously 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 and continuing offsite working and performance against a range of key targets in these areas has largely been maintained.

6. There remain, nonetheless, inherent risks within the Council's activities. Unsuccessful attempts to defraud the Council through a fictitious change of supplier details were made in December 2022, leading to updates in current procedures and refresher training being provided.

Risks included within Council risk register

7. A number of specific finance- and procurement-related risks linked to the COVID-19 emergency (and corresponding mitigating actions) were identified for inclusion in the Council Incident Management Team (CIMT) Risk Management Plan and actively monitored during 2021/22. While these COVID-specific risks have lessened somewhat, the Financial and Budget Management risk within the Council's Risk Report remains rated as high and outside the Council's current moderate risk appetite. This is mainly due to the impact of exceptional inflationary pressures alongside reduced resources and limited options identified for immediate savings. The Council also has a share of the substantial budget gap within the Edinburgh Integration Joint Board (EIJB). In light of these risks, the Council is developing a Medium-term Financial Plan (MTFP), albeit the related savings required to bridge these gaps remain at a formative stage. Development of robust and sustainable savings sufficient to bridge the immediate 2024/25 gap and make significant inroads into future years' requirements will therefore be a key priority in the coming months, particularly as I will be retiring at the end of September 2023.

Implementation of Internal Audit recommendations

8. The Finance Division has also taken forward, or embedded, a number of specific audit actions during the year, including the creation and maintenance of a shadow ICT register, improved contract management arrangements for high-risk contracts, enhanced financial systems training and improved oversight and consistency across a range of financial models, including a half-yearly, risk-based peer review. Finance colleagues are also working closely with relevant colleagues elsewhere within Corporate Services in implementing the recommendations of recent audits in the areas of payment card industry data security and purchase cards.

9. A review of the Council's capital budget-setting and management processes undertaken in early 2022 concluded that current arrangements were effective. A report on the procedures and processes for administration of the Transfer of the Management of Development Funding (TMDF) Grants also found these to be effective.

10. More recently, an internal audit examining procedures for Housing Revenue Account budget-setting and monitoring noted a number of positive aspects. In January 2023, the Council's preparations for implementation of the IFRS16 leasing standard were also favourably assessed.

11. The key findings and recommendations arising from a review of the Council's most recent budget-setting process will be reported to the Finance and Resources Committee of 20 June 2023 and Finance staff will work with relevant colleagues in taking any improvement actions forward. A Financial Management customer survey based on the CIPFA FM Code has also recently been completed and will be used to agree and implement improvement actions.

12. Progress in implementing internal audit 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 arrangements to track progress also in place.

13. As part of the Accounts Commission's national studies, an assessment of the Council's arrangements for the prevention and detection of fraud in procurement was also reported in May 2020 . 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

14. 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 2022/23, the section reported to the Head of Legal and Assurance. It also has, however, unfettered access to the Chief Executive, Executive Directors, Service Directors (including the Service Director: Finance and Procurement) and elected members of the Council when required.

15. The Head of Internal Audit will present an 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 September 2023. In line with the equivalent 2021/22 opinion, in-year progress reports on audit action implementation and internal audits newly undertaken, this is anticipated to consolidate recent improvements, albeit with further actions still required. 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

16. 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 continuing homeworking, 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. This reporting frequency was relaxed somewhat in 2022/23, albeit still at an enhanced level relative to pre-COVID periods;

- **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 revenue outturn. Thanks to savings in corporate budgets, a provisional in-year underspend of £13.7m was achieved, alongside not requiring to draw down planned levels of reserves to offset in-year COVID-related impacts. While acknowledging that the majority were in corporate budgets, approved savings delivery in 2022/23 was some 98%, the highest level achieved since these have been actively tracked;
- **clearly defined capital and other expenditure guidelines** communicated to services and set out in the Finance Rules which were refreshed in May 2023. The Financial Regulations were also reviewed and minor amendments to their content made in May 2023;
- a **five-year revenue budget framework and ten-year capital strategy** approved by Council in February 2023. The Council's Best Value Assurance Review encouraged the Council, once the recurring impacts of the pandemic became clearer, to continue to look at opportunities to adopt medium- to longer-term financial planning. To this end, an update on the development of the Council's Medium-Term Financial Plan will be reported to the Finance and Resources Committee on 20 June;
- **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. 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 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. These meetings continue, albeit on a revised frequency.

17. 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.

18. 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, as in previous years, **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**.

19. 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 to be to consolidate these improvements, identify any further required actions and gain necessary assurance by regularly assessing their effectiveness. These arrangements have been thoroughly tested both during the COVID pandemic and amidst continuing home-working and, across the piece, have performed well although there is always room for improvement.

CIPFA Financial Management Code

20. 2022/23 marks the second year of implementation of the requirements of 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.

    A focus has been maintained to embed improvements introduced through the 2021/22 and 2022/23 budget processes including:

    - maintaining an increased level of unallocated general reserve;
    - incorporating explicit revenue budget provision for underlying service pressures including temporary accommodation for homeless households;
    - continuing to reflect the ongoing impacts of the pandemic, particularly for losses of income; and
    - earlier publication of the schedule of proposed fees and charges for 2023/24.

21. Improvements introduced for the 2023/24 budget process include the following:

    - progress in the identification of service revenue budget savings, with £13.4m of new service savings options approved in setting a balanced revenue budget for 2023/24;
    - improved financial performance in service revenue budgets with the provisional outturn for 2022/23 showing services delivered within the approved revenue budgets across the Place, Children, Education and Justice Services and Corporate Services Directorates;

- the establishment of a formal change programme is underway to support the development of the Council's Medium-Term Financial Plan. The Year 1 focus will include the Social Care Operating Model, Inclusion Services and the HR/Pay Core System. The MTFP remains at a formative stage and the Council's Leadership Team, supported by service managers, will need to develop realistic and robust savings options to address projected medium-term funding gaps.

22. Further initiatives are completed or underway to support my assessment and further strengthen financial management arrangements including:

    - positive outcomes from Internal Audit reviews of financial management arrangements for both the Council's Capital Investment Programme and Housing Revenue Account;

    - a Financial Management customer survey has recently been completed based on the CIPFA FM Code and will be used to agree and implement improvement actions. Areas for development are likely to include greater use of benchmarking and other techniques to assess the value for money of services and to identify opportunities for improvement; and development of training necessary to support budget management including training in the use of core financial management systems.

    - updated Financial Management guidance is being finalised and will incorporate additional guidance on the Capital Investment Programme and Housing Revenue Account.

    - business cases to recruit additional professional accounting staff have been approved to recognise additional workload, risk and complexity relating to the Council's Capital Investment Programme and areas of the revenue budget including Housing, Refugee Support and Homelessness. Adequate resourcing of the Finance function will be a prerequisite for continued compliance with the requirements of the FM Code going forward.

23. 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 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.

24. While the above position reflects a number of positive aspects, I have continued to impress upon all elected members and CLT the need for additional savings proposals to be brought forward if the Council's financial sustainability is to be maintained.

25. The urgent need to initiate a structured medium to longer-term savings programme was also highlighted in both the Council's Best Value Assurance Report and the external auditor's report for 2021/22 and while I am somewhat disappointed at the time it has taken to initiate this programme, relevant work is now underway. Given the extent of the financial challenge, members will need to make increasingly difficult choices about the Council's priorities, including considering service reductions, across all service areas to maintain expenditure in line with available income.

26. In addition to the Council's own activities, I have 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.

27. 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 continue to be taken forward with CLT colleagues.

Hugh Dunn
Service Director: Finance and Procurement
2 June 2023

This page is intentionally left blank

Appendix 3

Annual Report 2023
of
Lothian Pension Fund
and
Scottish Homes Pension Fund

"Statement on the system of internal financial control

for the year ended 31 March 2023"

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". Service Director: Finance and Procurement 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.

In compliance with standard accounting practice, the Section 95 Officer, 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 2023.

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" APPROVED by Hugh Dunn, Service Director: Finance and Procurement, City of Edinburgh Council, dated June 2023, 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, other public service pension schemes and private sector 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. Based on audit reviews undertaken and liaison with the Chief Internal Auditor to-date, 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.

Hugh Dunn
Service Director: Finance and Procurement
2 June 2023

Pensions Committee

2.00pm, Wednesday, 21 June 2023

Statement of Investment Principles

Item number 6.5

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 adopt the revised Statement of Investment Principles.

David Vallery
Chief Executive Officer, Lothian Pension Fund

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

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

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 2022.

2.2 The investment strategies approved by the Committee in June 2021 are detailed in Appendix A.

2.3 There is one material change to the SIP – the removal of the actual portfolio allocations, which were previously contained in Appendix B. These are reported to the Committee in the Annual Investment Update, which is item 6.6 on the agenda.

2.4 There are other minor changes to update dates and asset percentages where these have changed, but there are no changes to the principles themselves.

2.5 The Joint Investment Strategy Panel (JISP) reviewed and recommended approval of the revised SIP (which is presented with changes in Appendix 1) in June 2023.

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 2022, the JISP confirmed its belief that the SIP satisfies Committee's statutory duty and is an accurate reflection of current advice.

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. The investment strategies, presented in Appendix A, have not changed since June 2021.

4.3 Appendix B of the SIP that Committee approved in June 2022 presented the changes to investment strategy implementation over the year ending 31 March 2022. It is proposed that Appendix B is removed from the document as it duplicates the table presented in section 4 of the Annual Investment Update, which is deemed a more appropriate place to report on the annual change of investment exposures.

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 (21 June 2023)
- Appendix B – UK Stewardship Code 2020 - Principles
- Appendix C – Statement of Compliance with the CIPFA Principles for Investment Decision Making in the Local Governance Pension Scheme

LOTHIAN
PENSION FUND

STATEMENT OF
INVESTMENT PRINCIPLES
JUNE 2023

INTRODUCTION

This Statement of Investment Principles (SIP) describes the objectives, policies and principles adopted by the Pensions Committee (Committee) of the City of Edinburgh Council (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.

The SIP was agreed by the Pensions Committee (Committee) of the City of Edinburgh Council (CEC) on 21 June 2023. CEC is the administering authority for the Lothian Pension Fund and Scottish Homes Pension Fund (the Funds).

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.

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.

GOVERNANCE

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.

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.

Responsibility for implementing the strategy is also 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.

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.

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

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/.)

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.

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.

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.

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

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.

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'd like to minimise the fluctuations in contributions and on the other hand, they'd 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

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.

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).

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.

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.

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.

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.

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.

RESPONSIBLE INVESTMENT

With liabilities extending decades into the future, it's 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.

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's 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.

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting, and Appendix C lists the principles of the FRC's voluntary Stewardship Code 2020. To become a signatory to the Code, organisations must submit a Stewardship Report to the FRC demonstrating how they have applied the Code's principles. The Funds submitted a report in October 2021, which met the high stewardship standards that the FRC sets. The Funds' Stewardship Report is published as a standalone document.

FUNDS' OBJECTIVES

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

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

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

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.

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).

- **LDI** are gilts, which 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 Index Linked Gilts 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.

- **Cash** 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.

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

FUNDS' STRATEGIES

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.

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

- **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 94% of employers' assets are invested in the Main Strategy.

- **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.

- **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. Less than 1% of employers' assets are invested in the 50/50 Strategy.

- **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 5.5% of Fund assets.

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's not practical for the Fund to offer individual employers full flexibility on asset allocation.

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.

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.

STRATEGY IMPLEMENTATION

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.

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.

To reduce the risk that a Fund doesn't 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.

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.

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.

OTHER INVESTMENT CONSIDERATIONS

Realisation of investments

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

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 doesn't 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

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

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

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

COMPLIANCE

Regulations and Investment Limits

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

The Regulations contain limits on the percentage of a pension fund that may be invested in certain asset types. 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

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

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 (21 JUNE 2023)

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 Debts	10%	0-20%
LDI (Formerly Gilts)	10%	0-20%
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 Debts	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.

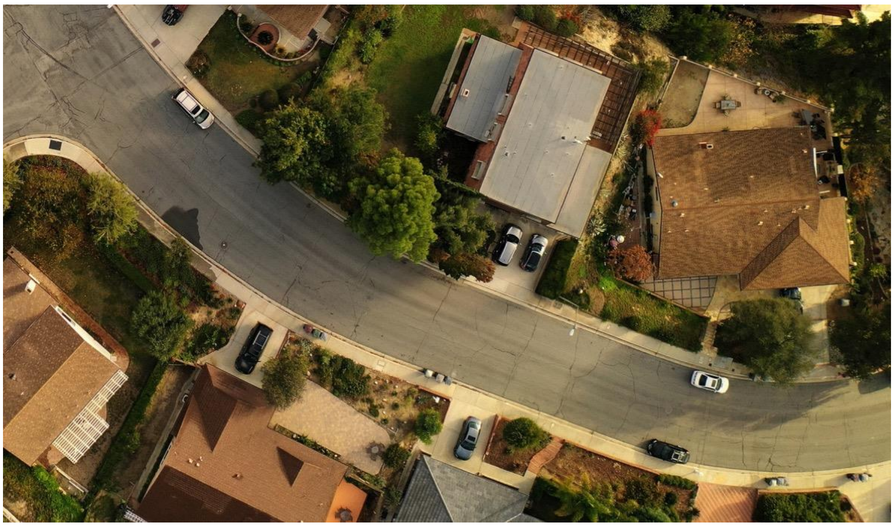
Investment Strategy: to achieve its objective, the Buses Strategy invests in a proportion of the MEG Strategy and the Main Strategy that reflects the maturity of liabilities. This is currently 45:55. Based on the Main Strategy above, the Buses Strategy will have the following exposures.

Policy group	Target weight 2021-2024	Permitted range
Equities	33.0%	28-38%
Real Assets	11.0%	6-16%
Non-Gilt Debt	5.5%	0-11%
LDI (formerly Gilts)	50.5%	40-60%
Cash	0.0%	0-10%
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 – 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 C – 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 a requirement to undertake no less than three days (21 hours) of training in each financial year for all Pensions Committee and Pension Board members) 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's 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 the Statement of Responsible Investment, both of which can be found on the Funds’ website.
- The Funds’ policy on responsible ownership is included in the Stewardship Report, which has been assessed by the Financial Reporting Council, which can be found on the Funds’ website. See Appendix C for a list of the Stewardship Code 2020 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, Statement of Responsible 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 and 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.

This page is intentionally left blank

Pensions Committee

2.00pm, Wednesday, 21 June 2023

Joint Investment Strategy Panel Activity

Item number 6.7

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the activities of the Joint Investment Strategy Panel during the financial year 2022/23.

Bruce Miller,

Chief Investment Officer, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

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 2023, 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 2021. During 2022/23, 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 policy group allocation, manager structure and strategies, benchmarks and performance, portfolio diversification and allocations to private market investments, including infrastructure and corporate loans. For the fully funded Scottish Homes Pension Fund, the JISP continued to monitor the asset-liability matching.

3. Background

3.1 The Heads of Finance/Chief Financial Officers of the Lothian, Falkirk, and Fife Pension Funds operate the JISP to provide strategic investment advice to their Pensions Committees and officers.

3.2 The JISP currently comprises:

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

3.3 The JISP has been operating with two external, independent advisers (Kirstie MacGillivray and Stan Pearson) for almost 18 months since the retiral of the third adviser. During that time, the Heads of Finance/Chief Financial Officers have assessed the effectiveness of the JISP with two advisers rather than three and concluded that the arrangement provides effective advice and support enabling them to implement each of their funds' investment strategies.

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

3.5 The JISP also provides strategic advice on the implementation of strategy for the Fife and Falkirk Pension Funds.

3.6 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 officers at least 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 2022/23 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 Certain items that would be expected to be addressed by Panel regularly and were during 2022/23 included:

- Annual review of investment strategy
- Annual reviews of each policy group, including strategy, portfolio constraints, currency exposures, activity, and risk / return
- Annual reviews of all investment mandates with assessment of strategic fit
- Annual review of all internally managed portfolios by external advisers
- Regular consideration of the financial market regime and its impact on investment strategy
- Internal portfolio development discussions on the equity styles, European equities, cash management and credit
- Investment benchmarking analysis and proposals
- Investment cost benchmarking
- Additional voluntary contribution (AVC) provision
- Assessment of JISP effectiveness
- Stewardship and engagement activities, including annual reviews of Statement of Investment Principles and Statement of Responsible Investment Principles and portfolio carbon monitoring exercise
- Risk management, controls, and regulatory compliance
- Resourcing needs
- The implications of a merger of the Lothian and Falkirk funds

4.5 Other matters are topical and are not necessarily predictable. There were a few of these during 2022/23, which resulted in detailed discussions and consideration by the Panel and officers:

- The acceleration in inflation resulting from the COVID-related monetary and fiscal stimulus
- The political instability in the UK that culminated in a mini-budget with outsized consequences, including three prime ministers in four months and a dramatic spike in real interest rates
- The geopolitical tensions emanating from the war in Ukraine, including the potential impact on Chinese intentions with regards to Taiwan
- The uncertainties of the evolving regulatory and commercial landscape of responsible investment

4.6 Over the year, JISP's activity has resulted in various important outcomes, some of which support officer opinion that the Panel is undertaking its responsibilities diligently and effectively, working between quarterly meetings when required:

- The year was dominated by the spectacular move in bond yields. Following an extended period with a significant underweight exposure to UK gilts, during which they generated deeply negative returns, the JISP responded at short notice to consider, challenge, and ultimately support the internal team's proposal to add to the LDI policy group. In so doing, the Fund was able to take advantage of market weakness and the availability of the first positive real yields in several years.

- The year was also one of notable progress in terms of investing in critical infrastructure assets, several of which will support the energy transition. This is a less liquid asset class, and the investing activity has taken several years to build a diversified portfolio. At end March 2023, the Fund had achieved its targeted position.
- Mandate objectives and controls for each investment portfolio and each policy group were updated after consideration of investment constraints, ESG analysis and risk.
- Shared knowledge of the evolution of the regulatory environment for asset management firms around important issues, such as ESG.
- The advisers provided support and challenge in equal measure to evolve the shape of the equity policy allocation over the coming years. The new internally managed global quality portfolio is now under construction. It is small but assets are expected to gradually increase.
- The JISP provided the independent expertise to aid the governance and oversight of investment activity and investment positioning across all policy groups.
- LPFI increased the assets it manages for partner funds. It now manages two different global equity strategies and two different sovereign bond strategies.
- After long consideration, an adjustment to the Fund benchmark was recommended to the Pensions Committee.

4.7 Importantly, the focus of the JISP is the long-term funding of the pension fund through the allocation of contributions and invested assets. The short-term volatility of asset prices is less important given that the fund remains open to new entrants and cash flow is relatively stable. The JISP continues to focus on deploying each Fund's long-term capital at an appropriate level of risk for the expected return. The JISP also provides the expertise to advise and support oversight of implementation.

4.8 Members of JISP, including external advisers, present at training events and Committee meetings. They will continue to do that in the year ahead, starting in June when the external advisers will comment on activities during 2022/23, the Fund's investments and on the current investing environment.

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 advice of the JISP influences investment strategy 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 Appendix 1

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 2023

Special Items
- Policy Group Focus – Real Assets (property, infra & timber)
- Policy Group Focus – Currency Exposures/Hedging
- Stewardship (including Statement of Responsible Investment Principles)
- Investment Controls & Compliance
- LPF Chief Risk Officer (verbal update)
- Audit of Foreign Exchange Transaction Costs
- Portfolio review – Direct Property
- Terms of Reference – JISP

Quarterly Items
- Multi-Asset Strategy & Perspectives
- Investment Strategy Implementation/ Funding Updates
- Investment Portfolio Monitoring (Traffic Lights)

December 2023

Special Items
- Policy Group Focus – Debt Assets (LDI (Gilts), Non-Gilt Debt, Cash)
- Joint Investment Strategy Panel - Effectiveness
- Review of Governance of Internal Portfolios by external JISP members
- Investment Strategy Reviews/Actuarial Valuations/ Funding Strategy Statements (if data received from Actuary)
- Portfolio review – Debt Assets

Quarterly Items
- Multi-Asset Strategy & Perspectives
- Investment Strategy Implementation/ Funding Updates
- Investment Portfolio Monitoring (Traffic Lights)

Future Joint Investment Strategy Panel Dates

- Tuesday 5th September 2023, 10.30am, TEAMS meeting or Atria One Boardroom
- Monday 4th December 2023, 10am, TEAMS meeting or Atria One Boardroom

Appendix 1

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)		June
	Real Assets (property, infra & timber)		September
	Currency Exposures/Hedging		September
	Debt Assets (LDI (Gilts), Non-Gilt Debt, Cash)		December
	Securities Lending Policy Review		June
	Traffic Lights Process – Annual Review		June
	Investment Controls & Compliance		September
	Statements of Investment Principles	Committee Report	June
	Joint Investment Strategy Panel – Terms of Reference		June
	Joint Investment Strategy Panel - Effectiveness		December
	LPF Chief Risk Officer attends JISP meeting		September
	Audit of Foreign Exchange Transaction Costs		September
	Stewardship (including Statement of Responsible Investment Principles)	Committee Report	September
	Pension Fund Cost Benchmarking	Committee Report	December or March
	Review of Governance of Internal Portfolios by external JISP members		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/Actuarial Valuations/ Funding Strategy Statements (at least every 3 years)		Due 2023/24	Typically December or March
	Internal Mandate Reviews	**Most recent review**	**Review due**	March, June, September and December
	UK All Cap	June 2021	June 2024	
	UK Mid Cap	June 2021	June 2024	
	Europe ex-UK	March 2023	March 2026	
	US	March 2022	March 2025	
	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			

This page is intentionally left blank

Pensions Committee

2.00pm, Wednesday, 21 June 2023

Annual Investment Update – Lothian Pension Fund

Item number 6.6

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: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1967

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 2023.

2.2 Over the twelve months to 31 March 2023, the total Fund return was +0.3%, which compares with the benchmark return of -14.6%. Investment market returns were mixed over the period with notable declines in UK gilts the standout feature.

2.3 Lothian's predominantly lower risk equities performed reasonably well, given the market backdrop, gaining 4.3%. The Fund's real asset investments performed even better, returning +7.9% as the unlisted infrastructure and timber & agriculture assets delivered gains of 19.6% and 12.0% respectively, offsetting weak returns from property (-12.4%). Returns within the debt policy groups were negative given the rising rate environment. The Fund's Non-Gilt Debt assets fell 3.7% over the 12-month period, though this compared favourably to the benchmark return of -10.0%. Weakness within the LDI (gilts) category was the standout with Lothian experiencing a return of -38.6%, broadly in-line with the benchmark return of -39.1%. Relative to strategic benchmark, the Fund benefitted from being underweight LDI.

2.4 The Fund aims to achieve a return broadly in line with its strategic benchmark, over the long term, with a lower-than-benchmark level of risk. Following strong relative returns over the last twelve months, the Fund has delivered returns above the benchmark over the five-year period to end March 2023. This has been achieved with notably lower risk. It returned +6.3% per annum compared with the benchmark +4.5% per annum (with ex-post risk of 7.0% for the Fund vs. benchmark risk of 11.2%). Over ten years, the Fund has gained 8.3% per annum, outperforming the benchmark gain of 6.9% per annum. Again, this was achieved with notably lower risk (ex-post risk of 6.8% vs. 9.3%).

2.5 Lothian Pension Fund's funding level (the ratio of assets to liabilities) is formally assessed on a triennial basis, with the most recent figure of 106% at the March 2020 valuation. Based solely on the movements of the Fund's assets and a proxy for the Fund's liabilities, the funding level will have improved over the period to end March 2023 as the Fund's assets have increased in value while the liabilities are estimated to have declined in value due to rising interest rates. The next triennial valuation at 31 March 2023 will be undertaken during 2023 and concluded by 31 March 2024 at the latest.

3. Background

3.1 The purpose of the report is to provide an update on the investments of the Lothian Pension Fund to 31 March 2023.

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

3.3 The Fund's investment strategy was approved by the Pensions Committee in June 2021. The objective of the strategy is to achieve an investment return that the actuary prudently assumes will be consistent with acceptable and stable contribution rates. The expectation is that with such a return, the Fund will be able to pay pensions as they fall due.

Employer Strategies

3.4 To provide suitable investment strategies for the differing requirements of employers, the Fund 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.

Employer Group Strategies	Assets (£m)	Weight
Main Strategy	9,104	94.0%
Mature Employer Strategy	16	0.2%
50/50 Strategy	39	0.4%
Buses Strategy	530	5.5%
Total	9,689	100%

At end March 2023

3.5 Most employer liabilities are funded under the Main strategy, which adopts a long-term investment strategy, aiming to generate an investment return that will minimise the cost to the employer within reasonable and considered risk parameters. 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.

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

3.7 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 MEG strategy.

3.8 The Buses strategy, which was introduced on 31 January 2019 when the assets and liabilities of Lothian Buses Pension Fund were consolidated into the Lothian Pension Fund, is a 55/45 mix of the Main Strategy and the MEG strategy.

Policy Groups

3.9 For reporting purposes, Fund strategy is 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 to provide perspective on the expected risk of each group in relation to Fund liabilities.

3.10 The table below presents the policy group allocations of the four investment strategies at end March 2023 along with the total fund strategy, which is the weighted average of the four strategies.

Employer Strategies

Policy Groups	Main Strategy	Mature Employer Strategy	50/50 Strategy	Buses Strategy	Total Fund Strategy
Equities	60%	0%	30%	33.0%	58.3%
Real Assets	20%	0%	10%	11.0%	19.4%
Non-Gilt Debt	10%	0%	5%	5.5%	9.7%
Gilts	10%	100%	55%	50.5%	12.5%
Cash	0%	0%	0%	0.0%	0.0%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Totals may not sum due to rounding

Governance

3.11 Implementation of the investment strategy is currently delegated from the Pensions Committee to the Service Director: Finance and Procurement, who in turn delegates implementation to the Funds officers. Advice is taken 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 provides strategic advice to the Pensions Committee and officers on long term objectives and investment risk, and monitors implementation activity.

4. Main Report

Market background to 31 March 2023

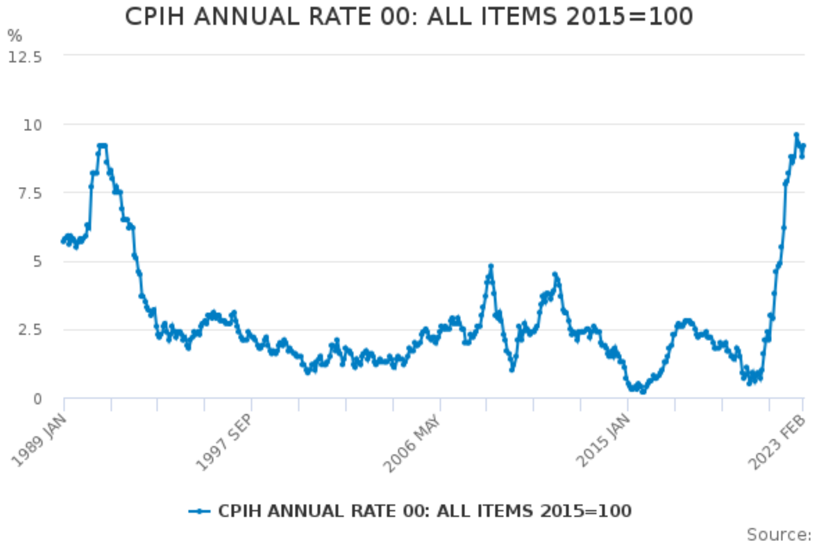
4.1 For the 12 months to 31 March 2023, global equities, as measured by the MSCI ACWI index, returned -1.4% in sterling terms (source: MSCI). However, the weaker pound masked a more pronounced decline of -7.4% in US dollar terms (source: MSCI). It was a year almost as extraordinary as 2020, when Covid emerged, and returns for most asset classes were curtailed by the challenging conditions.

4.2 Soaring inflation and central banks' policy responses dominated the backdrop for financial markets. The mounting pace of inflation was worsened by the supply shock brought about by the war in Ukraine, with UK consumer price inflation reaching 40-year highs. The reaction from most major central banks was to aggressively tighten monetary policy, marking a dramatic shift from the extremely low interest rates that had been in place since the financial crisis of 2008. This is an environment that many had become unaccustomed to and the unfamiliar conditions exposed frailties in the financial system, contributing in some part to the LDI crisis in the UK and the failure of two large US banks.

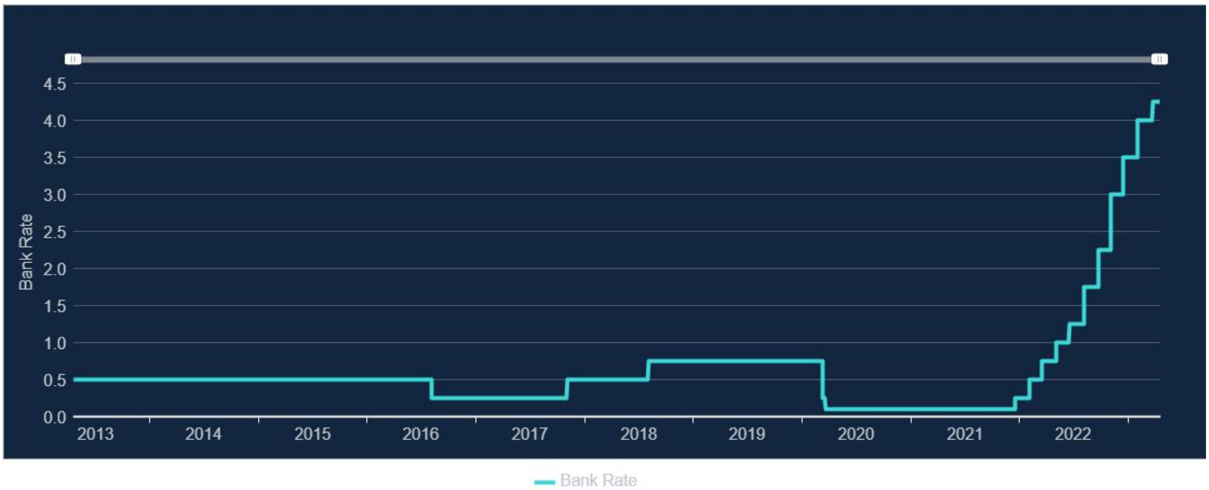
4.3 Government bond prices fell over the year, due to rising base rates and higher inflation, with the political crisis in the UK causing forced sales of long-dated gilts by some pension funds. 10-year gilt yields rose from 1.61% to 3.49% (reaching as high as 4.6%), giving an annual return of -10.9%. Although corporate bond credit spreads (the difference in yields between bonds of differing quality) widened over the year, it was the sharp rise in underlying government bond yields that caused most of the damage, with sterling investment grade credit returning -10.2% over the year. Commercial real estate returns were also strained by falling capital values as property owners, many of which are highly leveraged, contended with rising borrowing costs. However, some of the most eye-catching falls were among 'growth' stocks where valuations were severely marked down as sentiment for this part of the market soured.

4.4 Inflation's influence over investment markets appears set to continue with disinflation to pre-pandemic levels likely to take some time. However, there is cause to believe that inflation has already peaked amid moderating commodity prices and the cooling effect of monetary policy. With that, central banks appear to be nearing the peak of this tightening cycle which may signal a more favourable backdrop ahead for asset valuations. However, risk remains around whether inflation proves to be 'stickier' than hoped. Expectations for corporate earnings have held up well to date, though those forecasts may prove overly optimistic as economic growth deteriorates in the face of the tight monetary policy, declining real wages and heightened geopolitical tensions. Meanwhile, fiscal policy is handicapped by high debt burdens and costlier borrowing, as demonstrated by the rapid unwinding of the Truss government's plans. More positively, the recent reversal of China's 'zero-Covid' policy provides a welcome boost for growth. With several meaningful macroeconomic and geopolitical challenges to be navigated, it is hard to imagine that there will not be further significant financial market volatility in the coming years.

UK Inflation (CPIH) and Bank of England Official Rate



Source: https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/l55o/mm23



Source: https://www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp

4.5 The graph below shows index returns over 12 months to 31 March 2023 for a range of asset classes.

Source: FTSE, Bloomberg, MSCI, Portfolio Evaluation (MSCI ACWI, FTSE Actuaries Gilts >15 Yrs, FTSE UK Govs Index Linked >15 Yrs, iBoxx £ Non-Gilts, IPD Balanced Monthly & Quarterly Property Index – all GBP total return)

Asset Allocation and Strategy Implementation

4.6 As described above, the overall Fund strategy is made up of four investment strategies. The strategic allocation to policy groups is the weighted average of the four employer strategies. The strategic allocations at end March 2022 and end March 2023 are shown in the table below along with the actual allocations. There were no changes to fund strategy over the year to end March 2023. Movements in the relative size of these strategies has resulted in modest changes to the Total Fund Strategy weightings. The actual allocations changed as a result of the relative movements of investment markets described above and investment activity during the year.

	Actual Allocation		Strategic Allocation	
Policy Group	**31 Mar 2022**	**31 Mar 2023**	**31 Mar 2022**	**31 Mar 2023**
Equities	58.5%	58.0%	58.0%	58.3%
Real Assets	17.3%	20.0%	19.3%	19.4%
Non-Gilt Debt	7.6%	6.3%	9.7%	9.7%
LDI	8.5%	11.1%	12.8%	12.5%
Cash	8.1%	4.7%	0.0%	0.0%
Total	100%	100%	100%	100%

4.7 Over the year, the actual allocation to **Equities** is broadly unchanged. The **Real Assets** allocation increased as new infrastructure investments were made throughout the year which offset distributions of income and capital for existing private market investments. The allocation to **Non-Gilt Debt** fell modestly over the year, due to a net reduction of £71m during Q4 2022 and cash distributions over the year from Private Debt. In contrast, the exposure to **LDI** (or gilts) increased, despite weak returns. Having been underweight LDI for some time, the Fund took the opportunity to accelerate its hitherto gradual purchases of UK government bonds during the Truss government-induced market weakness in September/ October 2022. The net result of the changes was a reduction in **Cash**. The cash position twelve months ago was highlighted to be a temporary, defensive position which was supported by the Fund's advisers. Some of this cash was utilised during the market dislocation in gilts referenced above, to purchase gilts at more attractive yields and move the Fund closer to the strategic target allocation. The actual allocations lie within the permitted ranges defined in the Statement of Investment Principles (SIP).

4.8 The Fund retains a broadly neutral exposure to Equities and Real Assets. The Cash position, while lower than 12 months ago, remains reasonably significant at close to 5% and will be utilised when opportunities arise. An investment strategy review will take place in conjunction with the triennial actuarial valuation over the coming months. Results and conclusions from this review will be presented to Committee in due course.

4.9 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 2022 and 31 March 2023

Policy Groups & Mandates	Manager	Actual Allocation 31 March 2022	Actual Allocation 31 March 2023
EQUITIES		**58.5%**	**58.0%**
Global Low Volatility	Internal	**13.5%**	**13.2%**
Global High Dividend Yield	Internal	**13.5%**	**13.9%**
Global Stable Multi-factor	Internal	**12.4%**	**12.4%**
Global Quality	Internal	**0.0%**	**0.7%**
Global Stable Equities	Nordea	**3.7%**	**3.4%**
Global Value	Harris	**1.4%**	**1.4%**
Global Alpha	Baillie Gifford	**1.9%**	**1.8%**
UK All Cap	Internal	**2.8%**	**3.1%**
UK Mid Cap	Internal	**1.2%**	**1.0%**
Europe (ex UK) Quality	Internal	**2.6%**	**2.1%**
US Value	Internal	**3.8%**	**3.9%**
Private Equity	Various	**1.8%**	**1.1%**
Currency Hedge	Internal	**0.0%**	**0.0%**
REAL ASSETS		**17.3%**	**20.0%**
Property	Various	**6.1%**	**5.1%**
Other Real Assets	Various	**11.2%**	**14.9%**
NON-GILT DEBT		**7.6%**	**6.3%**
Other Bonds	Various	**7.6%**	**6.3%**
LDI		**8.5%**	**11.1%**
UK Gilts	Internal	**8.5%**	**11.1%**
CASH		**8.1%**	**4.7%**
TOTAL FUND		**100%**	**100.0%**

Note: numbers may not sum due to rounding

Equities

4.10 The current equity investment strategy has remained broadly unchanged for several years now. Over the course of the last twelve months there were no complete sale of existing mandates. A new, Global Quality Equity, portfolio was launched during the year and while small initially, will gradually be built up over time.

4.11 Income continues to be withdrawn from the three large, internally managed core global portfolios, with £159m withdrawn over the 12-month period.

4.12 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.

4.13 None of the Fund's equity portfolios have explicit exclusion policies, nor are they 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 77% and 86% of benchmark risk.

4.14 As of 31 March 2023, approximately 87% of the Fund's listed equities are managed internally with the majority of these in low cost, low turnover strategies, which are expected to enhance the Fund's risk-adjusted returns over the long term.

4.15 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.

4.16 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. Alongside opportunistic reductions in listed private equity during the year, as historic limited partnership investments mature cash is being returned. The allocation to private equity reduced to 1.1%.

Real Assets

4.17 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.

4.18 The Real Assets allocation increased during the year, primarily due to net new investment activity. In particular, new infrastructure investments were made throughout the year which offset distributions of income and capital for existing private market investments. The Fund continued to source new investments to achieve the target real asset allocation, and the Real Asset policy group was a net investor during the year. The allocation to Real Assets rose from 17.3% to 20.0%.

Non-Gilt Debt

4.19 Exposure to Non-Gilt Debt fell slightly over the year, due to a net reduction of £71m in Q4 2022 to fund the increased LDI allocation and cash distributions over the year from Private Debt. The allocation to Non-Gilt Debt fell from 7.6% to 6.3%.

LDI

4.20 In contrast to Non-Gilt Debt, the exposure to LDI (or gilts) increased, despite weak returns. Having been underweight LDI for some time, the Fund took the opportunity to accelerate its hitherto gradual purchases of UK government bonds during the Truss government-induced market weakness in September/ October 2022. The exposure to LDI rose from 8.5% to 11.1%.

Cash

4.21 The net result of the changes was a reduction in cash. The cash position twelve months ago was highlighted to be a temporary, defensive position which was supported by the Fund's advisers. Some of this cash was utilised during the market dislocation in gilts referenced above, to purchase gilts at more attractive yields and move the Fund closer to the strategic target allocation. The allocation to cash fell from 8.1% to 4.7%.

Unfunded Commitments

4.22 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 2023 are shown in the table below. Unfunded commitments of £232m compares with £218m at 31 March 2022.

Private Markets Unfunded Commitments	£m	% Fund Assets
Private Equity	31.0	0.3%
Infrastructure	97.5	1.0%
Timber & Agriculture	27.0	0.3%
Property	17.5	0.2%
Private Debt	59.3	0.6%
Total	**232.2**	**2.4%**

Investment performance to 31 March 2023

4.23 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 (CPIH) and average weekly earnings (AWE)

Annualised returns to 31 March 2023 (% per year)	**1 Year**	**5 Years**	**10 Years**
Lothian Pension Fund	0.3%	6.3%	8.3%
Benchmark	-14.6%	4.5%	6.9%
Relative	*14.8%*	*1.7%*	*1.4%*
Liability proxy	-29.7%	-6.4%	0.6%
Consumer price index (CPIH All Items)	8.8%	3.8%	2.6%
Average Earnings (AWE)	4.9%	4.3%	3.5%

4.24 The Fund aims to achieve a return broadly in line with its strategic benchmark, over the long term, with a lower-than-benchmark level of risk. Over the twelve months to end March 2023, the Fund produced an absolute return of +0.3%. While very modest in absolute terms, this was notably ahead of the benchmark return of -14.6%. With risk significantly below benchmark, it outperformed its long-term objective over the short 1-year timeframe. Returns were predominantly driven by equities and real assets. The Fund's equities gained 4.3% over the year, comfortably ahead of the global index (MSCI ACWI in GBP) return of -1.4%. Within the Real Assets category, the return of +7.9% was led by strength in both unlisted infrastructure (+19.6%) and timber & agriculture (+12.0%) investments.

4.25 Five-year returns were above benchmark at +6.3% p.a. vs +4.5% p.a. and over ten years the comparison was +8.3% p.a. vs +6.9% p.a. In summary, over each of these time periods, Fund returns have been above benchmark.

4.26 On the risk side of the equation, the Fund has achieved its returns with notably lower levels of volatility than its benchmark (approximately 63% of benchmark risk over five years and 73% over ten years), so from a risk / return perspective the outcomes were better than expected over 1, 5 and 10-year timeframes.

4.27 The returns from the Fund's broad policy group benchmarks over 1 and 5 years are as follows (policy group returns not available for 10 years):

To end March 2023

Policy Group	1 Year (%)		5 Year (% pa)		10 Year (% pa)	
	Fund	Benchmark	Fund	Benchmark	Fund	Benchmark
Equities	4.3	-1.4	8.4	9.7		
Real Assets	7.9	-36.6	7.5	-3.8		
Non-Gilt Debt	-3.7	-10.0	1.9	-0.5		
LDI (Gilts)	-38.6	-39.1	-6.7	-6.7	0.9	1.3
Total Return	0.3	-14.6	6.3	4.5	8.3	6.9
Total Risk*	8.3	10.8	7.0	11.2	6.8	9.3

**1 year predicted; 5 years ex-post (source: Portfolio Evaluation)*

4.28 In the table above, absolute returns have been positive from both equities and real assets and compare favourably against weak benchmark returns. Within equities, Lothian's lower risk equities have, unsurprisingly, lagged the notable equity market gains over the 5-year period. This was particularly evident through 2020, when the Fund's lower risk exposure was negatively impacted by Covid and associated lockdowns, relative to the benchmark. This will continue to impact longer-term figures for some time. Despite this, absolute equity returns remain strong at +8.4% p.a. Real assets have gained 7.9% over 12 months and 7.5% p.a. over 5 years and are notably ahead of their (gilts +2.5% p.a.) benchmark.

4.29 While non-gilt debt produced modest returns over the 12-month and 5-year periods (-3.7% and +1.9% p.a. respectively), the real stand out has been within LDI (gilts). For a "risk-free" asset to produce a -38.6% return over the last 12 months is unusual to say the least. This clearly impacts longer term figures, with the 5-year return for Lothian's LDI (gilts) exposure now -6.7% p.a.

4.30 Over the year to 31 March 2023, notable performance within each policy group was as follows:

- The Fund's equity investments produced a reasonable absolute return of +4.3% but, within this, results were mixed. Weakness was seen from UK All Cap (-3.0%), Baillie Gifford Global Alpha (-3.9%), UK Mid Cap (-9.0%) and private equity (-15.7%). All of the other equity portfolios produced positive returns, with double-digit returns from both the Global High Dividend (+10.0%) and Europe ex-UK (+13.4%) equity portfolios.
- The Fund's Real Assets allocation returned +7.9% over the year. While returns from property (-12.4%) were weak, relative strength was seen from unlisted infrastructure (+19.6%) and timber & agriculture (+12.0%).
- The Fund's Non-Gilt Debt exposure produced a return of -3.7% over the year. Relative strength was seen in private debt (+8.7%) with weakness from US TIPS (-11.1%), Baillie Gifford Corporate Bonds (-11.2%) and more defensive credit - Legal & General AAA-AA-A Fund – (-9.9%).
- In what was an undeniably volatile and difficult year for UK gilts, the Fund's

LDI (gilts) investments delivered a return of -38.6%%, notably lagging other policy group returns.

4.31 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

4.32 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. A complete list of holdings is also made available on the Fund's website.

Funding Level Update

4.33 Based on the movements of the Fund's assets and a proxy for the Fund's liabilities, the funding level is expected to have improved over the year to end March 2023 as the Fund's assets are broadly unchanged in value from end March 2022, while the liabilities are estimated to have declined in value due to rising rates.

4.34 The next triennial valuation at 31 March 2023 will be undertaken during 2023 and concluded by 31 March 2024 at the latest.

Conclusions

4.35 In general, the investment strategy changes were relatively small as one would expect from a long-term pension scheme. The changes to actual asset mix were also relatively minor. The largest actual changes were the 2.6% increase in LDI, the 2.7% increase in real assets and the 3.5% reduction in cash.

4.36 The equity allocation was broadly unchanged over the year and is close to strategic target at 31 March 2023 (58.0% vs 58.3%). The largest deviation from strategy is the overweight position in cash (+4.7%). Twelve months ago, the elevated cash position (8.1%) was highlighted to be a temporary, defensive position which was supported by the Fund's advisers. Some of this cash was utilised during the market dislocation in gilts referenced above, to purchase gilts at more attractive yields and move the Fund closer to the strategic target allocation in LDI (11.1% vs 12.3%.). The Fund is underweight Non-Gilt Debt (6.3% vs 9.7%) and modestly overweight the Real Assets (20.0% vs 19.4%) policy group following notable investment in infrastructure. The Fund has operated comfortably within the prescribed ranges over the year.

4.37 The most significant investment activity during the year was the increase in LDI (+£496m), the ongoing net investment into unlisted infrastructure (+£175m) and the sweep of income from the three core global equity portfolios (-£159m).

4.38 The absolute performance of Lothian Pension Fund over the twelve-month period was +0.3%. Five-year performance is +6.3% per annum. Over ten years, the Fund returned +8.3% per annum.

4.39 The returns for the 12-months to end March 2023 are very modest in absolute terms but are notably ahead of benchmark (+0.3% vs. -14.6%). Given that relative strength, five and ten-year returns are now ahead of benchmark, and reasonable in absolute terms (+6.3% vs +4.5% and +8.3% vs +6.9% respectively). These returns have been achieved at notably lower than benchmark risk which is broadly consistent with strategy. The results are therefore better than expectations (the strategy is to target lower risk with an expectation of broadly similar returns to benchmark).

4.40 The funding level is expected to have improved over the year to end March 2023 as the Fund's assets are broadly unchanged in value from end March 2022, while the liabilities are estimated to have declined in value due to rising rates. The funding level will be updated at the time of the triennial actuarial valuation in 2023.

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.

This page is intentionally left blank

Pensions Committee

2.00pm, Wednesday, 21 June 2023

Annual Investment Update – Scottish Homes Pension Fund

Item number 6.8

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

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

Annual Investment Update – Scottish Homes Pension Fund

2. Executive Summary

2.1 This report provides an update for the year to end March 2023 on the strategic allocation and the invested assets of the Scottish Homes Pension Fund (the Fund).

2.2 The actuarial funding level of the Scottish Homes Pension Fund on 31 March 2020 was 118%. The Fund's actuary, Hymans Robertson, reported the same funding level of 118% in their funding update dated 31 March 2022, and in their recent 2022/2023 Actuarial Statement (dated May 2023) have stated that the funding level at end March 2023 is "likely to be fairly similar to that reported at the previous formal valuation."

2.3 The triennial actuarial valuation is currently underway, following which the formal valuation result at 31 March 2023 will be confirmed, which will include any changes reflecting fund experience and financial and demographic assumptions.

2.4 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% on 31 March 2020 rising to 100% in 2044. The Actual Funding Level (AFL) on 31 March 2020 was 118%.

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, and these have been set at £90,000 per annum. Any 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 reflected 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 reaffirmed the following investment objective in June 2021:

- *To match the cash flow from gilt income and redemption payments as closely as possible with the expected liability payments of the Fund*.

4.4 This is reflected in the Statement of Investment Principles.

Investment Strategy

4.5 The investment strategy to minimise risk means that the Fund only invests in bonds (UK gilts, UK T-bills, and cash), which provide certainty of cash flows.

4.6 An analysis of the Fund's liabilities shows that some of them are fixed in nature and some index linked. To achieve as close a match as possible with liabilities, the Fund invests in both nominal and index-linked gilts. The actual asset allocations at 31 March 2022 and 31 March 2023 are shown in table 1 below.

Table 1

Policy Group	Actual Allocation 31 March 2022	31 March 2023
Gilts	**91.9%**	**84.6%**
Index-Linked Gilts	*64.6%*	*59.1%*
Nominal Gilts	*27.3%*	*25.5%*
Cash	**8.1%**	**15.4%**
TOTAL	**100%**	**100%**
Asset Value (£)	**£154m**	**£125m**

4.7 The value of the assets fell over 2022/23, due to higher discount rates as the BOE raised base rates significantly over the period to address high inflation. The fall in the value of the assets is estimated to have been matched by the fall in the value of the liabilities.

4.8 At end March 2023, 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.

4.9 Hymans Robertson, the Fund's actuary, have stated that the funding level at end March 2023 (the next triennial valuation) is "likely to be fairly similar to that reported at the previous formal valuation".

4.10 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 2022/23, £7.2m was redeemed to pay pensions, which compares with the Fund value of £125m at the end of March 2023.

4.11 Being fully funded, the fund invests excess cash in short-dated bills and gilts. Cash increased over 2022/23, as the fund holds more short-dated paper than it needs for cash outgoings and a number of these redeemed over the period. The cash and cash equivalents balance at end March 2023 covers expected pension payments for approximately thirty-two months. Following the confirmation of the March 2023 valuation results, the cash position will be reviewed in order to cover expected outflows to March 2027.

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.

Pensions Committee

2.00pm, Wednesday, 21 June 2023

Risk & Compliance Update

Item number 6.9

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the LPF group's Risk Register and Quarterly Risk Overview, and raise any relevant points arising from the review with the Pensions Committee on 21 June; and

1.2 note the ongoing strategy and development around the group's risk management framework.

Kerry Thirkell
Chief Risk Officer, Lothian Pension Fund

Contact: Kerry Thirkell, Chief Risk Officer, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

Risk & Compliance Update

2. Executive Summary

2.1 This paper provides an overview of monitoring and assurance undertaken in LPF since the last meeting, noting any material observations or exceptions.

2.2 This paper also provides a summary of the work to enhance current risk management arrangements.

3. Risk Management Arrangements

3.1 The programme of work on the Risk Management Framework ('RMF') is underway. Key developments and updates since the last committee meeting are:

- Risk & Compliance mandate document created
- LPF risk language/taxonomy developed and agreed
- LPF risk evaluation methodology simplified
- All staff RMF update training completed

3.2 As noted previously, a key part of the operational plan will be an evaluation of the effectiveness of changes as they are introduced and embedded, through observation, feedback and testing. Willingness and flexibility to adapt, change, modify or remove aspects is critical to the successful implementation and embedding of the new risk management framework and any changes will need business support and engagement. Training and awareness will underpin the programme and ensure that staff understand their role in the framework.

3.3 Recruitment has been underway for a new hire in the R&C team with subject matter expertise in investment compliance and front office monitoring and oversight. An offer has been accepted by the preferred candidate with anticipated start date towards the end of the summer.

4. Monitoring & Assurance Summary

Themed Reviews

Investment Services Review

4.1 As reported previously, the themed review on Investment Services raised several observations around the following themes:

- Governance & Conflicts

- Client Management (and presentation of 'advice')
- Documentation & Record-keeping
- Risk Management Framework
- Middle Office
- Supplier Management

4.2 Subsequently the Investment Governance Improvement Plan ('IGIP') has since been established to remediate the gaps and weaknesses identified from the review. This project is expected to run for approximately 9 months, and draws on the expertise from the same external consultants as the original review, to facilitate delivery of agreed enhancements. Notwithstanding the effort provided by the external consultants, proper and appropriate engagement with LPF resources is critical to the success of this project.

Financial Crime Review

4.3 This review looked at the adequacy and effectiveness of arrangements to manage the risks of financial crime across the LPF group. Specifically with regard to LPFI, the review helped facilitate the production of the annual MLRO report to the LPFI Board, which is a FCA requirement. It concluded that LPFI is compliant with money laundering regulations and FCA rules, with some enhancements to meet best practice – such as a more detailed money laundering risk assessment, and more frequent sanctions screening.

4.4 LPF group activities require a number of enhancements to meet best practice, such as a business wide risk assessment of the LPF activities which may be used to launder money or provide resources to sanctions targets – such as property or private market investments.

4.5 Group wide observations were categorised into six findings, and will be addressed as part of LPF's issues management process:
- limited financial crime or AML risk assessments (now completed)
- inconsistent documentation of procedures
- inconsistent issue or completion of mandatory training
- record keeping on the regulated status of private market fund managers
- reliance on third parties carrying out due diligence to be reviewed and clarified
- lack of robust or repeatable procedures on sanctions and asset freezes

BDO Compliance Monitoring Programme (CMP)

4.6 All testing scheduled for the period 1 January to 31 March 2023 has been completed. A total of 6 new issues were identified and recorded, and are noted below.

Findings & Recommendations

4.7 The following enhancements were recommended by BDO:

- improve documentation of internal controls and records for client mandates
- improve record keeping and procedures on use of insider lists
- ensure LPFI organisational chart is accurate and up-to-date
- ensure intra-group services between LPF, LPFI, and LPFE are documented in appropriate detail
- ensure regulatory disclaimers are contained in emails to clients
- produce MLRO report as soon as possible

Non-FCA Compliance Monitoring Programme ('CMP')

4.8 20 tests were undertaken, with 18 of these assessed as 'fully compliant'. The remaining 2 tests were not fully compliant primarily due to documentation not being up to date, rather than any operational failures.

Internal Audit

4.9 Since the last meeting, CEC Internal Audit reviews have completed on Third Party Supplier Management and Information Governance. Whilst neither LPFI or LPFE have a formal dedicated third line of defence, the scope of these reviews was sufficiently broad to ensure applicability across the group, acknowledging the common systems and controls that sit across the LPF group. The audit regarding the Adequacy of Technology Security Assurance Arrangements has been delayed until Q3 2023 due to the unforeseen resourcing challenges within the LPF IT team during Q4 2022 and Q1 2023. This has been agreed with CEC Internal Audit to allow the various initiatives and activities already acknowledged and in train, to complete.

4.9.1 **Third Party Supplier Management** - The objective of this review was to assess LPF's current third party supplier management arrangements against industry good practices. The review recognised that LPF's supplier management framework has only recently been implemented, and acknowledged that such frameworks take time to embed. Nevertheless, areas identified to strengthen and improve are:

- Consistency of supplier management processes for critical suppliers
- Contract exit planning
- Supplier management framework to cover end-to-end third party lifecycle
- Supplier onboarding processes to be clearer and centralised
- Training and awareness for supplier management
- Ongoing monitoring and oversight, with clear responsibility for oversight

4.9.2 **Information Governance** - The purpose of this review was to assess the adequacy of design effectiveness of the key controls over data strategy and information governance, many of which were newly implemented or refreshed following the transfer to LPF's new IT provider, Cased Dimensions, in 2021. Six findings were noted to further enhance the information governance framework:
Clear plan to implement remaining policy, standards and procedures

- Data access management
- Use data classifications in accordance with GDPR guidelines
- Establish information governance oversight and governance structure Compliance monitoring of information governance matters
- Various registers to be co-ordinated and aligned – including Information
- Asset Register, Records Retention, and systems and suppliers lists

4.10 As reported in February, we have agreed with CEC Internal Audit a programme of reviews to be undertaken in 2023/24 that is also relevant to LPFI and LPFE. The proposal was approved by the Pension Committee when they met in March and the programme is now underway, having agreed provisional timings with CEC Internal Audit:

People Processes

4.11 (May – July): to provide assurance on the people processes supporting the employee lifecycle (terms of reference expected to be agreed shortly)

Business Continuity & Incident Response

4.12 (Aug – Oct): review of the adequacy and operating effectiveness of key controls and processes established to provide assurance that LPF maintains business continuity plans to ensure they maintain services during an emergency or extended incident

Senior Managers & Certification Regime

4.13 (Aug – Oct): to provide assurance of compliance with the key elements and prescribed responsibilities of the FCA SM&CR

Information Security Arrangements

4.14 (renamed Adequacy of Technology Security Assurance Arrangements) (Sep – Dec): review the design of the suite of IT policies, standards and procedures that have been developed during 2022 to prevent, respond and manage information security across LPF, as well as ensuring they are aligned to the IT strategy due to be formalised during 2023

Project Forth

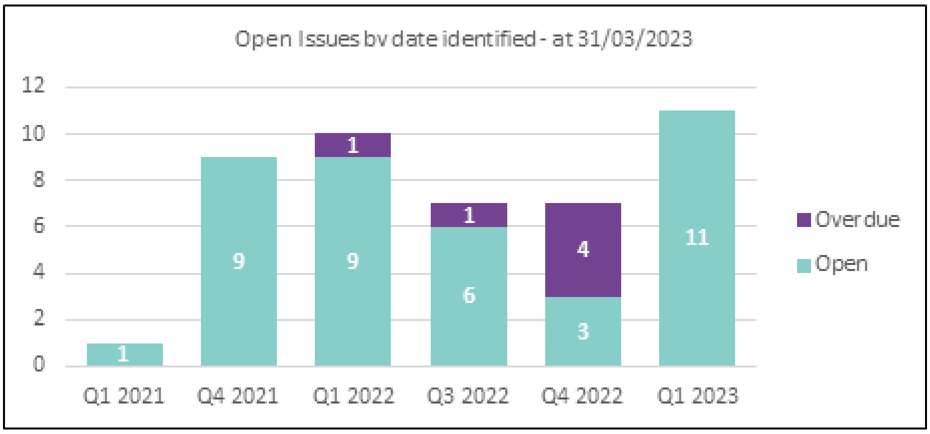
4.15 (TBC): audit to be decided. Suggested areas include project delivery or associated elements such as resulting Transfer of Undertakings - Protection of Employment (TUPE) or asset transfer.

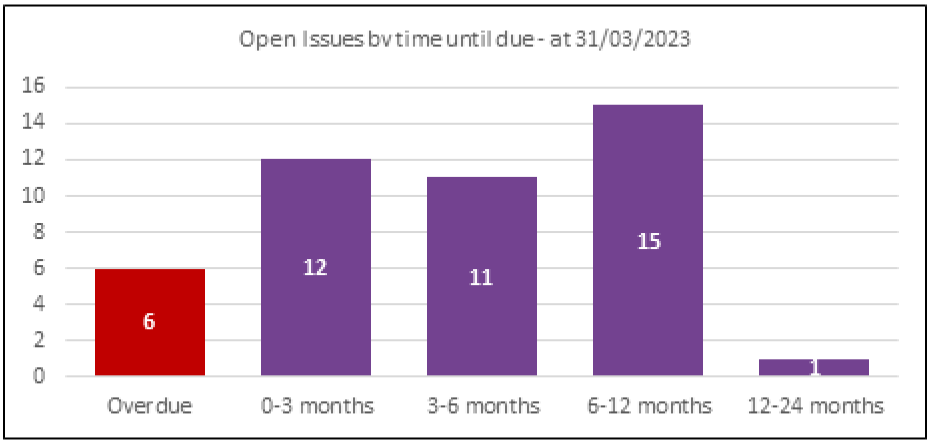
Issues & Incidents

4.16 Improvements continue to be made to the processes, governance and reporting regarding LPF Issues and incidents. A summary status of issues and incidents from Q1 2023 is noted below.

Issues

4.17 During Q1, 15 issues were closed and 12 new issues were raised. These issues comprise findings from internal audit and 2LoD (including BDO CMP) monitoring and assurance work, as well as any other self-identified items, and the 12 added in the period, include 6 issues arising from the Third Party Supplier Management internal audit.



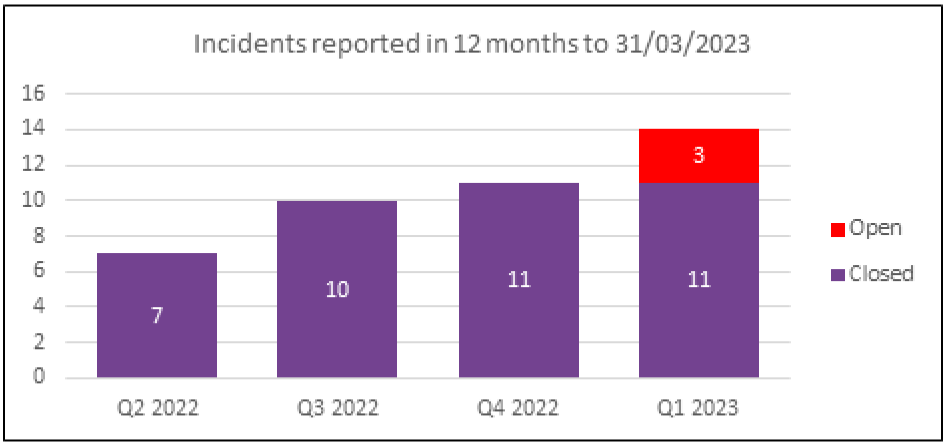


4.18 Since end Q1, a further 17 issues have been added, predominantly from the Investment Services Review, the Financial Crime Review, and the internal audit on Information Governance. At the time of writing, there are currently 57 open issues, 3 of which are overdue. 10 issues have a due date by the end of June 2023 and the

Risk & Compliance team continue to actively engage with issue stakeholders to ensure agreed actions are being taken.

Incidents

4.19 Fourteen incidents were raised during Q1 2023, three of which were classified as non-reportable data breaches. None were classified as FCA regulatory breaches. Required actions to remediate eleven of these incidents were completed during Q1, and the incidents subsequently closed. Three remain open while actions are underway.



4.20 Following the end of Q1, 10 further incidents have been raised.

4.21 The quality of information being recorded continues to be enhanced making analysis of any themes or trends more effective. Insufficient or unclear processes within the Charles River system has been observed to cause or contribute to several incidents – including manual workaround when trade authorisation rules did not function as expected; a late major shareholding notification for LPF; and an unexpected early trade settlement leading to an overdrawn account charge for LPFI clients. The work included in the IGIP project as well as the new R&C hire are both expected to introduce improvements to the use and functionality of Charles River.

4.22 Further information on issues and incidents is available on request.

FCA Regulatory Compliance – ICARA

4.23 LPFI is required to hold adequate financial resources (also referred to as regulatory capital or capital adequacy) and to establish systems and controls to manage potential harms. The FCA rules on this were previously known as the Internal Capital Adequacy Assessment Process (ICAAP), and in 2022 were replaced under the Investment Firms Prudential Regime (IFPR) by the Internal Capital Adequacy and Risk Assessment (ICARA). These systems and controls must include a process to assess and allocate additional capital where a residual, material risk remains.

4.24 Following LPFI's successful application to the FCA during 2022 to remove the private restriction on assets under management (AuM), at £1.25billion, there has been a steady increase in AuM. When the value of AuM exceeds this figure some additional regulatory reporting and methodology is triggered and is required to be undertaken due to LPFI's FCA category within the ICARA framework changing from a Small and Non-Interconnected firm (SNI) to a 'non-SNI' firm.

4.25 The increase in AuM for LPFI is expected to cross the FCA SNI/non-SNI reporting threshold in June. Whilst the Finance team have been undertaking some capital modelling on the anticipated AuM, BDO were engaged to provide an analysis of the FCA IFPR requirements for LPFI's transition from SNI to non-SNI. This analysis has been reviewed and a series of actions and timeline identified, with relevant stakeholders aware of any required changes to processes and reporting.

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 Summary as at 2 May 2023

Appendix 2 – Government Actuary Department Scottish LGPS Section 13 report as at 21 March 2020

Quarterly Risk Overview

Executive Summary

This document provides a summary of the assessment of the LPF group's risks as agreed by the Risk Management Group (RMG) on 02 May 2023 . The RMG reviews the LPF group risk register on at least a quarterly basis.

Risk Register as at 02 May 2023

Total risks	High	Moderate	Low
39	1	11	27

See Appendix 2 for full list of risks.

Changes since risk register 07 Feb 2023:

New	Closed	Improved	Deteriorated	Unchanged
0	0	2	1	36

Summary of changes:

- New – no new risks added.
- Closed – no risks removed.
- Improved – **Project and Change** & **Pension Payments** risk scores improved.
- Deteriorated – **Supplier and third-party systems** risk score worsened from Low to Moderate.

Further detail is provided on the following pages.

Risk Scoring Changes

No new risks added to, or existing risks removed from register.

Score changes to existing risks since last RMG meeting on 07 Feb 2023:

Risk	Score	Movement	Update
35. Supplier and third-party systems Inadequate, or failure of, supplier and other third-party systems (including IT and Data security).	30	Deteriorated	Score deteriorated from 25 to 30, to reflect recommendations in supplier management audit. Internal audit of supplier management was completed in March 2023, with conclusion that significant improvement to the effectiveness of LPF's processes is needed to ensure sufficient governance and oversight. An action plan has been agreed to address findings and score will remain elevated while these actions are underway.
15. Late payment of pension Failure to pay pensions as they fall due including as a result of administration failure	21	Improved	Score improved from 21 to 14. Contingency payment process improved as part of business continuity improvements / testing.
38. Project and change activities Risk that project and change activities are not effectively managed, leading to delays or failure to deliver, change fatigue, negative impact on daily operations	24	Improved	Score improved from 32 to 24, moderate to low, following pause of Project Forth. Probability remains higher due to number of other project and change activities. Current mitigating actions are: project & change control process being introduced in 2023.

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	
	High: resolve urgently where possible (probability and impact total 35 and above)
	Moderate: resolve where possible (probability and impact total 25 to 34)
	Low: monitor (probability and impact total 24 and below)

Risk Distribution – at 02 May 2023:

Probability \ Impact	1	2	3	4	5	6	7	8	9	10
10										
9										
8										
7				1	1					
6				1	3					
5			1	1	3	2				
4				5	9	4	1	1		
3			1	2	1		1			
2							1			
1										

Appendix 2 – Risk Register

One page overview of risk register & RAG status at 02 May 2023.

Code	Risk name	RAG & Score
1	Investment Performance	
2	Adverse Movement - pressure on employer contributions	
3	Failure of an employer to pay contributions	
4	Recruitment & retention	
5	Fraud by LPF staff or relating to members	
6	Staff competence	
7	IT systems	
8	Culture & engagement	
9	Pension Committee decisions	
10	Pension Board effectiveness	
11	Business continuity	
12	Data protection	
13	Responsible Investment	
14	Incorrect pension payments	
15	Late payment of pension	
16	Market abuse	
17	Investment operations	
18	Disclosure of confidential information	
19	Material breach of contract	
20	Regulatory breach	
21	Information Rights	
22	Member communications	
23	Acting beyond proper authority/delegations	
24	Inappropriate use of pension fund monies	
25	Procurement/framework breach	
26	Procurement process	
27	Group structure and governance	
28	Claim or liability arising from shared services	
29	Employer systems access	
30	Incorrect member data	
31	Inadequate contractual protection	
32	Over reliance on single core service provider	
33	Staff Resource	
34	Health and safety	
35	Supplier and third-party systems	
36	Cybersecurity	
37	Climate change	
38	Project and change activities	
39	Key Person	

Appendix 3 – Three-year risk trends

Ref	Risk name	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023
1	Investment Performance	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠
2	Adverse Movement - pressure on employer contributions	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠
3	Failure of an employer to pay contributions	🟢	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠
4	Recruitment & retention	🟢	🟢	🟢	🟠	🟠	🟢	🟠	🟠	🟠	🟠	🟠	🟠
5	Fraud by LPF staff or relating to members	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
6	Staff competence	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
7	IT systems	🔴	🔴	🔴	🔴	🟠	🟠	🟠	🟢	🟢	🟢	🟢	🟢
8	Culture & engagement		🟠	🟠	🟠	🟠	🟠	🟢	🟢	🟢	🟢	🟢	🟢
9	Pension Committee decisions	🟠	🟢	🟠	🟢	🟢	🟠	🟢	🟠	🟠	🟢	🟢	🟢
10	Pension Board effectiveness	🟠	🟢	🟠	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
11	Business continuity	🔴	🔴	🔴	🔴	🟠	🟠	🟠	🟢	🟢	🟢	🟢	🟢
12	Data protection	🔴	🔴	🔴	🔴	🟠	🟠	🟠	🟠	🟢	🟢	🟢	🟢
13	Responsible Investment					🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
14	Incorrect pension payments	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
15	Late payment of pension	🟠	🟠	🔴	🟠	🟠	🟠	🟢	🟢	🟢	🟢	🟢	🟢
16	Market abuse	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
17	Investment operations	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
18	Disclosure of confidential information	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
19	Material breach of contract	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
20	Regulatory breach	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🔴	🔴
21	Information Rights	🟢	🟢	🟢	🟢	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟢
22	Member communications	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
23	Acting beyond proper authority/delegations	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠
24	Inappropriate use of pension fund monies	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
25	Procurement/framework breach	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠
26	Procurement process	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
27	Group structure and governance	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🔴	🟠	🟠	🟠	🟠
28	Claim or liability arising from shared services	🟢	🟠	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
29	Employer systems access	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
30	Incorrect member data	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
31	Inadequate contractual protection	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
32	Over reliance on single core service provider	🟠	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
33	Staff Resource	🟠	🟠	🟠	🟠	🟠	🔴	🔴	🟠	🟠	🟠	🟠	🟠
34	Health and safety	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
35	Supplier and third-party systems	🟢	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠
36	Cybersecurity	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠	🟠
37	Climate change					🟢	🟢	🟢	🟢	🟢	🟢	🟢	🟢
38	Project and change activities							🟠	🟠	🟠	🟠	🟠	🟢
	Power outages										🟢		
39	Key Person											🟠	🟠

DRAFT FOR INCLUSION IN REPORT TO PENSIONS COMMITTEE, JUNE 2023 – COMPLIANCE and RISK UPDATE:

GAD's Scottish LGPS Section 13 report as at 31 March 2020

The Public Service Pensions Act 2013, Section 13, placed a requirement was on Scottish Ministers to carry out an independent review of every LGPS local valuation to ensure compliance with four criteria:

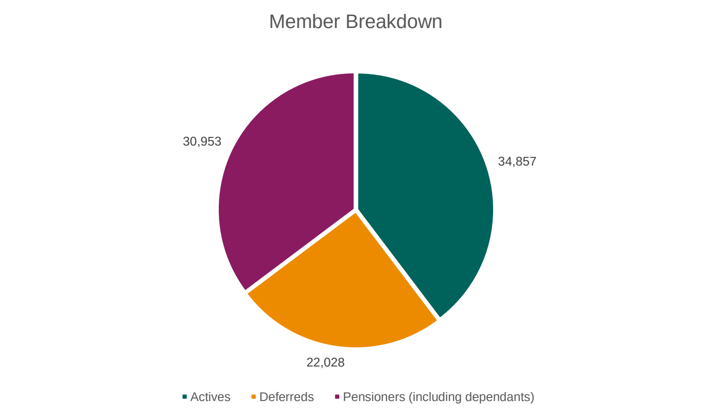
- **Compliance** with the Regulations
- A valuation that is not **inconsistent** with others
- A funding plan that ensures **solvency** of the fund
- A **long-term cost-efficient** funding plan

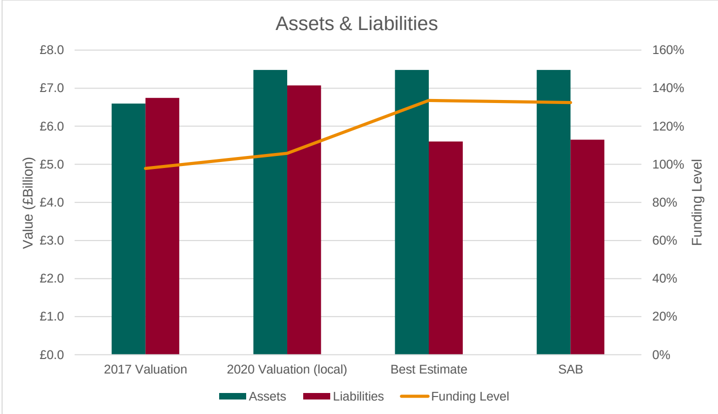
The Government Actuary's Department (GAD) has completed and published its Section 13 report on the 2020 actuarial valuations for the LGPS in Scotland**.** Importantly, neither Lothian Pension Fund, nor Scottish Homes Pension Fund, has received any amber or red flags. The GAD Section 13 report and its related appendices are included at Appendix 1 [tbc], together with, at Appendix 2, the detailed dashboard analysis for solvency and long-term cost efficiency analysis, specific to Lothian Pension Fund.

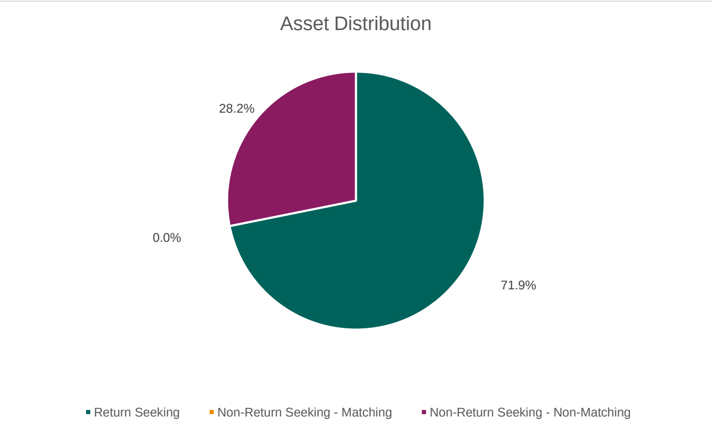
Appendices:

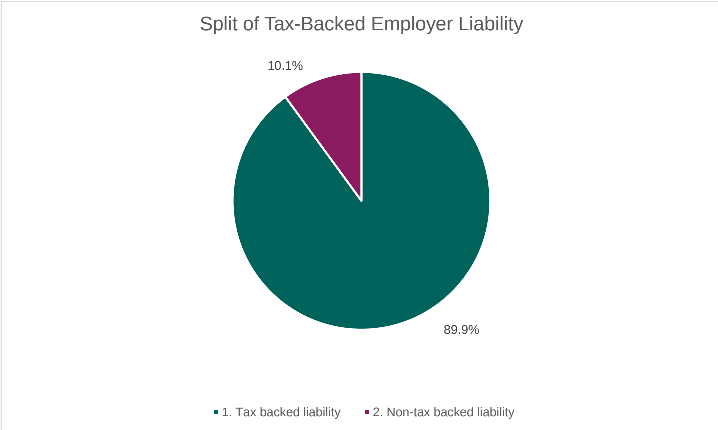
1. Local Government Pension Scheme (Scotland) Section 13 report as at 31 March 2020 - GOV.UK (www.gov.uk)
2. GAD's solvency and long-term cost efficiency analysis for Lothian Pension Fund, Section 13 report as at 31 March 2020.

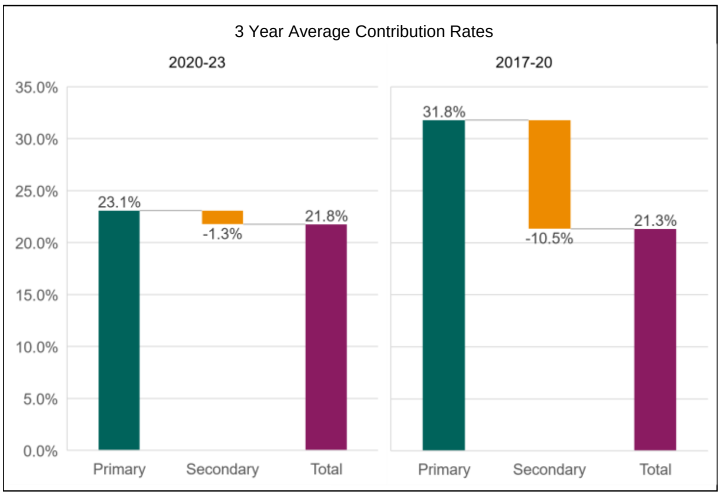
Lothian Pension Fund

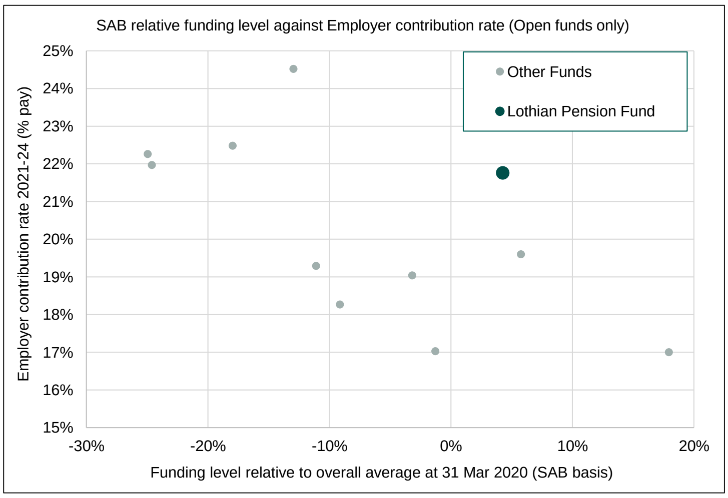












Lothian Pension Fund

Solvency Breakdown

Asset Shock

Assets are divided into the following classes:

Return seeking - Equity, Property, Infrastructure debt & other return seeking assets

Non-return seeking - All other assets

Return seeking assets are stressed by reducing them by 15%

New deficit

$= (Pre\text{-}stress\ asset\ value - Post\text{-}stress\ asset\ value)$

This deficit is then spread over 20 years of annual payments, and compared to the fund's pensionable payroll

	£m
Pre-stress asset value	£7,479.1
Return seeking assets	£5,373.7
Non-return seeking assets	£2,105.4
Post-stress asset value	£6,673.1
Return seeking	£4,567.7
Non-return seeking	£2,105.4
Reduction in asset value	£806.1
Equates to an annual amount (spread over 20 years)	£43.7
Total pensionable payroll	£788.5
Reduction to surplus as a percentage of pensionable payroll	5.5%
Deficit percentage of pensionable payroll (allowing for post-asset shock surplus)	Surplus

Employer Default Shock

Determine funding level on GAD's best estimate basis

If the fund is in deficit, non-tax backed deficits are allocated to tax-backed

The non-tax backed deficit is spread over 20 years and compared to the fund's pensionable payroll

	£m
Deficit on best estimate basis	£0.0
Proportion of deficit allocated to non-tax raising authorities	£0.0
Annual deficit payment (spread over 20 years)	£0.0
Deficit percentage of pensionable payroll	Surplus

Fund Open/Closed	Open
SAB Funding Level	132.4%

Long Term Cost Efficiency

Deficit Recovery Period

Implied deficit recovery period calculated on a standardised market consistent basis

Recovery period (years)	Surplus
Ranking of fund (out of 11 open funds)	Not Applicable

Required Return

Required investment return rates to achieve full funding in 20 years' time on the standardised market consistent basis

Required return under best estimate basis	2.3%
Ranking of fund (out of 11 open funds)	1

Surplus Retention

A comparison of the average actual employer contribution rate with the contribution rate required to meet the cost of accruing future benefits (including allowance for surplus) calculated on the standardised market consistent basis

Actual contribution rate paid less SCR on best estimate basis (allowing for surplus)	4.5%

Return Scope

Required investment return rates as calculated in required return, compared with the fund's expected best estimate future returns assuming current asset mix maintained

Expected return	4.2%
Required return	2.3%
Difference	1.9%
Ranking of fund (out of 11 open funds)	9

Deficit Recovery Plan

Consideration of how the deficit recovery plan has changed compared to 2017 valuation

Valuation	*2017*	*2020*
Deficit Recovery End Point	2037	Surplus

2018-21 Average Contribution Rate	21.3%
2021-24 Average Contribution Rate	21.8%
Increase in contributions	
Difference in Average Contribution Rate between 2018-21 and 2021-24	0.4%
Increase in deficit recovery end point (years)	Surplus

Minor inconsistencies in totals may occur due to rounding.

Government Actuary's Department

This document is intended only for discussions between GAD, SPPA, the relevant Local Authority and their actuary

This summary will be included as appendix to the full Section 13 report

Lothian Pension Fund — **Dashboard summary**

Past service funding position - local funding basis

Funding level (assets/liabilities)	105.8%
Funding level (change since previous valuation)	7.9%
Asset value used at valuation	£7,479,118,788
Value of liabilities	£7,071,426,818
Surplus (deficit)	£407,691,971
Discount rate(s)	3.0%
Assumed pension increases (CPI)	2.0%
Method of derivation of discount rate, plus any changes from last valuation	There is a 75% likelihood that the Fund's investments will return at least 3.0% over the next 20 years based on a stochastic asset projection.
Assumed Life expectancies for pensioners at age 65	
Average life expectancy for current pensioners - men currently age 65	20.5 years
Average life expectancy for current pensioners - women currently age 65	23.3 years
Average life expectancy for future pensioners - men currently age 45	22.0 years
Average life expectancy for future pensioners - women currently age 45	25.2 years

Past service funding position - SAB basis (for comparison purposes only)

Market value of assets	£7,479,118,788
Value of liabilities	£5,647,440,430
Funding Level on SAB basis (assets/liabilities)	132%
Funding level on SAB basis (change since last valuation)	n/a

Contribution rates payable

Primary contribution rate:	23.1%		
Secondary contribution rate (cash amounts each year in line with CIPFA guidance):			
Secondary contributions 2021/22	-£11,262,000		
Secondary contributions 2022/23	-£11,378,000		
Secondary contributions 2023/24	-£11,530,000		
Giving total expected contributions:			
Total expected contributions 2021/22 (£ figure based on assumed payroll)	£179,980,296	Based on assumed payroll of	£827,888,729
Total expected contributions 2022/23 (£ figure based on assumed payroll)	£184,577,231	Based on assumed payroll of	£848,291,045
Total expected contributions 2023/24 (£ figure based on assumed payroll)	£189,254,311	Based on assumed payroll of	£869,196,152
Average employee contribution rate (%of pay)	6.2%		
Employee contribution rate (£ figure based on assumed payroll)	£51,329,101	Based on assumed payroll of	£827,888,729

Additional information

Percentage of liabilities relating to employers with deficit recovery periods longer than 20 years	0.0%
Percentage of total liabilities that are in respect of employers participating in LGPS (S) who have no local or national taxpayer backing, nor a full guarantee, or other pass-through arrangement, with a body with such backing.	10.1%

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

Document is Restricted

This page is intentionally left blank

Pensions Committee

2.00pm, Wednesday, 21 June 2023

LPF – 'Project Forth'

Item number 9.2

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 agree to cease any further development of the merger of Falkirk Council and Lothian LGPS pension funds, in line with the guidance provided by the City of Edinburgh Council but continue discussions with Falkirk Council around enhancing the collaboration between Falkirk and Lothian LGPS based on existing operational arrangements.

1.2 note the Lothian Pension Fund and Falkirk Council Pension Fund project forth cessation communications plan (appendix 2) which is predicated on this agreement.

David Vallery

Chief Executive Officer, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk Tel: 0333 996 1900

LPF – 'Project LPF – 'Project Forth'

2. Background

2.1 The Pension Committees of both LPF and Falkirk Council Pension Fund (FCPF) approved a merger and the key basis of the merger in December 2021. The merger is subject to approval by both City of Edinburgh Council (**CEC**) and Falkirk Council (**FC**), as well as the completion of a legal process, regulatory approval from the Financial Conduct Authority (**FCA**) and receipt of tax clearances.

2.2 The Committees authorised officers to set up a project to complete remaining aspects of due diligence of the proposed structure and progress towards legal completion with an initial target date of 31 March 2023. That date being advantageous in terms of being the financial year end and triennial valuation date as well as reducing project risk and colleague uncertainty through a longer period to completion.

2.3 On the 8 March 2023 the Chief Executive of City of Edinburgh requested that Project Forth be paused to allow consideration of its progress and alignment with other council priorities.

3. Executive Summary

3.1 The purpose of this report is to enable committee to consider the email received from the CEO of City of Edinburgh Council on 1 June 2023. The email sent to David Vallery, CEO, LPF, communicates the view of Group Leaders of the City of Edinburgh Council and their preference not to prioritise the proposed merger for FCPF and LPF at this time.

3.2 The report also provides committee with oversight of the cessation communications plan for Forth including the proposed announcements following the communication from the CEC Chief Executive about Project Forth.

3.3 The Committee should note that the Falkirk Council Pension Fund committee and board were being informed of the views outlined in the communication from the CEC Chief Executive and thereby the expectation that Forth would not be progressing at this time.

4. Main Report

4.1 On 1 June 2023, David Vallery, LPF CEO received written confirmation from the City of Edinburgh Council (CEC) that, based on an informal and high-level consideration of various risks and issues, there is currently no appetite to explore further fundamentally changing the existing model of Lothian Pension Fund.

4.2 This message has been relayed to the Chief Executive of Falkirk Council by the CEC Chief Executive verbally and in writing, and also to the Falkirk Council Finance Director who is the responsible officer for FCPF and co-sponsor of the project.

4.3 Appendix one of this report sets out the email from Andrew Kerr, CEO of the City of Edinburgh Councils to David Vallery communicating the view of the Group Leaders of the City of Edinburgh Council.

4.4 Appendix two of this report sets out the merger (Project Forth) cessation communications overview ensuring that all LPF and Falkirk stakeholders are notified of the recent decision.

5. Stakeholder/Regulatory Impact

5.1 There is no regulatory impact although both the SPPA and FCA will be informed as part of the communications plan.

6. Background reading/external references

6.1 None.

7. Appendices

Appendix 1 – Email from Andrew Kerr, CEO of the City of Edinburgh Council.
Appendix 2 - The Lothian Pension Fund and Falkirk Council Pension Fund project forth cessation communications plan.

This page is intentionally left blank

by virtue of paragraph(s) 1, 3 of Part 1 of Schedule 7A
of the Local Government(Scotland) Act 1973.

Document is Restricted

This page is intentionally left blank

Amendment by Councillor Burgess
Pensions Committee
21 June 2023
Item 6.5: Statement of Investment Principles

Committee:

1.1 Agrees to adopt the revised Statement of Investment Principles with the following adjustment:

Principle 11: Committee believes that responsible investment should reduce risk and may improve returns,

[Delete] *but that mechanistic divestment is inconsistent with the Funds' fiduciary duty to members and employers*

[Insert] and that specific divestment may be consistent with the Funds' fiduciary duty to members and employers.

1.2 Regarding Principle 12, requests a report outlining the Lothian Pension Fund's engagement activities and successes, specifically focusing on instances where voting has influenced the activities of fossil fuel or related companies and including how LPF voted at the 2023 AGMs of BP, Shell, TotalEnergies, Exxon and Chevron in relation to the shareholder resolutions calling for these companies to align their 2030 reduction target for Scope 3 emissions with the goal of the Paris Climate Agreement.

Addendum by Councillor Burgess
Pensions Committee
21 June 2023
Item 6.6: Annual Investment Update – Lothian Pension Fund

Add to recommendations

Committee:

1.2 Requests a report to its next meeting detailing all investments currently held by Lothian Pension Fund in companies whose principle business is in fossil fuels for example BP, Shell, TotalEnergies, Exxon and Chevron.