Public Document Pack

Notice of Meeting and Agenda

Pensions Committee

2.00 pm Wednesday, 27th September, 2023

Hybrid Meeting - Lomond Suite, EICC, Morrison Street, Edinburgh / Microsoft Teams

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 Any items under "Private Business" will not be published, although the decisions will be recorded in the minute.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

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1. Quorum Check

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

2. Order of Business

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

3. Declaration of Interests

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

4. Deputations

4.1 If any.

5. Minutes

5.1 Minute of the Pensions Committee of 21 June 2023 (circulated) – submitted for approval as a correct record 9 - 16

6. Reports

Pension Fund (circulated)

7. Motions

7.1 Motion by Councillor Burgess – Lothian Pension Fund Investments in Oil and Gas Companies

"Committee:

1. Notes given the Climate Emergency and the fiduciary duty of pension funds that it is important for the Lothian Pension Fund to be clear about its investments in companies whose principal business is oil and gas.
2. Requests a report to the next committee meeting detailing all investments currently held by Lothian Pension Fund in companies whose principal business is in fossil fuels, for example BP, Shell, TotalEnergies, Exxon and Chevron."

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 Business

9.1	Employer Covenant Review 2023 - report by the Chief Finance Officer, Lothian Pension Fund (circulated)	541 - 560
9.2	Employers Participating in Lothian Pension Fund – report by the Chief Operating Officer, Lothian Pension Fund (circulated)	561 - 568

9.3	2023 Triennial Valuation - High Level Indicative Results – report by the Chief Executive Officer, Lothian Pension Fund	569 - 572

Nick Smith

Service Director, Legal and Assurance

Committee Members

Councillors Watt (Convener), Burgess, Doggart, Nicolson and 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 on a hybrid basis in the Lomond Suite, EICC, Morrison Street, Edinburgh and by Microsoft Teams. The meeting is open to all members of the public. The meeting will be monitored by Susan Handyside.

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
Alan Sievewright, Chief Finance 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, Assistant Company Secretary, Lothian Pension Fund, PO Box 24158, Edinburgh, EH3 1GY, Tel 0333 996 1971, email lpfgovernancecomms@lpf.org.uk .

A copy of the agenda and papers for this meeting will be available for inspection prior to the meeting at the Main Reception, City Chambers, High Street, Edinburgh EH1 1YJ.

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

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Pensions Committee Minutes

2pm, Wednesday 21 June 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 Alan Williamson.

Other Attendees:

Andy McKinnell (Independent Professional Observer).

Apologies: Darren May and Brian Robertson, Pension Board members.

1. Quorum

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

2. Order of Business

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

3. Declaration of Interests

To note there were no declarations of interest.

4. Minute

Decision

1) To approve the minute of the Pensions Committee of 23 March 2023 as a correct record subject to noting that LAPFF minutes would be circulated to members for information.

2) To request officers to consider establishing a rolling actions log for future meetings to track outstanding actions.

5. Pension Board Oversight

To note that the Pension Board had met prior to this meeting and that Pension Board members would provide comment on relevant matters during the meeting.

6. Agenda planning

An overview of proposed reports for future Pensions Committee and Pensions Audit Sub-Committee meetings for September and December 2023 and March 2024 was presented.

Decision

1) To note the agenda planning document and the revisions to the agenda planning document.

2) To note that an additional meeting of the Pensions Audit Sub-Committee would be held on Tuesday 19 March 2024 if required.

3) To note that the Convener of the Audit Sub-Committee would prepare a written annual report highlighting any specific issues raised at the Sub-Committee for presentation to the next Pensions Committee meeting for information.

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

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

7. Funding Strategy Statement

As required under the Scheme regulations, a valuation of the funds would be carried out at 31 March 2023. Data had 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 was ongoing following submission of employer year-end data and it was anticipated that data would be submitted to the actuary in July 2023 with initial employer results being available in Autumn 2023.

The final valuation report and final revised funding strategy statement would be presented to the Pensions Committee in March 2024.

Decision

1) To note that the Fund intended to consult with employers on the revised Funding Strategy Statement.

2) To 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.

(Reference – report by the Senior Pensions Employers and Members Manager, Lothian Pension Fund, submitted)

8. LPF Unaudited Annual Report (and Financial Statements) 2023

Details were provided of the unaudited Annual Report (and Financial Statements) for the year ended 31 March 2023 for Lothian Pension Fund and Scottish Homes Pension Fund.

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

Scottish Homes Pension Fund had 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 had declined but funding level had remained consistent with last year.

Decision

1) To note the unaudited Annual Report (and Financial Statements) for the year ended 31 March 2023 for Lothian Pension Fund and Scottish Homes Pension Fund.

2) To note the unaudited Annual Report (and Financial Statements) for the year ended 31 March 2023 would be submitted to the auditor, Azets Audit Services Ltd, by the due date of 30 June 2023.

3) To note that final proof reading of the report was still ongoing and that any potential corrections and minor amendments would be completed prior to release to the auditor and publication on the website.

4) To include a reference to the Local Authority Pension Fund Forum in the investment engagement section of the accounts.

5) To include in the accounts a comment that the Fund had introduced an honorarium for the two external Pensions Committee members.

6) To record the Committee's thanks and appreciation to all staff involved with preparation and finalisation of the annual accounts.

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

9. Statement of Investment Principles

The Statement of Investment Principles (SIP) for Lothian Pension Fund and Scottish Homes Pension Fund was submitted. There had been one material change to the SIP which was the removal of the actual portfolio allocations which were previously contained in Appendix B and were now reported as part of the annual investment update.

The Joint Investment Strategy Panel had reviewed the SIP in June 2023 and had confirmed that the SIP satisfied the Pensions Committee's statutory duty and was an accurate reflection of current advice which included reconsideration of long-term investment strategy following the triennial actuarial valuation.

The following proposal was submitted by Councillor Burgess in terms of Standing Order 11:

"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."

Decision

1) To defer the decision to adopt the revised Statement of Investment Principles to the September meeting of the Committee.

2) To request a briefing note for members in advance of the September meeting providing further information on the content of the proposal submitted by Councillor Burgess in relation to principle 12 ie. "the Lothian Pension Fund's engagement activities and successes, specifically focusing on instances where voting had influenced the activities of fossil fuel or related companies and including how Lothian Pension Fund voted at the 2023 Annual General Meetings 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."

3) To note that the Fund's voting records would be reinstated on the Lothian Pension Fund website.

4) To note that Hermes EOS would be included in a training session for members in September 2023.

(References – Pensions Committee 29 June 2022 (item 11); report by the Chief Investment Officer, Lothian Pension Fund, submitted)

10. Joint Investment Strategy Panel Activity

An update was provided 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 (LPF) and the Scottish Homes Pension Fund (SHPF).

During 2022/23 JISP had continued to advise and assist in the oversight of the Lothian, Falkirk and Fife Pension funds' investment strategies, focussing on asset allocation, risk and performance. This included the oversight of Lothian Pension Fund and Scottish Homes Pension Fund.

The JISP monitored and advised on the implementation of investment strategy by officers and the internal investment management team focusing on achieving target allocations within the constraints defined by the Pensions 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 SHPF, the JISP continued to monitor the asset-liability matching.

Decision

To note the activities of the Joint Investment Strategy Panel during the financial year 2022/23.

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

11. Annual Investment Update – Lothian Pension Fund

An update was provided on the investments and funding position of the Lothian Pension Fund to 31 March 2023.

Over the twelve months to 31 March 2023, the total Fund return was +0.3% which compared with the benchmark return of -14.6%. Investment market returns were mixed over the period with notable declines in UK gilts.

The Fund aimed to achieve a return in line with its strategic benchmark over the long term with a lower-than-benchmark level of risk.

Lothian Pension Fund's funding level (ratio of assets to liabilities) was formally assessed on a triennial basis with the most recent figure of 106% at the March 2020 valuation. Over ten years the Fund had gained 9.7% per annum lagging the benchmark gain of 10.0% per annum but with lower risk.

The next triennial valuation would be undertaken during 2023 and concluded by 31 March 2024 at the latest.

The following proposal was submitted by Councillor Burgess in terms of Standing Order 11:

"Committee:

Requests a report to its next meeting detailing all investments currently held by Lothian Pension Fund in companies whose principal business is in fossil fuels for example BP, Shell, TotalEnergies, Exxon and Chevron."

Decision

1) To note the asset allocation, investment performance and funding update of the Lothian Pension Fund.

2) To note the terms of the proposal submitted by Councillor Burgess.

3) To note that officers would provide the link to the investments published on Lothian Pension Fund website to members with a request that any feedback be forwarded to the Chief Investment Officer, Lothian Pension Fund.

4) Thereafter, as a result of any feedback received, if members agreed an additional report was required, this would be presented to Committee.

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

12. Annual Investment Update – Scottish Homes Pension Fund

An update was provided on the strategic allocation and the invested assets of the Scottish Homes Pension Fund (SHPF) for the year to 31 March 2023.

The actuarial funding level of the Fund was 118% at the March 2020 valuation. The Fund's actuary had reported the same funding level in their funding update dated 31 March 2022 and in their recent 2022/23 Actuarial Statement in May 2023, had stated that the funding level at end March 2023 was likely to be fairly similar to that reported at the previous formal valuation.

The triennial actuarial valuation was currently underway following which the formal valuation result at 31 March 2023 would be confirmed including any changes reflecting fund experience and financial and demographic assumptions.

In line with the Scottish Government guidance, the Fund's objective was to minimise the investment shortfall risk of assets relative to liabilities. The Fund's assets comprised UK gilts and cash as closely matched to the estimated liability payments as possible.

Decision

To note the asset allocation, investment performance and funding update of the Scottish Homes Pension Fund.

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

13. Risk and Compliance Update

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

A summary was also provided of the work being undertaken to enhance current risk management arrangements.

A key part of the operational plan would be an evaluation of the effectiveness of changes as they were introduced and embedded through observation, feedback and testing. Training and awareness would underpin the programme and ensure that staff understood their role in the framework.

Recruitment had been underway for a new post in the Risk and Compliance team with subject matter expertise in investment compliance and front office monitoring and oversight. An offer had been accepted by the preferred candidate with an anticipated start date towards the end of the summer.

Decision

1) To note the Lothian Pension Fund Group's Risk Register and Quarterly Risk Overview.

2) To note the ongoing strategy and development around the Group's risk management framework.

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

14. Annual LPF Group Governance Update

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

The annual update was provided on the operation of the LPF Group's legal, regulatory and governance structures together with the activities of its corporate subsidiaries LPFE Limited and LPFI Limited.

A summary was presented of the key changes and activities within LPF's governing bodies over the last 12 months together with a summary of future planned improvements over the next 12 months.

Decision

To note the annual LPF Group governance update.

(Reference – report by the Governance Manager, Lothian Pension Fund, submitted)

15. Project Forth

The Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, was requested to exclude 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.

Following discussion by members and taking into consideration advice from officers, the Committee agreed to consider the covering report in public and to make it available on the public website but to retain appendices 1 and 2 as private at this time.

The Chief Executive Officer advised the Committee that, on 1 June 2023, he had received written confirmation from the City of Edinburgh Council that, based on an informal and high-level consideration of various risks and issues, there was currently no appetite to explore further fundamentally changing the existing model of Lothian Pension Fund.

This messaged had been relayed verbally and in writing to the Chief Executive of Falkirk Council by the Chief Executive of City of Edinburgh Council and also to the Falkirk Council Finance Director who was the responsible officer for Falkirk Council Pension Fund and co-sponsor of the Project.

In light of the information contained in the written communication from the Chief Executive of the City of Edinburgh Council, the Chief Executive Officer, Lothian Pension Fund was recommending cessation of Project Forth and that, if agreed by the Pensions Committee, the communications plan set out in appendix 2 of his report would be progressed.

The Committee expressed concerns that they had not been afforded the opportunity to have sight of the updated business case as requested at previous meetings nor had they had the opportunity to fully assess and debate the benefits, risks and governance around the project.

Proposal 1

The following proposal was moved by Councillor Watt:

To approve the recommendations set out in the report by the Chief Executive Officer, Lothian Pension Fund as follows:

1) To 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 to continue discussions with Falkirk Council around enhancing the collaboration between Falkirk and Lothian LGPS based on existing operational arrangements.

2) To note the Lothian Pension Fund and Falkirk Council Pension Fund Project Forth cessation communications plan (appendix 2) which was predicated on this agreement.

Proposal 2

The following proposal was moved by John Anzani:

1) To reject the recommendations set out in the report by the Chief Executive Officer, Lothian Pension Fund and agree to progress with Project Forth.

2) To agree that an options paper on proposed governance structures be submitted to the Pensions Committee as previously discussed by Committee on 29 September 2022 and 7 December 2022.

Voting

For Proposal 1 - 2 votes

For Proposal 2 - 4 votes

(For Proposal 1 – Councillors Burgess and Watt.)

(For Proposal 2 – John Anzani, Councillor Doggart, Richard Lamont and Councillor Ross.)

Decision

To approve Proposal 2 by John Anzani as follows:

1) To reject the recommendations set out in the report by the Chief Executive Officer, Lothian Pension Fund and agree to progress with Project Forth.

2) To agree that an options paper on proposed governance structures be submitted to the Pensions Committee as previously discussed by Committee on 29 September 2022 and 7 December 2022.

(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), 23 March 2023 (item 15); report by the Chief Executive Officer, Lothian Pension Fund, submitted)

Pensions Committee

2.00pm, Wednesday, 27 September 2023

Agenda Planning and Governance Update

Item number 6.2

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the agenda planning document and the action tracker (appendix 2);

1.2 note the recruitment of the new Independent Professional Observer subject to agreement regarding mutually acceptable Terms and Conditions, for the provision of the Independent Professional Observer Service for Lothian Pension Fund;

1.3 note the LPF governance update regarding the changes in membership of the LPFE and LPFI Board;

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

1.5 note Hugh Dunn, Chair of LPFE and LPFI Boards significant contribution to LPF; and

1.6 note the significant contribution of Andy McKinnell, Independent Professional Observer to LPF.

David Vallery
Chief Executive Officer, Lothian Pension Fund

Contact: Susan Handyside, Assistant Company Secretary, Lothian Pension Fund
E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

Agenda Planning and Governance Update

2. Executive Summary

2.1 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.

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

2.3 The report also provides an update on the appointment process for an 'independent professional observer (IPO) for LPF and asks the committee to note the appointment.

2.4 The recruitment process for the IPO took place in July and August. The post received a total of six applicants with four being considered by the review panel.

2.5 The contract has been awarded to Alison Murray and the term of the new contract awarded will be from September 2023 to September 2026, with options to extend for up to 2 further periods of 2 years, giving a total potential contract period of 7 years.

Furthermore, the report updates committee on the LPFE and LPFI succession planning considerations, with the current Chair of both LPFI and LPFE, Hugh Dunn's retiral on 30 September. It has been agreed that the Executive Director of Corporate Services, CEC Dr Deborah Smart will be appointed as LPFE Chair and that Leslie Robb iNED be appointed LPFI Chair. Nareen Owens, Service Director, HR, CEC will also become a director of LPFE with effect from 1 October 2023.

3. Background

3.1 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.

3.2 Committee meetings are held on a quarterly basis and additionally as required; the Audit Sub Committee meetings are held at least three times a year.

3.3 The IPO role was introduced in March 2013, with the aim of enhancing scrutiny, experience, continuity, knowledge and impartiality within the Fund.

3.4 The service is in accordance with guidance issued by the Scottish Government on the participation of the IPO in assuring high standards of governance.

3.5 The current IPO contract for delivery of the service, commenced in September 2018 and is currently held by Andy McKinnell. Andy's contract will end at the end of September 2023.

3.6 The Pension Committee approved the establishment of a corporate structure to facilitate the more efficient administration of the Fund, reinforce its separate governance and statutory obligations and enable it to effectively collaborate with other LGPS funds. As a result, LPFI (regulated investments) and LPFE (staffing and group operational services) were established in 2015/16.

3.7 Hugh Dunn, Chair of LPFI and LPFE (and Service Director: Finance and Procurement, CEC) has been a director on LPFI and LPFE since 2015.

3.8 On the 4 September 2023 both the LPFI and LPFE boards considered succession planning alongside preparation for the imminent retiral of Hugh Dunn the current chair of LPFE and LPFI

4. Main Report

Agenda Planning

4.1 The proposed agendas for the December 2023, March 2024 and June 2024 meetings are set out in the following tables, based on the usual Committee cycle plus any additional and intra-cycle requests.

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.*

June 2024

Pensions Committee	**Audit Sub Committee**
• Referrals/ recommendations from Pensions Audit Sub Committee • Funding Strategy Statement • LPF Annual Report and Accounts (Unaudited) • Statement of Investment Principles • Joint Investment Strategy Panel Activity • Annual Investment Update – Lothian Pension fund. • Annual Investment Updates - Scottish Homes Pension Fund • Compliance and Risk Quarterly Update	• LPF Annual Report and Accounts (Unaudited) • IA Annual Report and Opinion year end 31 March 2023 • Internal Audit Update

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**
• Tuesday 5 December 2023 at 1.30pm • Wednesday 20 March 2024 at 2pm • Wednesday 26 June 2024 at 2pm	• Monday 4 December 2023 at 2pm • Tuesday 19 March 2024 at 2pm • Tuesday 25 June 2024 at 2pm

Independent Professional Observer

4.3 At the end of 2022 Andy McKinnell confirmed his intention to leave the fund in 2023 and a recruitment process to appoint a new IPO was carried out in July and August of 2023.

4.4 The recruitment process was supported by FWB recruitment and mirrored the committee and board nominations and appointment policy consisting of a two-stage process.

4.5 The first stage consisted of an initial evaluation of the candidates CV and an informal chat with candidates via teams with a view to exclude any applicants that had a serious conflict of interest or did not meet the required standards in terms of knowledge, understanding or expertise.

4.6 The Second Stage was conducted by a review panel consisting of the Convenor of the Pensions Committee, Convenor of the Audit Sub Committee, Chair of the Pension board and CEO of LPF.

4.7 A total of six candidates applied for the role. One candidate withdrew from the process after the first interview and one was deselected. Four candidates were taken forward for interview by the review panel.

4.8 All candidates were required to complete a written evaluation exercise providing feedback and observations on a selection of the June Pension Committee papers and deliver a presentation in order to demonstrate their knowledge, understanding and ability to communicate effectively.

4.9 The preferred candidate was unanimous and the contract has been awarded to Alison Murray. The term of the new contract awarded will be from September 2023 to September 2026, with options to extend for up to 2 further periods of 2 years, giving a total potential contract period of 7 years.

4.10 Feedback has been provided to all the candidates that took part in the process. Additionally, a summary of the feedback and those candidates who withdrew or were deselected was provided to the review panel.

4.11 Andy McKinnell has held the position of IPO since 2018, attending both Pension Board and Pensions Committee meetings as well as all the committee and board training events. Andy has provided guidance and support to both board and committee members, his expertise has been valued and appreciated. Committee are asked to note Andy's significant contribution to LPF.

LPFE and LPFI Board changes

4.12 Hugh Dunn LPFE Chair will retire on 30 September and his role becomes vacant. In line with the shareholder agreement, the Executive Director of Corporate Services will be appointed as Chair of LPFE. Further to this CEC as shareholder of LPFE, CEC have appointed Nareen Owens, Service Director: HR, CEC as director of LPFE with effect from 1 October 2023.

4.13 Since Hugh Dunn also chairs LPFI this position also becomes vacant. After the consideration of a succession planning report the LPFI board agreed to appoint Leslie Robb, as Independent Chair of LPFI. This will be subject to being formally approved by the FCA as a suitable Chair of the Board. Because Leslie has served on the LPFI Board as an iNED since February 2017 and has had a long career in the investment management sector it is anticipated that this appointment will be satisfactory for the FCA.

4.14 The incoming Service Director: Finance and Procurement, Richard Lloyd-Bithell will be appointed as Director of LPFI at its next meeting in December.

4.15 The table below illustrates the current and incoming directors:

LPFE Board			LPFI Board		
Name	**Appointment Date**	**Contract end data**	**Name**	**Appointment Date**	**Contract end date**
Dunn, H	February 2015	September 2023	Dunn, H	January 2016	September 2023
Marchant, A	February 2021	February 2025	Lloyd-Bithell, R	October 2023	None
Owens, N	October 2023	None	Marchant, A	January 2021	January 2025
Robb, L	December 2017	February 2025	Miller, B	February 2015	January 2024
Smart, D	October 2023	None	Robb, L	February 2017	February 2025
Vallery, D	July 2021	None	Thirkell, K	September 2022	None
Watt, M	August 2022	May 2027	Vallery, D	July 2021	None

4.16 Hugh Dunn has played a pivotal role in the LPFE Ltd and LPFI Ltd since 2015. The development of the two businesses under his direction have ensured that both businesses continue to evolve and flourish. The committee are asked to note Hugh's contribution as Chair.

Governance team restructure

4.17 A review of the LPF governance team structure is now complete and the appointment for a permanent Company Secretary to lead the team is underway with an appointment being made by the end of September. The Company Secretary role applies specifically to the LPFE and LPFI boards however the Company Secretary is also functional head and co-ordinates the rest of the LPF governance teams activities. Job titles and descriptions have been updated and the team has been renamed the secretariate team. The Company Secretary position has been filled for the last 12 months on an interim basis by Rachel Kirwan.

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 2 – Action Tracker

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LOTHIAN PENSION FUND

Pensions Committee

2.00pm, Wednesday 27 September 2023

Project Forth – Recommendation to cease

Item number 6.3

1. Recommendations

The Pensions Committee ("Committee") is requested to:

1.1 Note, as requested at the June 2023 committee meeting, the provision of the paper originally prepared for the March committee, which set out results of the updated and final evaluation of the proposed merger structures and the recommendations that had been anticipated at that time;

1.2 Support the recommendation as originally made in June to cease the project for the reasons given at that meeting, noting that Falkirk Council Pension Fund are operating under the presumption that Project Forth will not be proceeding and do not anticipate revisiting a merger within the next couple of years; and

1.3 Note that officers may revisit the proposals when either circumstances or priorities change.

David Vallery

Chief Executive Officer, Lothian Pension Fund

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

Project Forth – Recommendation to cease

2. Main Report

2.1 The paper attached as appendix 1 includes the background to Project Forth and the Committee are well versed in the history of the project, with it having been covered at each of the Committee meetings and many additional training events over the last two years.

2.2 Although written for presentation at the March 2023 meeting, and as communicated at the time, this paper was not presented following discussion with the City of Edinburgh Council leadership team. The reason for this was concerns raised about outstanding questions on the proposal and we agreed to prepare a clean paper, effectively from first principles, addressing the "why's and how's" of deeper collaboration with Falkirk Council Pension Fund recognising that since the genesis of Project Forth various facts and circumstances were believed to have changed and not all the current Committee or City of Edinburgh Council officers were fully conversant with the history or any changed circumstances. This delay and plan was communicated to Falkirk Council and the Falkirk Council Pension Fund at that time.

2.3 Council officers were of the view that significant further work would require to be undertaken to explore concerns raised, and potentially undertake further due diligence prior to any Council consideration of the proposals, the Chief Executive sought guidance from the political group leaders to get a steer as to whether it was a priority matter for the Council to expend officer time and investment into.

2.4 Subsequently and prior to the June 2023 Committee, and as reported at that meeting, the Chief Executive of the Council, indicated that following discussion with the political group leaders there was little appetite to fundamentally change the existing model and that in comparison with other challenges facing the Council, Project Forth couldn't be considered a priority. As noted above, the purpose of this intervention was to save further resources being committed to a proposal which was unlikely to ultimately receive the support of City of Edinburgh Council. Again, this message was relayed to Falkirk Council and its Pension Committee.

2.5 As a result, the recommendation to the June Committee was made to cease ongoing work on the project. The Pensions Committee rejected the recommendation and requested sight of the withdrawn paper setting out the results of the revised evaluation of Project Forth and the different structures. (appendix 1)

2.6 Falkirk Council having been informed about the lack of political will within City of Edinburgh Council to progress a merger at this time and have subsequently been working on alternative plans to maintain and enhance their operations and indicated an unwillingness to reconsider merger proposals at this time.

2.7 Falkirk Council Pension Fund and Lothian Pension Fund intend to continue the current investment collaboration alongside Fife Pension Fund, where in addition to collaboration in the Joint Investment Strategy Panel, LPFI provides investment advisory services and manages certain assets for each fund. There remains the expectation that LPFI will manage a further tranche of assets for Falkirk in the near term, but the current indications are that they have no appetite to go beyond that. Nevertheless, we will continue to be open to options where they benefit both funds.

2.8 Whilst the merits of merger may still exist, they would need to be proven to the satisfaction of all parties involved and without willing participants there cannot be a merger and therefore there is a recommendation to formally close, or at least suspend, the project. No actual work is being done on the project nor has it since March 2023 and all colleagues in both funds have been informed the merger won't be proceeding in the foreseeable future.

2.9 As can be seen in the paper attached, whilst the original decision to approve the merger was taken in December 2021, the May 2022 elections resulted in new elected members being appointed to the Committee, and since then the views of the current Committee have not formally been taken.

2.10 The Committee should note that although the merger won't be proceeding at this time and it is recommended that the project be formally closed, the potential merger may be revisited at some point in the future, when either circumstances or the political views and priorities within City of Edinburgh Council change.

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

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Pensions Committee

2pm, Wednesday, 27 September 2023

Project Forth

Executive/routine
Wards

1. Recommendations

1.1 Committee is asked to note the contents of this report.

Andrew Kerr

Chief Executive

Contact: Dr. Deborah Smart, Executive Director of Corporate Services

E-mail: deborah.smart@edinburgh.gov.uk | Tel: 0131 529 4822

Report

Project Forth

2. Main report

2.1 Before you at this Pension Committee is a paper from the Chief Executive of Lothian Pension Fund ("LPF") in relation to Project Forth. This was the draft LPF paper from March 2023 and which Committee has requested sight of.

2.2 Whilst it is not specifically detailed within today's report, I wanted to ensure that Committee members were aware that the section 95 officer of LPF (at that time), as well as others, had expressed concerns and reservations about the proposals at the time.

2.3 I consider it important that Committee members are made aware of the full background here and why Council officers were not supportive of the paper proceeding at that time. Hence the reason for this supplementary report.

2.4 Council officers make no comment as to whether the concerns of the section 95 officer (as well as other officers in LFP) were/are justified or reasonable but that is precisely why they would require to be considered in detail before any decision to proceed. I do not consider that simply referring to such risks in the report but not referring to the strength of feeling from such a key officer sufficiently highlights the issues. It is clearly important that any proposals for a Council decision are subject to appropriate, robust and agnostic analysis to ensure that all options and associated risks and benefits have been appropriately considered. With that in mind, as you may be aware I approached the Group Leaders to seek a steer as to whether they considered that Council would wish to divert officer time to address this potential project as a priority. The feedback received was that it was not a key priority and accordingly this message was fed back. I spoke directly to the Chief Executive of Falkirk Council to provide an update in this regard.

2.5 Hopefully you will understand that I feel the need to bring such matters directly to your attention to ensure that full information is available for your deliberations. To be clear, Council officers have no strong view on the "why" and "how" of Project Forth. However, if in the future it is to be taken forward by the Council then it is clear that all options would need to be properly analysed to ensure that any decision to proceed with a merger of such magnitude would do so on the basis of clear knowledge and analysis of the options and associated risks and benefits.

2.6 Accordingly, if Project Forth were to proceed in the future then in my view Council would need to agree in advance as to the resources required to be able to present such a properly analysed proposal later to Council. Given competing priorities and per the discussion with Group Leaders, this would likely mean that other Council activity may need to cease or be delayed.

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Pensions Committee

2.00pm, Wednesday 27 September 2023

Updates to Investment Governance arrangements

Item number 6.4

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the contents of this report as they relate to documentation of roles and management of conflicts in relation to investment decision-making.

1.2 adopt the revised Statement of Investment Principles.

David Vallery
Chief Executive Officer

Contact: Jane McKeown, Head of Legal, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1931

Updates to Investment Governance arrangements

2. Executive Summary

2.1 As a result of the expansion of services provided by LPFI to its Fife and Falkirk, and a recent regulatory compliance review of LPFI, changes are being made to the terms of reference of the Joint Investment Strategy Panel (**JISP**).

2.2 These changes enable better management and documenting of the known and accepted potential conflicts in the role of LPFI as both investment adviser and fund manager, whilst not changing the substance of the service delivery that is valued by LPF's strategic partner funds.

2.3 The changes have no bearing on the responsibilities of the Pension Committee for investment strategy, nor either the advice and oversight provided to LPF via the JISP and specifically the external advisers, nor to the responsibilities of Lothian Pension Fund's Chief Investment Officer (**CIO**) to implement the investment strategy as approved by the Committee.

2.4 As a result of these changes, references in the Statement of Investment Principles (**SIP**) should be updated. Other minor amendments to simplify and remove duplication within the SIP are also recommended.

2.5 The report presents the SIP for Lothian Pension Fund and Scottish Homes Pension Fund for approval.

3. Background

3.1 The Committee is reminded that:

3.1.1 under the Committee's Terms of Reference, the Committee is responsible for determining LPF's investment strategy and for reviewing and monitoring investment arrangements.

3.1.2 individuals (fund officers) have been delegated responsibility for implementing the investment strategy and for appointing, monitoring and reviewing managers and advisers. This is set out in a chain of documents collectively referred to as the 'Scheme of Delegation to Officers'. Authority delegated to officers is subject to Committee oversight.

3.2 Under LGPS Regulations, proper advice must be taken about pension fund investments. For this reason, an 'investment strategy panel' comprised of advisers appointed to support fund officers making decisions in relation to the investment strategy was created. Since 2019, fund officers from Falkirk and Fife have used the same advisers under a joint engagement.

3.3 The JISP also provide services to the Committee through training and attending at least one meeting per year. These services will not change.

3.4 To date:

3.4.1 the Council's Service Director: Finance and Procurement has attended JISP meetings on behalf of LPF, under the authority sub-delegated to him from the Executive Director of Corporate Services under the Scheme of Delegation to Officers. This arrangement was described in the SIP.

3.4.2 LPFI Limited has been part of the JISP and the LPF CIO has attended JISP meetings as LPFI's representative.

3.5 The Committee is reminded that the decision to adopt the revised SIP presented to the June meeting of the Committee was deferred to this meeting so that Principle 11 could be updated in light of Councillor Burgess's comment.

4. Main Report

4.1 A recent review of the LPF group's investment governance arrangements identified the need to clarify responsibility for LPF's investment decisions under the current delegated authorities.

4.2 It is now proposed that LPF's CIO should attend the quarterly meetings with the JISP as LPF's representative (to be referred to as the 'Client Representative') in place of the Council's Service Director: Finance and Procurement. The authorities sub-delegated by the LPF CEO to the LPF CIO will expressly state that the CIO is responsible for "*Implementing the investment strategy of the pension fund with advice from the Joint Investment Strategy Panel (JISP) where appropriate*" as currently happens in practice.

4.3 This change will support improvements in LPF's investment governance arrangements in particular, conflict of interest management and the role of decision-makers with authority over the assets of LPF which should be clearly distinguished from the role of Council officers performing the functions of the local authority. This is particularly pertinent for the Service Director: Finance and Procurement (also the Council's s95 officer), whose responsibility for the finances of the Council (the largest scheme employer within LPF) could conflict with the interests of LPF relevant to investment decisions.

4.4 LPFI's position as an adviser which is part of the JISP will also be changed, to address a separate conflict identified in the investment governance review. As a result of such change, LPFI will not be attending the JISP meetings with Client Representatives as an adviser. Previously LPFI appeared to be able to advise the Fife and Falkirk fund officers to transfer the management of assets to LPFI – a clear conflict of interests. Any such decision to transfer assets to LPFI's management will be advised on solely by the external JISP advisers.

4.5 LPFI will continue to provide information and advice to external clients and the JISP meetings, but the documentation will be enhanced to clearly distinguish the nature of service and document any potential or actual conflicts.

4.6 An updated description of the advisory responsibilities of the JISP, including LPFI's updated role, is set out in the latest JISP Terms of Reference. This is presented in Appendix 1 for noting.

4.7 The revised JISP Terms of Reference were discussed at the JISP meeting on 8 September with the changes broadly supported. Some minor feedback to add more context about the strategic intent that underpins the JISP meetings and emphasise the continuity of service from LPFI to both Fife and Falkirk has been requested. The expectation is that the three funds will formally adopt the revised JISP Terms of Reference at the December 2023 meeting.

4.8 The SIP contained sections which describe the 'Governance' and 'Strategy implementation'. As a result of the changes described in paragraphs 4.2 and 4.4, these have been reviewed. It is recommended to delete details of the investment governance arrangements where these are not required or overlap with other documents.

4.9 In-line with this approach of removing superfluous or overlapping information, it is recommended that other parts of the SIP are removed. The suggested amendments are explained in the 'schedule of explanatory comments of changes' within the mark-up of the SIP which is presented in Appendix 2 for approval. A clean version of the SIP is also included in Appendix 3.

4.10 This version of the SIP also addresses the amendment to Principle 11 which was requested by Councillor Burgess at the Committee meeting in June 2023.

5. Financial impact

5.1 There are no direct financial implications of this report.

6. Stakeholder/Regulatory Impact

6.1 The LGPS regulations relevant to the SIP have been reviewed to ensure the updated version continues to meet the regulatory requirements.

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

7. Background reading/external references

7.1 None.

8. Appendices

8.1 Appendix 1 – Joint Investment Strategy Panel Terms of Reference (draft)

8.2 Appendix 2 – Statement of Investment Principles (with tracked changes) including:

- Appendix A – Investment Strategies
- Appendix B – Statement of Compliance with the CIPFA Principles for Investment Decision Making in the Local Governance Pension Scheme
- Schedule of explanatory comments of changes

8.3 Appendix 3 – Statement of Investment Principles (clean version) including:

- Appendix A – Investment Strategies
- Appendix B – Statement of Compliance with the CIPFA Principles for Investment Decision Making in the Local Governance Pension Scheme

Appendix 1

Draft
Joint Investment Strategy Panel
Terms of Reference
August 2023

1. INTRODUCTION

Lothian Pension Fund, Falkirk Council Pension Fund and Fife Council Pension Fund (the "**Pension Funds**") use a panel of jointly appointed external, independent advisers known as the Joint Investment Strategy Panel ("**JISP"**). These terms of reference set out how the JISP operates.

Each Pension Fund retains responsibility for its own decisions and specifically:

- The Pensions Committee of each Pension Fund is responsible for **determining** the investment strategy and for reviewing and monitoring investment arrangements.
- Individuals (i.e. fund officers or "**Client Representatives**") have been delegated responsibility for **implementing** the investment strategy and for appointing, monitoring and reviewing managers and advisers.

2. PURPOSE OF THE JISP

As contemplated by the memoranda of understanding between the Pension Funds (whereby the Pension Funds agreed to collaborate with each other on a shared service basis), the JISP was established to promote collaboration between the Pension Funds by using shared advisers to provide an independent, expert view to support decisions in relation to investment strategy.

Under s11 of The LGPS (Management and Investment of Funds) (Scotland) Regulations 2010, the administering authority of each Pension Fund must obtain proper advice at reasonable intervals about its investments. This means that the investment decision-makers acting on behalf the administering authority have a duty to take advice. The JISP is used to provide this advice, supporting a key area of governance in the investment decision-making process.

3. RESPONSIBILITIES OF THE JISP

The Client Representatives are responsible for implementing the investment strategy of the Pension Funds. They have appointed the JISP to support their decisions in relation to investment strategy to benefit from the JISP's additional knowledge, experience and impartiality, including to support, challenge and scrutinise LPFI's advice to the Pension Funds (explained below).

The Client Representatives are required to implement the investment strategy in accordance with the Statement of Investment Principles ("**SIP**") maintained by the Pensions Committee of each Pension Fund. The SIP describes the principles governing decisions relating to the investment of fund money and therefore the JISP's advice should refer to the relevant fund's SIP.

The JISP's responsibilities to the Client Representatives are:

Investment Policy and Strategy

1. To advise on the content of each Pension Fund's SIP and the Statement of Responsible Investment Principles ("SRIP").
2. To provide advisory input on investment risk and return to support each Pension Fund's Pensions Committee in setting investment strategy.
3. To identify, analyse and advise on suitability of asset classes (policy groups) and benchmarks to be used by the Pension Funds.

Investment Implementation

4. To provide advice to Client Representatives on appropriate investment management styles, portfolio structures and implementation costs to achieve the Pension Funds' investment objectives.
5. To advise on appropriate objectives and restrictions for all portfolios of the three funds.
6. To provide advisory input on the selection and appointment process of external managers.
7. To review and discuss the potential impact of the investment environment on policy groups and investment strategies.
8. To review quarterly updates and outlooks for each policy group.
9. To advise on how to deal with any deviations from the Pension Funds' investment strategies, including the management of cash.
10. To advise on the use of stock lending services by the Pension Funds.

Monitoring

11. To monitor and review compliance with investment-related constraints and diversification objectives as set out in the SIP, in line with aggregate, policy group and individual mandate guidelines.
12. To monitor and review compliance with responsible investment policies, including:
    - evidence of environmental, social and governance (ESG) analysis within the processes of all investment managers, including LPFI
    - evidence of voting and engagement activity
13. To monitor the risk and return profile of the Pension Funds' investments at component and aggregate level, based on analysis of independent performance measurement providers.
14. To review analysis of the costs to support investment strategy implementation.
15. To monitor cash flow trends and advise on any implications for investment strategy.
16. To monitor manager performance (including LPFI's performance) based on a review of LPFI's advisory report.

The purpose of the JISP's monitoring described in paragraphs 11 - 16 is to inform their advice to the Client Representatives.

4. LPFI'S ADVISORY ROLE

As referred to above, LPFI Limited, a wholly owned subsidiary of Lothian Pension Fund, has been engaged by each Pension Fund to produce advisory reports for consideration at the JISP meetings. The advisory reports contain advice collated from both the JISP and the LPFI advisers for consideration by the Client Representatives, highlighting any differences of opinion between the JISP and LPFI. The advisory reports also include supporting information and investment data.

LPFI provides its draft advisory report to the JISP approximately 9-10 days in advance of the quarterly JISP meeting. LPFI representatives then organise an "adviser briefing" with the JISP in the week before the JISP meeting, in order to address any points of clarification or provide more detail and context to the advisory report. The final version of the advisory report is issued to the Client Representatives prior the JISP meeting and reflects the matters discussed at the adviser briefing.

5. JISP MEETINGS

Attendees: Each JISP meeting will be attended by:

- Advisers that make up the JISP.
- Client Representatives from each Pension Fund and their deputies (or a nominated substitute). The Client Representatives are as follows:
    - Lothian Pension Fund: Chief Investment Officer
    - Falkirk Council Pension Fund: Chief Finance Officer
    - Fife Council Pension Fund: Head of Finance

Each Pension Fund may invite other officers involved in their day-to-day operations to attend a JISP meeting, to support the relevant Client Representative.

With the prior agreement of each Client Representative, the Independent Professional Observer ("**IPO**") for any Pension Fund's Pensions Committees can attend any JISP meeting to support/inform their role. It is anticipated that attendance by the IPO will be on an infrequent basis, and not happen more than once per year.

Part of LPFI's role includes minute-taking at JISP meetings, therefore an LPFI Investment Administrator will also attend JISP meetings.

Additional attendees may attend JISP meetings where appropriate.

Chair: One of the Client Representatives will chair the discussions at JISP meetings, and the role of the Chair will rotate between the Client Representatives annually. The current Chair may appoint any other Client Representative as an alternative Chair. If the Client Representative who is scheduled to be Chair is absent, any other Client Representative can appoint itself as Chair.

Frequency: JISP meetings will take place quarterly and are expected to last up to half a day each in March, June, September and December each year. JISP meetings will take place at the offices of Lothian Pension Fund unless otherwise arranged in advance.

Reporting: LPFI's finalised advisory report (described above) will be distributed to the Client Representatives at least one week in advance of the JISP meeting (unless a shorter period is agreed by the Chair).

Minutes: LPFI will prepare minutes of each JISP meeting as a record of the discussions and any advice given by the JISP. Draft minutes will be forwarded to the JISP and the Client Representatives to confirm accuracy within ten working days of the JISP meeting. After this, LPFI will circulate copies of the minutes to the IPOs of each Pension Fund and the Conveners of each Pensions Committee. Minutes will be approved by the Client Representatives at the next JISP meeting.

6. TERMS OF REFERENCE REVIEW

These terms of reference will be reviewed by the Client Representatives and JISP annually and submitted to the Pensions Committee of each Pension Fund, for information.

August 2023

INTRODUCTION

This Statement of Investment Principles (SIP) describes the principles governing decisions of the Pensions Committee (Committee) of the City of Edinburgh Council (CEC) as administering authority of Lothian Pension Fund and Scottish Homes Pension Fund relating to the investment of fund money. It has been prepared in accordance with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, as amended (the 2010 Regulations).

Commented [JM1]: Comment 1

The SIP should be read in conjunction with the Statement of Responsible Investment Principles (SRIP). The SRIP explains the Committee's approach to the oversight and monitoring of investment activities from a Responsible Investment (RI) and Stewardship perspective. This covers the Committee's policy on the extent to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments; and the exercise of the rights (including voting rights) attaching to investments.

Commented [JM2]: Comment 2

Commented [JM3]: Comment 3

HIGH LEVEL INVESTMENT PRINCIPLES

The following principles guide the investment strategy, including the investment objectives and investment policies, adopted by the Committee.

Commented [JM5]: Comment 5

Governance

Principle 1: Committee believes that investment decisions must give precedence to the fiduciary duty owed to members and employers.
Fiduciary duty is paramount. The Committee recognises the potential conflicts of interests inherent in a local authority administering a multi-employer pension fund. The objectives of the local authority are not necessarily the same when it is acting in its capacity as the administering authority of a pension fund. The primary objective of the pension fund is to ensure sufficient funding in the long term so that retirement benefits owed to members under scheme rules can be paid when they fall due. (The most recent legal advice on fiduciary duty for the Scottish Local Government Pension Scheme is available at https://lgpsab.scot/fiduciary-duty-guidance/.)

Principle 2: Committee believes that risk should be mitigated by ensuring alignment of interests wherever possible.
Agency costs are high in the financial services industry – agents are often motivated to act in their best interests rather than those of the principal (the pension fund). 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 pension fund 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 the investment returns received by the pension fund. 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 investment 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 and oversight.
Implementation of more granular investment decisions (such as the selection/deselection of individual managers and assets) 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 pension fund and how investment decisions have contributed to such objectives.

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 available to scheme employers. The ultimate objective is to ensure long-term solvency so that retirement benefits owed 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.

LOTHIAN
PENSION FUND

Principle 7: Committee believes that requests for different investment strategies from employers with different objectives should be considered.

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 they are asked to contribute to the pension fund. Committee believes in allocating employers to different investment strategies in a way which reflects their timescale for participation in the pension fund and their covenant strength. Employers may have different objectives, so they should be given the opportunity to request an alternative investment strategy. The Fund should consider such requests, taking account of issues such as the strength of the employer's covenant and implementation costs.

Commented [JM6]: Comment 6

Investments

Principle 8: Committee believes that the ability of the pension fund 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.

Commented [JM7]: Comment 7

Commented [JM8]: Comment 8

The LGPS was designed with an important social purpose in mind – the provision of retirement income for individuals. The Committee's 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. The 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 pension funds 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 pension funds as they fall due, so monitoring activity is complex. The pension 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.

PENSION FUND OBJECTIVES

The **primary objective** of the pension fund is to ensure that there are sufficient funds available to meet all liabilities as they fall due.

The **funding objectives** 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 the investment strategy and govern the allocation across various asset classes.

The **investment objectives** of the pension fund are to achieve a return on assets which is sufficient over the long term to meet the funding objectives outlined in the Funding Strategy Statement, i.e. to pay liabilities and to make the scheme affordable to employers now and in the future, while minimising any increase in contribution rates.

Committee has set the 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 **timberland**. 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 pension fund should achieve diversification and better risk-adjusted returns by investing in assets from each policy group.

INVESTMENT 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 the pension fund. The 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.

Commented [JM10]: Comment 10

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.

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.

STRATEGY IMPLEMENTATION

With advice from the Joint Investment Strategy Panel, the CIO and senior members of the investment team identify the combination of investment managers and mandates within the policy groups to deliver the objectives of the pension fund. The investment strategies are listed in Appendix A. Both external and internal managers are used, recognising that there are cost and alignment advantages of an in-house investment team.

To reduce the risk that the investment objective is not met, 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 internal 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 advisers on a quarterly basis.

OTHER INVESTMENT CONSIDERATIONS

Realisation of investments

Most of the pension fund investments are in liquid markets and can be expected to be sold relatively quickly if required. A proportion of the 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 the assets is considered in the light of potential demands for cash.

Stock Lending

The pension fund lends a proportion of their investments to generate income from share ownership. Stock lending is conducted within parameters prescribed in the 2010 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 strict parameters on 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

A derivative is a security or contract that derives its value from its relationship with another asset. The Committee has approved the use of derivatives, subject to compliance with relevant legislation and control levels outlined in investment management agreements. The pension fund 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 pension fund to reduce risk from currency fluctuations and equity futures allow the pension fund to reduce risk during major portfolio rebalances/transitions.

Voting and Engagement

Commented [JM14]: Comment 14

The approach to exercising ownership rights attached to investments (including voting rights) is described in the SRIP.

Safekeeping of Assets

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

LOTHIAN PENSION FUND

COMPLIANCE WITH 2010 REGULATIONS

Increased Investment Limits

The 2010 Regulations contain limits on the percentage of a pension fund that may be invested in certain types of investment including partnerships. Partnerships are commonly used as the fund vehicle through which the pension fund makes an investment into assets such as infrastructure, timber, property, private equity and private debt (also referred to as unlisted investments). In accordance with the 2010 Regulations and based on proper advice from the JISP advisers, the Committee have agreed the following increased limits applicable to the pension fund's investments in partnerships to accommodate the allocation to unlisted investments:

- All contributions to any single partnership: 5% (statutory maximum of 5%)
- All contributions to)partnerships: 20% (statutory maximum of 30%)

The increased limits will apply for so long as the pension fund has an allocation to unlisted investments. This decision is compliant with the 2010 Regulations.

Commented [JM15]: Comment 15

CIPFA Principles for Investment Decision Making

The 2010 Regulations require the Committee to publish the extent to which it complies with guidance issued by Scottish Ministers. This includes the six *Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2009* published by the Chartered Institute of Public Finance and Accountancy (CIPFA) and based on the Myners principle, as updated in 2008. Details of the CIPFA principles, and how the Committee complies with such guidance, is provided in Appendix B.

Review of SIP

The Committee will review this statement annually and, in the case of any material change in the Committee's policy, before the end of a period of six months beginning with the date of that change. The Committee will consult with such persons as it considers appropriate and take proper advice when revising this statement.

APPENDIX A – INVESTMENT STRATEGIES (27 SEPTEMBER 2023)

Commented [JM16]: Comment 16

<table>
<tr><th>Strategy name</th><th>Investment objective</th><th>Investment strategy description</th></tr>
<tr><td colspan="3">Lothian Pension Fund</td></tr>
<tr><td>Main</td><td>To generate returns sufficient to pay pensions as they fall due.</td><td>To invest in the following exposures:
<table>
<tr><th>Policy group</th><th>Target weight 2021-2024</th><th>Permitted range</th></tr>
<tr><td>Equities</td><td>60%</td><td>50-70%</td></tr>
<tr><td>Real Assets</td><td>20%</td><td>10-30%</td></tr>
<tr><td>Non-Gilt Debts</td><td>10%</td><td>0-20%</td></tr>
<tr><td>LDI (Formerly Gilts)</td><td>10%</td><td>0-20%</td></tr>
<tr><td>Cash</td><td>0%</td><td>0-15%</td></tr>
<tr><td>Total</td><td>100%</td><td></td></tr>
</table></td></tr>
<tr><td>MEG (Mature Employers Group)</td><td>To achieve a return in line with gilts that match the duration of the liabilities.</td><td>To invest exclusively in UK Gilts and Cash matching the duration of employer liabilities with the duration of the invested assets.</td></tr>
<tr><td>50/50</td><td>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.</td><td>To invest 50:50 investment in the Main Strategy and the MEG Strategy which results in the following exposures:
<table>
<tr><th>Policy group</th><th>Target weight 2021-2024</th><th>Permitted range</th></tr>
<tr><td>Equities</td><td>30%</td><td>25-35%</td></tr>
<tr><td>Real Assets</td><td>10%</td><td>5-15%</td></tr>
<tr><td>Non-Gilt Debts</td><td>5%</td><td>0-10%</td></tr>
<tr><td>LDI (Formerly Gilts)</td><td>55%</td><td>45-65%</td></tr>
<tr><td>Cash</td><td>0%</td><td>0-10%</td></tr>
<tr><td>Total</td><td>100%</td><td></td></tr>
</table></td></tr>
</table>

<table>
<tr>
<td>Buses</td>
<td>To generate sufficient returns to pay pensions owed to members formerly employed by Lothian Buses as they fall due.</td>
<td>To invest 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, the Buses Strategy will have the following exposures:
<table>
<tr><th>Policy group</th><th>Target weight 2021-2024</th><th>Permitted range</th></tr>
<tr><td>Equities</td><td>33.0%</td><td>28-38%</td></tr>
<tr><td>Real Assets</td><td>11.0%</td><td>6-16%</td></tr>
<tr><td>Non-Gilt Debt</td><td>5.5%</td><td>0-11%</td></tr>
<tr><td>LDI (formerly Gilts)</td><td>50.5%</td><td>40-60%</td></tr>
<tr><td>Cash</td><td>0.0%</td><td>0-10%</td></tr>
<tr><td>Total</td><td>100%</td><td></td></tr>
</table>
</td>
</tr>
<tr>
<td colspan="3">Scottish Homes Pension Fund</td>
</tr>
<tr>
<td>Scottish Homes</td>
<td>To match cash flows from gilt income and redemption payments as closely as possible with the expected liability payments of the pension fund to minimise the risk of additional employer contributions being required.</td>
<td>To invest all assets in UK gilts and cash. As some liabilities are fixed in nature and some are inflation-linked, in the strategy is to invest 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.</td>
</tr>
</table>

APPENDIX B – COMPLIANCE WITH CIPFA PRINCIPLES

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 Committee focuses on setting the strategy for the pension fund 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.
- Fund officers are responsible for the provision of the training plan for Committee members to help them to make effective decisions and to ensure that they are fully aware of their statutory and fiduciary responsibilities.
- The Committee's Training and Attendance Policy is available on the website. It applies to both members of the Committee and the Pensions Board and is intended to support their knowledge to enable them to evaluate and challenge the advice they receive. Standards relating to the administration of the Committee's business are strictly upheld.

Commented [JM17]: Comment 17

- The Committee 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 JISP advisers advise the client representative (currently the LPF CIO) on the implementation of the investment strategies, reviewing structure, funding monitoring, performance and risk and asset allocation. The JISP meets at least quarterly and includes independent advisers who are experienced investment professionals.
- The fund's in-house investment team undertakes day-to-day monitoring of the investment. The team includes personnel with suitable professional qualifications and experience to provide the necessary skills, knowledge, advice and resources to support the JISP meetings and the Committee.

- Conflicts of interest are managed actively. At each Committee meeting, elected members of the 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 and includes the 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 SIP and the Funding Strategy Statement define the primary funding objectives of the pension fund.
- Asset-liability modelling is undertaken with the help of external advisers to aid the understanding of risks and the setting of investment strategy.
- Employers' attitude to risk is specifically considered in the setting of strategy, and employers can request a bespoke investment strategy.
- The setting of the Funding Strategy includes specific consideration of the desire to maintain stability in employer contribution rates.
- Reviews of investment strategy focus on the split between broad asset classes (equities, real assets, non-gilt debt, LDI and cash).
- External managers are appointed under investment management agreements which set clear benchmarks and risk parameters and include the requirement to comply with the SIP.
- The arrangements for advisers appointed to support the pension funds are reviewed regularly under a robust supplier management framework.

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 Committee take advice from the scheme actuary regarding the nature of the pension fund's 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.
- The Committee recognises that employers' circumstances vary and an alternative investment strategy may be deemed suitable for them. Requests for an alternative strategy will be considered, subject to practical constraints on implementation and, if appropriate, a review of the employer's contribution rates. It's not practical to offer individual employers full flexibility on asset allocation.

- The funding objectives for the pension fund are expressed in relation to the solvency and employer contribution rates. The covenants of participating employers are regularly assessed.
- The LPF CEO is responsible for ensuring the appropriate controls are applied to the pension fund. Controls are subject to internal audit, and results of audits are submitted to the Pensions Audit Sub Committee and/or the Committee.
- A risk register is maintained, and 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.

- Analysis of the performance and risk of the pension fund's investments 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 at the JISP. The JISP advisers assess the performance and risk of both internal and external investment managers on a regular basis (typically quarterly).
- Contracts with advisers are regularly market tested.
- The JISP advisers assess their own performance on a regular basis and report to Committee on their activities, typically annually.
- Training and attendance of members of the Committee and the Pensions Board is 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 Committee’s approach to responsible investment is described in the SIP and the SRIP, both of which can be found on the website.
- A description of how the pension fund adheres to the principles of the FRC’s Stewardship Code 2020 is set out in the Stewardship Report submitted annually to the FRC and available on the website.
- Details of the voting and engagement activities are available on the website. The pension fund's Annual Report and Accounts includes a summary of the 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 Committee are open to the public. Members of the public are entitled to make a deputation at Committee meetings. Committee papers are available on CEC’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.
- Policy statements are maintained regularly. Stakeholders are consulted on changes. Documents are available on the website.

The full report of the pension fund’s Annual Report and Accounts is available on the website and is sent to members on request. Regular newsletters for members are produced, as well as an annual benefit statement. Regular briefings are provided to employers. The website is updated regularly.

Schedule of explanatory comments of changes

Comment 1: The wording of the SIP has been edited to more accurately align with the requirements under the 2010 Regulations. Content which is not required under the 2010 Regulations has been omitted.

Comment 2: The SRIP is incorporated by cross-reference but content in the SIP which overlaps with SRIP has been taken out.

Comment 3: These are the requirements of the 2010 Regs.

Comment 4: As explained in [the Committee paper on JISP changes], the delegations have been updated so this section was inaccurate. As there is no requirement to include a description of governance in the SIP, it has been removed instead of being amended.

Comment 5: The substance of the Principles which Pensions Committee formulated based on advice from the JISP advisers is unchanged, but some of the wording has been edited for clarity. References to actions or decisions of the 'Funds' now refer to the Committee as the body responsible for the decisions. The Principles continue to be aligned with the Principles which have been adopted by the Pension Committees of Falkirk and Fife.

Comment 6: For consistency with the FSS, the word 'bespoke' has been replaced with the word 'alternative'.

Comment 7: Further to comments raised at the Committee meeting of June 2023, the reference to mechanistic divestment being inconsistent with fiduciary duty has been removed.

Comment 8: BM and GdC discussed and agreed removal of this wording with Cllrs Ross and Burgess (11/8/23)

Comment 9: As mentioned above, the SRIP is incorporated by cross-reference in the introduction but content in the SIP which overlaps with SRIP has been taken out.

Comment 10: Wording has been moved from later para.

Comment 11: This is not required to be included in the SIP, it is more appropriate for the FSS. Principle 7 is still included and addresses a similar point, therefore this para has been deleted.

Comment 12: References to responsibility for implementing the strategy have been updated to accurately reflect the authorities delegated to fund officers.

Comment 13: It is not necessary to include this wording.

Comment 14: This has been added for clarity, as the 2010 Regs specifically require the policy to include this.

Comment 15: The limits are unchanged. The 2010 Regs require the period during which the increase will apply to be stated, and this has been updated for accuracy.

Comment 16: This table replaces the text that was previously included but the content is unaffected.

Comment 17: Reference to the Training and Attendance policy means that these details are not required.

INTRODUCTION

This Statement of Investment Principles (SIP) describes the principles governing decisions of the Pensions Committee (Committee) of the City of Edinburgh Council (CEC) as administering authority of Lothian Pension Fund and Scottish Homes Pension Fund relating to the investment of fund money. It has been prepared in accordance with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, as amended (the 2010 Regulations).

The SIP should be read in conjunction with the Statement of Responsible Investment Principles (SRIP). The SRIP explains the Committee's approach to the oversight and monitoring of investment activities from a Responsible Investment (RI) and Stewardship perspective. This covers the Committee's policy on the extent to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments; and the exercise of the rights (including voting rights) attaching to investments.

HIGH LEVEL INVESTMENT PRINCIPLES

The following principles guide the investment strategy, including the investment objectives and investment policies, adopted by the Committee.

Governance

Principle 1: Committee believes that investment decisions must give precedence to the fiduciary duty owed to members and employers.
Fiduciary duty is paramount. The Committee recognises the potential conflicts of interests inherent in a local authority administering a multi-employer pension fund. The objectives of the local authority are not necessarily the same when it is acting in its capacity as the administering authority of a pension fund. The primary objective of the pension fund is to ensure sufficient funding in the long term so that retirement benefits owed to members under scheme rules can be paid when they fall due. (The most recent legal advice on fiduciary duty for the Scottish Local Government Pension Scheme is available at https://lgpsab.scot/fiduciary-duty-guidance/.)

Principle 2: Committee believes that risk should be mitigated by ensuring alignment of interests wherever possible.
Agency costs are high in the financial services industry – agents are often motivated to act in their best interests rather than those of the principal (the pension fund). 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 pension fund 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 the investment returns received by the pension fund. 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 investment 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 and oversight.
Implementation of more granular investment decisions (such as the selection/deselection of individual managers and assets) 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 pension fund and how investment decisions have contributed to such objectives.

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 available to scheme employers. The ultimate objective is to ensure long-term solvency so that retirement benefits owed 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 requests for different investment strategies from employers with different objectives should be considered.

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 they are asked to contribute to the pension fund. Committee believes in allocating employers to different investment strategies in a way which reflects their timescale for participation in the pension fund and their covenant strength. Employers may have different objectives, so they should be given the opportunity to request an alternative investment strategy. The Fund should consider such requests, taking account of issues such as the strength of the employer's covenant and implementation costs.

Investments

Principle 8: Committee believes that the ability of the pension fund 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.

The LGPS was designed with an important social purpose in mind – the provision of retirement income for individuals. The Committee's 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. The 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 pension funds 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 pension funds as they fall due, so monitoring activity is complex. The pension 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.

PENSION FUND OBJECTIVES

The **primary objective** of the pension fund is to ensure that there are sufficient funds available to meet all liabilities as they fall due.

The **funding objectives** 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 the investment strategy and govern the allocation across various asset classes.

The **investment objectives** of the pension fund are to achieve a return on assets which is sufficient over the long term to meet the funding objectives outlined in the Funding Strategy Statement, i.e. to pay liabilities and to make the scheme affordable to employers now and in the future, while minimising any increase in contribution rates.

Committee has set the 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 **timberland**. 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 pension fund should achieve diversification and better risk-adjusted returns by investing in assets from each policy group.

INVESTMENT 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 the pension fund. The 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.

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.

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.

STRATEGY IMPLEMENTATION

With advice from the Joint Investment Strategy Panel, the CIO and senior members of the investment team identify the combination of investment managers and mandates within the policy groups to deliver the objectives of the pension fund. The investment strategies are listed in Appendix A. Both external and internal managers are used, recognising that there are cost and alignment advantages of an in-house investment team.

To reduce the risk that the investment objective is not met, 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 internal 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 advisers on a quarterly basis.

OTHER INVESTMENT CONSIDERATIONS

Realisation of investments

Most of the pension fund investments are in liquid markets and can be expected to be sold relatively quickly if required. A proportion of the 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 the assets is considered in the light of potential demands for cash.

Stock Lending

The pension fund lends a proportion of their investments to generate income from share ownership. Stock lending is conducted within parameters prescribed in the 2010 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 strict parameters on 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

A derivative is a security or contract that derives its value from its relationship with another asset. The Committee has approved the use of derivatives, subject to compliance with relevant legislation and control levels outlined in investment management agreements. The pension fund 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 pension fund to reduce risk from currency fluctuations and equity futures allow the pension fund to reduce risk during major portfolio rebalances/transitions.

Voting and Engagement

The approach to exercising ownership rights attached to investments (including voting rights) is described in the SRIP.

Safekeeping of Assets

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

LOTHIAN
PENSION FUND

COMPLIANCE WITH 2010 REGULATIONS

Increased Investment Limits

The 2010 Regulations contain limits on the percentage of a pension fund that may be invested in certain types of investment including partnerships. Partnerships are commonly used as the fund vehicle through which the pension fund makes an investment into assets such as infrastructure, timber, property, private equity and private debt (also referred to as unlisted investments). In accordance with the 2010 Regulations and based on proper advice from the JISP advisers, the Committee have agreed the following increased limits applicable to the pension fund's investments in partnerships to accommodate the allocation to unlisted investments:

- All contributions to any single partnership: 5% (statutory maximum of 5%)
- All contributions to)partnerships: 20% (statutory maximum of 30%)

The increased limits will apply for so long as the pension fund has an allocation to unlisted investments. This decision is compliant with the 2010 Regulations.

CIPFA Principles for Investment Decision Making

The 2010 Regulations require the Committee to publish the extent to which it complies with guidance issued by Scottish Ministers. This includes the six *Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2009* published by the Chartered Institute of Public Finance and Accountancy (CIPFA) and based on the Myners principle, as updated in 2008. Details of the CIPFA principles, and how the Committee complies with such guidance, is provided in Appendix B.

Review of SIP

The Committee will review this statement annually and, in the case of any material change in the Committee's policy, before the end of a period of six months beginning with the date of that change. The Committee will consult with such persons as it considers appropriate and take proper advice when revising this statement.

APPENDIX A – INVESTMENT STRATEGIES (27 SEPTEMBER 2023)

<table>
<tr><th>Strategy name</th><th>Investment objective</th><th>Investment strategy description</th></tr>
<tr><td colspan="3">Lothian Pension Fund</td></tr>
<tr><td>Main</td><td>To generate returns sufficient to pay pensions as they fall due.</td><td>To invest in the following exposures:
<table>
<tr><th>Policy group</th><th>Target weight 2021-2024</th><th>Permitted range</th></tr>
<tr><td>Equities</td><td>60%</td><td>50-70%</td></tr>
<tr><td>Real Assets</td><td>20%</td><td>10-30%</td></tr>
<tr><td>Non-Gilt Debts</td><td>10%</td><td>0-20%</td></tr>
<tr><td>LDI (Formerly Gilts)</td><td>10%</td><td>0-20%</td></tr>
<tr><td>Cash</td><td>0%</td><td>0-15%</td></tr>
<tr><td>Total</td><td>100%</td><td></td></tr>
</table>
</td></tr>
<tr><td>MEG (Mature Employers Group)</td><td>To achieve a return in line with gilts that match the duration of the liabilities.</td><td>To invest exclusively in UK Gilts and Cash matching the duration of employer liabilities with the duration of the invested assets.</td></tr>
<tr><td>50/50</td><td>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.</td><td>To invest 50:50 investment in the Main Strategy and the MEG Strategy which results in the following exposures:
<table>
<tr><th>Policy group</th><th>Target weight 2021-2024</th><th>Permitted range</th></tr>
<tr><td>Equities</td><td>30%</td><td>25-35%</td></tr>
<tr><td>Real Assets</td><td>10%</td><td>5-15%</td></tr>
<tr><td>Non-Gilt Debts</td><td>5%</td><td>0-10%</td></tr>
<tr><td>LDI (Formerly Gilts)</td><td>55%</td><td>45-65%</td></tr>
<tr><td>Cash</td><td>0%</td><td>0-10%</td></tr>
<tr><td>Total</td><td>100%</td><td></td></tr>
</table>
</td></tr>
</table>

<table>
<tr>
<td>Buses</td>
<td>To generate sufficient returns to pay pensions owed to members formerly employed by Lothian Buses as they fall due.</td>
<td>To invest 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, the Buses Strategy will have the following exposures:
<table>
<tr><th>Policy group</th><th>Target weight 2021-2024</th><th>Permitted range</th></tr>
<tr><td>Equities</td><td>33.0%</td><td>28-38%</td></tr>
<tr><td>Real Assets</td><td>11.0%</td><td>6-16%</td></tr>
<tr><td>Non-Gilt Debt</td><td>5.5%</td><td>0-11%</td></tr>
<tr><td>LDI (formerly Gilts)</td><td>50.5%</td><td>40-60%</td></tr>
<tr><td>Cash</td><td>0.0%</td><td>0-10%</td></tr>
<tr><td>Total</td><td>100%</td><td></td></tr>
</table>
</td>
</tr>
<tr>
<td colspan="3">Scottish Homes Pension Fund</td>
</tr>
<tr>
<td>Scottish Homes</td>
<td>To match cash flows from gilt income and redemption payments as closely as possible with the expected liability payments of the pension fund to minimise the risk of additional employer contributions being required.</td>
<td>To invest all assets in UK gilts and cash. As some liabilities are fixed in nature and some are inflation-linked, in the strategy is to invest 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.</td>
</tr>
</table>

APPENDIX B – COMPLIANCE WITH CIPFA PRINCIPLES

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 Committee focuses on setting the strategy for the pension fund 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.

- Fund officers are responsible for the provision of the training plan for Committee members to help them to make effective decisions and to ensure that they are fully aware of their statutory and fiduciary responsibilities.

- The Committee's Training and Attendance Policy is available on the website. It applies to both members of the Committee and the Pensions Board and is intended to support their knowledge to enable them to evaluate and challenge the advice they receive. Standards relating to the administration of the Committee's business are strictly upheld.

- The Committee 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 JISP advisers advise the client representative (currently the LPF CIO) on the implementation of the investment strategies, reviewing structure, funding monitoring, performance and risk and asset allocation. The JISP meets at least quarterly and includes independent advisers who are experienced investment professionals.

- The fund's in-house investment team undertakes day-to-day monitoring of the investment. The team includes personnel with suitable professional qualifications and experience to provide the necessary skills, knowledge, advice and resources to support the JISP meetings and the Committee.

- Conflicts of interest are managed actively. At each Committee meeting, elected members of the 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 and includes the 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 SIP and the Funding Strategy Statement define the primary funding objectives of the pension fund.
- Asset-liability modelling is undertaken with the help of external advisers to aid the understanding of risks and the setting of investment strategy.
- Employers' attitude to risk is specifically considered in the setting of strategy, and employers can request a bespoke investment strategy.
- The setting of the Funding Strategy includes specific consideration of the desire to maintain stability in employer contribution rates.
- Reviews of investment strategy focus on the split between broad asset classes (equities, real assets, non-gilt debt, LDI and cash).
- External managers are appointed under investment management agreements which set clear benchmarks and risk parameters and include the requirement to comply with the SIP.
- The arrangements for advisers appointed to support the pension funds are reviewed regularly under a robust supplier management framework.

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 Committee take advice from the scheme actuary regarding the nature of the pension fund's 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.
- The Committee recognises that employers' circumstances vary and an alternative investment strategy may be deemed suitable for them. Requests for an alternative strategy will be considered, subject to practical constraints on implementation and, if appropriate, a review of the employer's contribution rates. It's not practical to offer individual employers full flexibility on asset allocation.

- The funding objectives for the pension fund are expressed in relation to the solvency and employer contribution rates. The covenants of participating employers are regularly assessed.
- The LPF CEO is responsible for ensuring the appropriate controls are applied to the pension fund. Controls are subject to internal audit, and results of audits are submitted to the Pensions Audit Sub Committee and/or the Committee.
- A risk register is maintained, and 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.

- Analysis of the performance and risk of the pension fund's investments 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 at the JISP. The JISP advisers assess the performance and risk of both internal and external investment managers on a regular basis (typically quarterly).
- Contracts with advisers are regularly market tested.
- The JISP advisers assess their own performance on a regular basis and report to Committee on their activities, typically annually.
- Training and attendance of members of the Committee and the Pensions Board is 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 Committee’s approach to responsible investment is described in the SIP and the SRIP, both of which can be found on the website.
- A description of how the pension fund adheres to the principles of the FRC’s Stewardship Code 2020 is set out in the Stewardship Report submitted annually to the FRC and available on the website.
- Details of the voting and engagement activities are available on the website. The pension fund's Annual Report and Accounts includes a summary of the 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 Committee are open to the public. Members of the public are entitled to make a deputation at Committee meetings. Committee papers are available on CEC’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.
- Policy statements are maintained regularly. Stakeholders are consulted on changes. Documents are available on the website.

The full report of the pension fund’s Annual Report and Accounts is available on the website and is sent to members on request. Regular newsletters for members are produced, as well as an annual benefit statement. Regular briefings are provided to employers. The website is updated regularly.

Pensions Committee

2.00pm, Wednesday 27 September 2023

Lothian Pension Fund - Contract Awards and Supplier Overview (Period 1 July 2022 to 30 June 2023)

Item number 6.5

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 Note the contents of this report.

1.2 Approve the continuation of the appointment of the Fund's external investment managers for global equities, by way of a waiver of the CSOs for the period from 1 October 2023, as referred to in paragraph 4.5 of this report.

David Vallery
Chief Executive Officer

Contact: Jane McKeown, Head of Legal, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1931

Lothian Pension Fund – Contract Awards and Supplier Overview (Period 1 July 2022 to 30 June 2023)

2. Executive Summary

2.1 The purpose of this report is to:

2.1.1 update the Committee on the contracts awarded by the Fund in the period 1 July 2022 to 30 June 2023. This provides visibility of contracts awarded under the Scheme of Delegation to Officers; and

2.1.2 seek approval to a waiver of the Council CSO's in connection with a further extension of certain high-value contracts.

2.2 It also provides an overview of the Fund's suppliers. It does not include details of suppliers for LPFI Ltd or LPFE Ltd as this information is reported to the relevant board.

3. Background

Contract awards

3.1 An annual report is presented to the Committee detailing the contracts awarded by the Fund. Contracts awarded by the Fund are entered into by the Council acting in its capacity as administering authority therefore the Council's Contract Standing Orders (CSOs) apply. The CSOs reflect the requirements of the applicable procurement legislation.

3.2 Previously:

3.2.1 the report has been prepared by the Council's Head of Commercial and Procurement Services, who prepares a similar report for the Council's Finance and Resources Committee. The Council's Commercial and Procurement Services team has agreed that Fund officers will be responsible for this report going forward.

3.2.2 the report has been supplemented with details of contracts awarded by LPFI Ltd and LPFE Ltd. This overlaps with the content of annual reports presented to the corporate boards, so it has been decided to exclude such details from this report.

Contract extensions

3.3 In March 2022, the Committee was made aware of a potential exemption from the requirement to conduct a regulated procurement process for investment management services, relevant to the requirement to seek Committee approval for extending the Fund's contracts with external equity managers. The Committee noted the Fund's intention to seek external advice, as part of Project Forth, to formally confirm the application of the financial services exemption to these services.

3.4 Similarly, the Committee approved the proposal to extend the property management and fund accounting services contract and the property valuation services contract until 30 September 2025. This date was suggested to allow 30 months from the expected date of completion of Project Forth.

Supplier overview

3.5 To support the Committee's awareness of the Fund's activities, the content of this report has been expanded to include an overview of the Fund's key suppliers. Suppliers are managed in accordance with LPF's supplier management framework.

4. Main Report

Contract awards

4.1 This report updates the Committee on the contracts awarded by the Fund in the period 1 July 2022 to 30 June 2023 (excluding contracts with a total value of less than £10,000).

4.2 The CSOs outline contract approval thresholds for goods, works and services, identifying both the level of award which can be undertaken and those with the authority to award. In specific circumstances, direct awards can be undertaken, where it is not practically viable to 'tender' the requirement.

4.3 A waiver of CSOs to allow a contract to be awarded or extended without competitive tendering may also be required in certain circumstances. Inevitably, there will always be a need for a select number of waivers, however each is evaluated on its own merits and approval given only if fully justifiable and in the best interests of the Council and other Fund stakeholders. Such circumstances continue to be tightly controlled and scrutinised and will be reported to this Committee moving forward.

4.4 A summary of contracts awarded by the Fund under delegated authority in the period 1 July 2022 – 30 June 2023 is presented in the table below. The spending under these contracts is within LPF's budget previously approved by the Pensions Committee.

Supplier	Contract Description	Duration	Contract Value
Azeus UK Limited	Governance board portal known as "Convene"	4 years	£32,000
Dealsco Ltd	Consultancy services relating to the Investment Services Review	3 months	£90,000
Dealsco Ltd	Consultancy services relating to the Investment Services Review Remediation Programme	6 months	£40,000
XLedger Limited	Financial ledger system	10 years	£243,000
CEM Benchmarking	Pension Administration Benchmarking Subscription	1 year	£16,000
Pinsent Masons LLP	Legal support with various private market transactions	One off	£100,000
CMS	Legal support with Project Forth	One off	£78,000
Contracts awarded by waiver of CSOs			
Deloitte	Project Forth - Specialist Tax Advice	One off	£21,600
PWC	Project Forth –VAT advice	One off	£10,000

Contract extensions

4.5 The Committee is reminded that, in March 2022, it agreed to extend certain high value contracts until the proposals for Project Forth were agreed. This included contracts with Baillie Gifford, Nordea, JLL and CBRE.

4.6 Notwithstanding the status of Project Forth, advice on the investment services exemption has now been instructed, so that the Fund can establish its procurement strategy for the appointment of its external equity managers.

4.7 The procurement strategy for the property contracts will also be reviewed.

Supplier overview

4.8 The framework was only launched in June 2022 and since then, expert input has been received through the internal audit of third-party supplier management completed in March 2023. In relation to the framework, the audit concluded 'significant improvement required'. All recommendations have been agreed and are being tracked via issue management processes.

4.9 Under the framework, the Fund classifies Tier 1 Suppliers as those who supply services which are critical to the Fund, meaning that operations cannot be carried out without their service and includes Suppliers who are critical of the Fund's compliance with law or regulation. The Tier 1 Suppliers are monitored by the Risk Management Group and details are set out below:

Supplier	**Service**	**Annual value (ex VAT)**	**Contract expiry date**	**Comments**
Charles River	Order management system	c£410,000	Term extended to October 2026	Service issues reported to LPFI board
Cased Dimensions	ICT Managed services	£312,000	31 March 2026	Stable service
Northern Trust	Global custodian	£340,000	Term extended to September 2024	Due for re-procurement (framework available)
Hymans Roberston	Actuarial support	£200,000	31 December 2025	CEO is now the Supplier Relationship Owner and reviewing the arrangements.
Heywoods	Pensions Administration Software	£225,000	28 November 2028	Stable service

4.10 In-line with the audit recommendations, the supplier relationship owners for Tier 1 Suppliers will be reviewing the exit plans and a due diligence checklist as part of their supplier monitoring responsibilities. Training will be delivered to all Fund staff later in the year.

5. Financial impact

5.1 A robust supplier management framework, proactive management of contract cycles and carrying out competitive procurement where appropriate, should continue to support commercial efficiency and achieve Best Value for the Fund contracts.

6. Stakeholder/Regulatory Impact

6.1 A waiver denotes a departure from the CSOs. There may be an increased risk if the Fund has departed from Scottish procurement regulations. The Council's Commercial and Procurement Services supports the Fund by scrutinising each waiver on its own merits in this context with appropriate checks and balances. A waiver should only be approved if justifiable and considered in the best interests, given the circumstances or permitted in accordance with the relevant legislative framework.

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

7. Background reading/external references

7.1 Agenda item 9.4 for Pensions Committee meeting on 22 March 2022 Lothian Pension Fund Contract Awards Update.

8. Appendices

8.1 None.

Pensions Committee

2.00pm, Wednesday, 27 September 2023

Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund

Item number 6.6

1. Executive Summary

The Pensions Committee (Committee) is requested to:

1.1 invite the Pension Board to raise any relevant matters or concerns which the Committee should consider;

1.2 note the report by Azets Audit Services 'Lothian Pension Funds 2022/23 Annual Audit Report to Members of the Pensions Committee and the Controller of Audit' (at Appendix 1);

1.3 **Approve** the audited Annual Report for the year ended 31 March 2023 for the Lothian Pension Fund and the Scottish Homes Pension Fund (at Appendix 2);

1.4 note that the audited financial statements, for the year ended 31 March 2023, of both the wholly owned companies, LPFE Limited and LPFI Limited, were approved by the respective Board of Directors in June 2023. These statements are shown in full at Appendices 3 and 4;

1.5 note the further Appendix 5, 'Letter of Representation (ISA 580), by the Chief Finance Officer, Lothian Pension Fund;

1.6 highlight any points that it would like to raise at the Pensions Committee on 2 September 2023

Alan Sievewright
Chief Finance Officer, Lothian Pension Fund

Contact: Jason Koumides, Financial Controller, Lothian Pension Fund

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

Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund

2. Executive Summary

2.1 The purpose of this report is to present the Audited Annual Report (and Financial Statements) for the year ended 31 March 2023 for Lothian Pension Fund and Scottish Homes Pension Fund. International Standard on Auditing (ISA) 260 requires the external auditor to communicate its finding to those charged with governance of the Funds. Accordingly, Azets Audit Services 'Lothian Pension Funds 2022/23 Draft Annual Audit report to Members of the Pensions Committee and the Controller of Audit' is included at Appendix 1.

2.2 Azets Audit Services intends to provide an unqualified opinion on the financial statements and other prescribed matters for Lothian Pension Fund and Scottish Homes Pension Fund and intends also to confirm that there are no matters on which it is required to report by exception.

3. Background

ISA 260 annual report by External Auditor

3.1 Under statutory accounting guidance issued by the Scottish Government, Administering Authorities are required to issue a separate Annual Report covering the Local Government Pension Scheme (LGPS) funds that they are responsible for. These Annual Reports are subject to a separate external audit.

3.2 International Standard on Auditing (UK and Ireland) 260 (ISA 260) requires the External Auditor to communicate its findings to those charged with governance of the Funds. This summarises any matters arising from the audit of the financial statements prior to the formal signing of the independent auditor's report.

3.3 As part of the standard, the External Auditor is required to provide a view of the following:

- any significant qualitative aspects within the Funds' accounting practice;
- any significant difficulties encountered during the audit;
- any material weakness in the design, implementation or operating
- effectiveness of the system of internal control;
- Any significant matters arising from the audit discussed with management;
- Any representations that have been requested from management; and
- Any other matter that is significant.

4. Main Report

Azets Audit Services - Lothian Pension Fund and Scottish Homes Pension Fund 2022/23 Annual Audit Report to Members and the Controller of Audit

4.1 The report by the external auditor on the financial statements is included at Appendix 1 – 'Azets Audit Services - 2022/23 Annual Audit Report to the Members of the Pensions Committee and the Controller of Audit'. This will be presented to Committee by Nick Bennett, Partner, Azets Audit Services.

4.2 Key points within the Audit Report include confirmation that:

4.2.1 Work has been performed in accordance with the Audit Scotland Code of Audit Practice, International Standards on Auditing (UK and Ireland) and Ethical Standards.

Financial statements audit

1. An unqualified opinion on the financial statements and other prescribed matters for Lothian Pension Fund and Scottish Homes Pension Fund (collectively referred to as the "Funds") will be given which will also confirm that there were no matters which we were required to report by exception.
2. no material adjustments have been required to the financial statements

Wider scope audit

1. LPF has effective arrangements for financial management and the use of resources
2. LPF has adequate arrangements in place to ensure ongoing sustainability.
3. Vision, Leadership and Governance arrangements at the Funds are appropriate.
4. The Funds have appropriate resources in place to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities.

4.3 In addition to members of the Pensions Committee and Pensions Audit Sub-Committee, Azets Audit Services will send the report to the Controller of Audit and has advised that it will therefore be published on Audit Scotland's website in due course.

Audited Annual Report 2023 for Lothian Pension Fund and Scottish Homes Pension Fund

Revisions from the Unaudited Annual Report 2023, as reported to Pensions Committee in June 2023

4.4 Some minor disclosure and presentational adjustments were identified during the audit. These have been reflected in the final set of financial statements.

4.5 With the completion of the work by Azets Audit Services, the Audited Annual Report 2023 for the Lothian Pension Fund and Scottish Homes Pension Fund has been finalised and is included at Appendix 2.

4.6 As part of the completion of the audit, the auditor seeks written assurances from the Service Director- Finance and Procurement, City of Edinburgh Council, on aspects of the financial statements and judgements and estimates made. A draft letter of representation under ISA580 is attached at Appendix 5.

Audited Financial Statements for the year ended 31 March 2023; LPFE Limited and LPFI Limited

4.7 The consolidated financial statements (within the Annual Report 2023) combine those of the Fund (the parent entity) and its controlled entities (the investment staffing company, LPFE Limited, and the investment services company, LPFI Limited), as defined in International Accounting Standard (IAS) 27. The financial statements of both companies have been audited by Azets Audit Services and were approved by the respective Boards of Directors in June 2023. In the interests of governance transparency, these statements are shown in full at Appendices 3 and 4.

4.8 LPFE Limited is the employment vehicle for the Fund's staff. It provides staffing services to the Lothian Pension Fund (acting through its administering authority the City of Edinburgh Council) (LPF), LPFI Limited and to Falkirk Council. The company's financial objective is to make a modest trading surplus before adjustments required under International Financial Reporting Standards (IFRS). Such adjustments primarily relate to pension costs, as required by International Accounting Standard (IAS) 19, and the related deferred tax. For the year ended 31 March 2023, the underlying trading profit of the company was £118,254 (2021: £115,889). Turnover was £7,309,586 (2022: £5,853,139).

4.9 LPFI Limited provides Financial Conduct Authority (FCA) regulated investment services, both to LPF and other likeminded pension funds and/or institutional investors but does not employ any staff directly. Its financial objective is to make a modest trading surplus. For the year ended 31 March 2022, the underlying trading profit of the company was £32,622 (2022: £32,459). Turnover was £1,873,534 (2022: £1,515,239).

4.10 The Annual LPF Group Governance Update, as reported to Pensions Committee in June 2023, provided further details on the operations of the two companies.

5. Financial impact

5.1 There are no direct financial implications as a result of this report beyond those otherwise stated.

6. Stakeholder/Regulatory Impact

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

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

7. Background reading/external references

7.1 None.

8. Appendices

Appendix 1 – Azets - Lothian Pension Fund 2022/23 Annual Audit Report to the Members of the Pensions Committee and the Controller of Audit;
Appendix 2 - Audited Annual Report 2023 for the Lothian Pension Fund;

Appendix 3 - LPFE Limited – Financial Statements (Audited) for the year ended 31 March 2023;

Appendix 4 – LPFI Limited – Financial Statements (Audited) for the year ended 31 March 2023;
Appendix 5 – Letter of representation (ISA 580) by Service Director- Finance and Procurement

Lothian Pension Fund

2022/23 Annual Audit Report to the Members of the Pensions Committee and the Controller of Audit

September 2023

Table of Contents

Key messages

This report concludes our audit of Lothian Pension Fund (LPF) and Scottish Homes Pension Fund ("the Funds") for the year ended 31 March 2023. This section summarises the key findings and conclusions from our audit.

Financial statements audit

Audit opinion	The annual accounts were considered and approved by the Pensions Committee on 27 September 2023. Our independent auditor's report is unqualified, subject to completion of pensions paid, cessation testing, group consolidation and contributions testing.
Key audit findings	The Funds had appropriate administrative processes in place to prepare the annual accounts and the supporting working papers. We have obtained adequate evidence in relation to the key audit risks identified in our audit plan. The accounting policies used to prepare the financial statements are considered appropriate. We are satisfied with the appropriateness of the accounting estimates and judgements used in the preparation of the financial statements. All material disclosures required by relevant legislation and applicable accounting standards have been made appropriately.
Audit adjustments	We have not identified any adjustments during the audit. We identified some disclosure and presentational adjustments during our audit, all of which have been reflected in the final set of financial statements.
Accounting systems and internal controls	We have applied a risk-based methodology to the audit. This approach requires us to document, evaluate and assess the Funds processes and internal controls relating to the financial reporting process. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we include these in this report. We consider the control environment within the Funds to be satisfactory, although there is scope for improvement.

Wider scope audit

Financial Management Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.	**Auditor judgement** Effective and appropriate arrangements are in place Lothian Pension Fund has effective arrangements for financial management and the use of resources. The Funds reported a small net increase in the funds held. Lothian Pension Fund reported a net withdrawal position in dealings with members of £18.190 million. Scottish Homes reported a net withdrawal position of £7.013 million. Annual operating plan updates are provided to each Pensions Committee meeting clearly explaining changes in group performance.
Financial Sustainability Financial sustainability looks forward to the medium and longer term to consider whether the Board is planning effectively to continue to deliver its services and the way in which they should be delivered.	**Auditor judgement** There are areas for improvement LPF has adequate arrangements in place to ensure ongoing financial sustainability. The focus of the Funds' investment strategy is to ensure a sufficient return over the long term to meet the funding objectives outlined by the Funding Strategy Statement. LPF has delivered low absolute performance in 2022/23 of 0.3% annual return on investments, which is higher than the benchmark returns of -14.6% while maintaining lower risk. The five-year and ten-year annualised investment returns for the first time in years outperformed the benchmark, due to consistent returns on equities and real assets relative to the benchmark. We would encourage Lothian Pension Fund to consider the medium and longer term implications of the expected triennial valuation results.

Vision, Leadership and Governance Vision, Leadership and Governance is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.	**Auditor judgement** There are areas for improvement Project Forth, a proposed merger between Lothian and Falkirk Pension Funds was approved by Lothian Pension Fund's Pensions Committee in September 2021, subject to the approval of City of Edinburgh Council and Falkirk Council as administering authorities. However, we noted further delays in progressing with the project and in June 2023 LPF decided to re-consider the merger proposal at their next meeting in September 2023. The cost of Project Forth to date, excluding officers time, amounts to £0.619 million. We recommend that after three years of pursuing the project, the Fund makes a clear decision regarding its strategic direction and builds this into future business plans and strategy documents. Governance arrangements at the Funds in relation to corporate governance and the information provided to the Board and Committees as well as the risk management are appropriate. We would recommend all members of the Board and Pensions Committee attend the minimum number of hours as required by the Funds' training policy.
Use of Resources to Improve Outcomes Audited bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities. This includes demonstrating economy, efficiency, and effectiveness through the use of financial and other resources and reporting performance against outcomes.	**Auditor judgement** Effective and appropriate arrangements are in place The Funds' investment performance is subject to regular review by the Pensions Committee. The Funds have appropriate arrangements in place to secure value for money through appropriate monitoring of performance of investments and the administration of the Funds. Performance remains strong with all ten performance measures met.

Definition

We use the following gradings to provide an overall assessment of the arrangements in place as they relate to the wider scope areas. The text provides a guide to the key criteria we use in the assessment, although not all of the criteria may exist in every case.

There is a fundamental absence or failure of arrangements

There is no evidence to support necessary improvement

Substantial unmitigated risks affect achievement of corporate objectives.

Arrangements are inadequate or ineffective

Pace and depth of improvement is slow

Significant unmitigated risks affect achievement of corporate objectives

No major weaknesses in arrangements but scope for improvement exists

Pace and depth of improvement are adequate

Risks exist to achievement of operational objectives

Effective and appropriate arrangements are in place

Pace and depth of improvement are effective

Risks to achievement of objectives are managed

Introduction

The annual audit comprises the audit of the financial statements and the wider-scope audit responsibilities set out in the Code of Audit Practice.

We outlined the scope of our audit in our External Audit Plan, which we presented to the Pensions Committee at the outset of our audit. We have not made any significant subsequent changes to the risks outlined in that plan.

Responsibilities

The Funds are responsible for preparing its annual accounts, including financial statements which show a true and fair view, and for implementing appropriate internal control systems. The weaknesses or risks identified in this report are only those that have come to our attention during our normal audit work and may not be all that exist. Communication in this report of matters arising from the audit or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on, the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

We would like to thank all management and staff for their co-operation and assistance during our audit.

Auditor independence

International Standards on Auditing in the UK (ISAs (UK)) require us to communicate on a timely basis all facts and matters that may have a bearing on our independence.

We confirm that we complied with the Financial Reporting Council's (FRC) Ethical Standard. In our professional judgement, we remained independent, and our objectivity has not been compromised in any way.

We set out in Appendix 1 our assessment and confirmation of independence.

Adding value

All of our clients quite rightly demand of us a positive contribution to meeting their ever-changing business needs. We add value by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way we aim to promote improved standards of governance, better management and decision making and more effective use of public money.

Any comments you may have on the service we provide would be greatly appreciated. Comments can be reported directly to any member of your audit team.

Openness and transparency

This report will be published on Audit Scotland's website www.audit-scotland.gov.uk.

Annual report and accounts audit

The Funds' annual report and accounts are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources.

Our audit opinion

Opinion	Basis for opinion	Conclusions
Financial statements	We conduct our audit in accordance with applicable law and International Standards on Auditing. Our findings / conclusions to inform our opinion are set out in this section of our annual report.	The draft financial statements. management commentary, annual governance statement, governance compliance statement and remuneration report were considered by the Pensions Committee and approved on 21 June 2023. They were reconsidered and approved post audit on 27 September 2023. We have issued unqualified audit opinions. We have not identified any misstatements during the audit. We received the draft annual accounts and supporting papers in line with our audit timetable. The accounts and working papers were prepared to a high standard. Further information and revisions were provided promptly where required. Our thanks go to the Finance team for their assistance with our work.

Opinion	Basis for opinion	Conclusions
Going concern basis of accounting	In the public sector, when assessing whether the going concern basis of accounting is appropriate, the anticipated provision of services is more relevant to the assessment than the continued existence of a particular public body. We assess whether there are plans to discontinue or privatise the Funds' functions. Our wider scope audit work considers the financial sustainability of the Funds.	Last year we concluded that a proposed LPF and Falkirk Pension Fund merger, Project Forth, would represent a transfer of services under combinations of public sector bodies, and hence does not negate the presumption of going concern. However, in June 2023 on the advice of the administering authority LPF took a decision to re-consider the merger decision, and therefore there is no further consideration in relation to going concern necessary until a decision on future strategy is made. Our audit opinion is unqualified in this respect.
Opinions prescribed by the Accounts Commission: • Management Commentary • Annual Governance Statement • Governance Compliance Statement	We read all the financial and non-financial information in the annual report and accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. We plan and perform audit procedures to gain assurance that the statutory other information has been prepared in accordance with	The annual report contains no material misstatements or inconsistencies with the financial statements. We have concluded that: • the information given in the Management Commentary is consistent with the financial statements and has been prepared in accordance with relevant statutory guidance. • the information given in the Annual Governance Statement is consistent with the financial statements and has been prepared in accordance with the Delivering Good Governance

Opinion	Basis for opinion	Conclusions
	relevant legislation and regulations.	in Local Government: Framework. • the information given in the Governance Compliance Statement is consistent with the financial statements and that report has been prepared in accordance with The Local Government Pension Scheme (Scotland) Regulations 2018.
Matters reported by exception	We are required to report on whether: • adequate accounting records have not been kept; or • the financial statements and the audited part of the remuneration report are not in agreement with the accounting records; or • we have not received all the information and explanations we require for our audit.	We have no matters to report.

An overview of the scope of our audit

The scope of our audit was detailed in our External Audit Plan, which was presented to the Pensions Committee in March 2023. The plan explained that we follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the Funds. This ensures that our audit focuses on the areas of highest risk (the significant risk areas). Planning is a continuous process, and our audit plan is subject to review during the course of the audit to take account of developments that arise.

At the planning stage we identified the significant risks that had the greatest effect on our audit. Audit procedures were then designed to mitigate these risks.

In our audit, we test and examine information using sampling and other audit techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain evidence through performing a review of the significant accounting systems, substantive procedures and detailed analytical procedures.

Significant risk areas and key audit matters

Significant risks are defined by auditing standards as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, we consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement. Audit procedures were designed to mitigate these risks.

As required by the Code of Audit Practice and the planning guidance issued by Audit Scotland, we consider the significant risks for the audit that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the audit team (the ‘Key Audit Matters’), as detailed in the tables below.

Our audit procedures relating to these matters were designed in the context of our audit of the annual accounts as a whole, and not to express an opinion on individual accounts or disclosures.

Our opinion on the annual accounts is not modified with respect to any of the risks described below.

Significant risks at the financial statement level

These risks are considered to have a pervasive impact on the financial statements as a whole and potentially affect many assertions for classes of transaction, account balances and disclosures.

Risk area	**Management override of controls**
Significant risk description	Management of any entity is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk will vary from entity to entity, this risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk on all audits.

Risk area	Management override of controls
	This was considered to be a significant risk and Key Audit Matter for the audit.
How the scope of our audit responded to the significant risk	**Key judgement** There is the potential for management to use their judgement to influence the financial statements as well as the potential to override controls for specific transactions. **Audit procedures** • Documenting our understanding of the journals posting process and evaluating the design effectiveness of management controls over journals. • Analysing the journals listing and determining criteria for selecting high risk and / or unusual journals. • Testing high risk and / or unusual journals posted during the year and after the unaudited annual accounts stage back to supporting documentation for appropriateness, corroboration and appropriate processing in line with the Funds' journals policy. • Gaining an understanding of the accounting estimates and critical judgements made by management. We challenged key assumptions and considered the reasonableness and indicators of management bias which could result in material misstatement due to fraud. • Evaluating the rationale for any changes in accounting policies, estimates or significant unusual transactions.
Key observations	Our work in this area is being finalised. We did not identify any indication of management override of controls from our audit work. We did not identify any areas of bias in key judgements made by management. Key judgements were consistent with prior years.

Significant risks at the assertion level for classes of transaction, account balances and disclosures

Key risk area	Fraud in revenue recognition
Significant risk description	Material misstatement due to fraudulent financial reporting relating to revenue recognition is a presumed inherent risk on every audit unless it can be rebutted. The presumption is that the Funds could adopt accounting policies or recognise income in such a way as to lead to a material misstatement in the reported financial position. Given the financial pressures facing the public sector as a whole, there is an inherent fraud risk associated with the recording of income around the year end. However, in respect of contributions received from member bodies we do not consider the revenue recognition risk to be significant due to a lack of incentive and opportunity to manipulate revenue of this nature. The risk of fraud in relation to revenue recognition is present in all other income streams. This was considered to be a significant risk and Key Audit Matter for the audit.
How the scope of our audit responded to the significant risk	**Key judgements** Given the financial pressures facing the public sector as a whole, there is an inherent fraud risk associated with the recording of income. **Audit procedures** • Evaluating the significant income streams and reviewing the controls in place over accounting for revenue. • Considering key areas of income and obtaining evidence that income is recorded in line with appropriate accounting policies and the policies have been consistently applied during the year. • Performing substantive test on all material revenue streams.
Key observations	Based on audit work performed, we gained reasonable assurance on the completeness and occurrence of all other material income streams and we are satisfied that income is fairly stated in the financial statements. However,

Key risk area	Fraud in revenue recognition
	confirmations from some auditors of the employer members of the LPF are still outstanding.

Key risk area	Fraud in non-pay expenditure
Significant risk description	As most public sector bodies are net expenditure bodies, the risk of fraud is also present in relation to expenditure. There is a risk that expenditure may be materially misstated in the financial statements.
How the scope of our audit responded to the significant risk	Based on our fieldwork assessment, we do not deem this risk to be present for expenditure due to the materially low levels of expenditure incurred. This was not considered to be a significant risk during our fieldwork.
Key observations	Based on audit work performed, we gained reasonable assurance on the completeness and occurrence of expenditure and we are satisfied that expenditure is fairly stated in the financial statements.

Key risk area	Investment valuations (significant accounting estimate)
Significant risk description	The Funds held investments of £9.650 billion as at 31 March 2023, of which 33% (£3.175 billion) were classified as level 2 or level 3 financial instruments, meaning the valuation was not based on unadjusted quoted prices in active markets. Judgements are taken by the Investment Managers to value those investments whose prices are not publicly available. Investments of this nature are complex, difficult to value and include a significant degree of judgement from the investment manager. The material nature of this balance means that any error in judgement could result in a material valuation error.
How the scope of our audit responded to the significant risk	**Key judgements** There is the potential for management to use their judgement to influence the values within the financial statements. **Audit procedures** • Evaluate the Funds' investment strategy and review the controls in place over accounting for investments. • Consider the Funds' material investments and obtain evidence that investments have been appropriately valued at 31 March 2023 including challenging fair value classification. • Review investment transactions and obtain evidence that investment transactions are recorded in line with appropriate accounting policies and the policies have been applied consistently across the year. • Review management experts including the custodian and external investment managers. This includes reviewing auditor reports on the internal controls at the custodian and at each key investment manager.
Key observations	We gained reasonable assurance over the valuation of investments at year end and are satisfied that investments and investment transactions are fairly stated in the financial statements.

Key risk area	Investment property valuations (significant accounting estimate)
Significant risk description	LPF hold a portfolio of investment properties. The management of the properties is undertaken by JLL, along with the Fund accounting for the portfolio. Investment properties are valued annually at fair value, in line with the Code. There is a significant degree of subjectivity in the measurement and valuation of investment properties. This subjectivity and the material nature of the Funds' investment property portfolio represents an increased risk of misstatement in the annual accounts.
How the scope of our audit responded to the significant risk	**Key judgements** There is the potential for management to use their judgement to influence the investment property values within the financial statements. **Audit procedures** • Ensuring that investment properties are recorded in the annual accounts in accordance with the Code and the Funds' accounting policies, and have been accounted for appropriately. We will review investment property valuations. • Considering the competence, capability and objectiveness of the valuer in line with ISA (UK) 500 Audit Evidence. We will review the valuation report and consider the assumptions used by the valuer against external sources of evidence. • Considering the scope of the valuer's work and the information provided to the valuer for completeness.
Key observations	LPF's investment properties were valued at £365.7 million as at 31 March 2023. The valuation undertaken by CBRE did not include any qualification. CBRE considers that sufficient market evidence exists upon which to base opinions of value. Based on our audit procedures and evaluation of expert's work we concur with this judgement. We gained reasonable assurance over the valuation of investment properties at the year end and are satisfied that

Key risk area	Investment property valuations (significant accounting estimate)
	investment properties are fairly stated in the financial statements.
Key risk area	**Valuation of defined benefit pension obligations (significant accounting estimate)**
Significant risk description	An actuarial estimate of the pension fund asset/liability is calculated on an annual basis under IAS 26 and on a triennial funding basis by an independent firm of actuaries with specialist knowledge and experience. The estimates are based on the most up to date membership data held by the Funds and have regard to local factors such as mortality rates and expected pay rises with other assumptions around inflation when calculating the liabilities. There is a risk that the assumptions used are not appropriate.
How the scope of our audit responded to the significant risk	**Key judgements** A significant level of estimation is required in order to determine the valuation of pension assets/liabilities. Small changes in the key assumptions (including discount rates, inflation and mortality rates) can have a material impact on the pension asset/liability. **Audit procedures** • Evaluating management processes and assumptions for the calculation of the estimates, the instructions issued to their actuarial experts and the scope of their work. • Evaluating the competence, capabilities and objectivity of management's actuarial expert. • Considering the basis on which the valuation was carried out and challenging the key assumptions applied. • Evaluating the information provided to the actuary for the purposes of their calculation of the IAS 26 estimate to ensure it was complete and consistent with our understanding.

Key risk area	Investment property valuations (significant accounting estimate)
Key observations	We reviewed the reasonableness of those assumptions used in the calculation against other local government pension fund actuaries and other observable data, with no issues identified. In addition, we reviewed the information in the actuarial report for completeness. We have considered the competence, capability and objectivity of the actuary in line with the requirements of *ISA (UK) 500 Audit Evidence*. From this review we did not identify any items which gave us cause for concern over the suitability of the actuary.

Estimates and judgements

We are satisfied with the appropriateness of the accounting estimates and judgements used in the preparation of the financial statements.

As part of the planning and fieldwork stages of the audit we identified all accounting estimates made by management and determined which of those were key to the overall financial statements. Consideration was given to pension assumptions, investments valuation, investment properties valuation, provisions for legal obligations, doubtful debts and expected credit losses, investment fees and accruals. Other than investments valuation, investment property valuation and pension assumptions, we have not determined the accounting estimates to be significant. We revisited our assessment during the fieldwork and completion stages of our audit and concluded that our assessment remained appropriate.

Our audit work consisted of reviewing these key areas for any indication of bias and assessing whether the judgements used by management are reasonable. We have summarised our assessment of this below, categorised between Prudent, Balanced and Optimistic.

Estimates and judgements	
Investments valuation	**Auditor judgement: Balanced**
Monthly valuation exercises of the investment portfolio exercises are carried out to confirm that the valuation provided by the Custodian, Northern Trust, is appropriate and in line with management's expectation. As at 31 March 2023, the Funds' internal valuation exercise resulted in a valuation of £9.646 billion, a valuation £5.3 million (0.06%) higher than the Custodian's valuation	

which is included in the accounts. The difference relates to timing of when information was received and the availability of information on certain foreign holdings. The Funds confirm that the valuation included in the accounts is materially in line with the internal exercise and that the Custodian's valuation better reflects information known at 31 March 2023.

We considered investment valuations against other sources of evidence and did not identify any indication that the valuation was materially misstated as at 31 March 2023.

Asset valuations at the Funds are based on third party information, where available, including publicly available market information, fund managers and custodian valuations. We evaluated the competence, objectivity and capability of management's expert in line with the requirements of ISA (UK) 500 and concluded that use of the experts was appropriate. We considered key assumptions against other sources of evidence.

Our findings and conclusions are included in the significant risk table above.

Investment property valuation	**Auditor judgement: Balanced**

Management consider the valuation of investment property on an annual basis. The valuation is carried out by the chartered valuation firm CBRE. We considered key assumptions against other sources of evidence and did not identify any indication that the valuation was materially misstated as at 31 March 2023.

Pensions Assumptions	**Auditor judgement: Balanced**

We reviewed the reasonableness of those assumptions used in the calculation against other local government pension fund actuaries and other observable data, with no issues identified. In addition, we reviewed the information in the actuarial report for completeness.

We have considered the competence, capability and objectivity of the actuary in line with the requirements of *ISA (UK) 500 Audit Evidence*. From this review we did not identify any items which gave us cause for concern over the suitability of the actuary.

Materiality

Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement and is affected by our assessment of the risk profile the Funds and the needs of users. We review our assessment of materiality throughout the audit.

Whilst our audit procedures are designed to identify misstatements which are material to our audit opinion, we also report to the Funds and management any uncorrected misstatements of lower value errors to the extent that our audit identifies these.

Group and the Funds materiality

Our initial assessment of materiality for LPF Group was £143 million. On receipt of the 2022/23 unaudited annual accounts, we reassessed materiality and updated it to £145 million, but kept the single entity unchanged. We consider that our updated assessment has remained appropriate throughout our audit.

Our initial assessment of materiality for Scottish Homes Pension Fund was £2.3 million. On receipt of the 2022/23 unaudited annual accounts, we reassessed materiality and updated it to £1.9 million. We consider that our updated assessment has remained appropriate throughout our audit.

	Group (£m)	Lothian Pension Fund (£m)	Scottish Homes Pension Fund (£m)
Overall materiality for the financial statements	145	143	1.9
Performance materiality	108.7	107.3	1.4
Trivial threshold	0.250	0.250	0.095

Materiality	Our assessment is based on approximately 1.5% of the group and Funds' net investment assets as disclosed in the unaudited annual accounts. We consider this to be the principal consideration for the users of the annual accounts when assessing the financial performance of the Funds' and the group. In performing our audit we apply a lower level of materiality to the audit of the Remuneration Report. Our materiality is set at £5,000.
Performance materiality	Performance materiality is the working level of materiality used throughout the audit. We use performance materiality to determine the nature, timing and extent of audit procedures carried out. We perform audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we perform a greater level of testing on the areas deemed to be at significant risk of material misstatement. Performance materiality is set at a value less than overall materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of the uncorrected and undetected misstatements exceed overall materiality.
Trivial misstatements	Trivial misstatements are matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

Special materiality for dealings with members

Our initial assessment of materiality for dealing with members for LPF was £13.1 million. On receipt of the 2022/23 unaudited annual accounts, we reassessed materiality and updated it to £14.2 million. The group materiality has been updated to £14.3 million accordingly. We consider that our updated assessment has remained appropriate throughout our audit.

	Group (£m)	Lothian Pension Fund (£m)	Scottish Homes Pension Fund (£m)
Dealings with members materiality	14.3	14.2	0.34
Performance materiality	10.7	10.6	0.25
Trivial threshold	0.250	0.250	0.017

Materiality	We apply lower materiality for dealings with members, based on the fact these transactions are significant to the Funds' activities and it would not be appropriate to use the assets based materiality to them. Our assessment is based on approximately 5% of the group and Funds' 2022/23 gross expenditure as disclosed in the unaudited annual accounts. We consider this to be the principal consideration for the users of the annual accounts when assessing financial performance of the Funds' and its group.
Performance materiality	Using our professional judgement, we have calculated performance materiality at approximately 75% of overall materiality.

Group audit

Lothian Pension Fund prepares its financial statements on a group basis. The group consists of Lothian Pension Fund and two special purpose vehicles, LPFE Ltd and LPFI Ltd. As group auditors under ISA (UK) 600 we are required to obtain sufficient appropriate audit evidence regarding the financial information of the components and regarding the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The following table sets out the components within the group.

Component	Significant	Level of response required
Lothian Pension Fund	Yes	Comprehensive
LFPI Ltd	No	Analytical
LPFE Ltd	No	Analytical

Comprehensive – the component is of such significance to the group as a whole that an audit of the component's financial statements is required for group reporting purposes.

Analytical - the component is not significant to the group and audit risks can be addressed sufficiently by applying analytical procedures at the group level.

LPFE Ltd and LPFI Ltd are fully consolidated. We did not consider either to be of individual financial significance to the group or, due to the specific nature or circumstances, include a significant risk of material misstatement to the group financial statements.

We are finalising our review of the consolidation entries made within the group accounts, to confirm those entries back to the financial statements of the group bodies. We do not expect any material adjustments arising from this work, as the group components are not material.

Azets is also the appointed auditor to LPFI Ltd and LPFE Ltd. During our audit we liaised with the audit teams to confirm that their programme of work is adequate for our purposes.

We revisited our assessment, following receipt of the unaudited accounts and our assessment remained the same.

We have nothing to report in respect of the following matters:

- No significant deficiencies in the system of internal control or instances of fraud were identified by the component auditor; and
- There were no limitations on the group audit.

Audit differences

We are pleased to report that there were no material adjustments to the financial statements or unadjusted audit differences.

We also identified minor disclosure and presentational adjustments during our audit which have been reflected in the final set of financial statements.

Internal controls

As part of our work we considered internal controls relevant to the preparation of the financial statements such that we were able to design appropriate audit procedures. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we report these to the Pensions Committee. These matters are limited to those which we have concluded are of sufficient importance to merit being reported.

We did not identify any significant control weaknesses during our audit.

Follow up of prior year recommendations

We followed up on progress in implementing actions raised by the audit in the prior year. Full details of our findings are included in Appendix 3.

Other communications

Accounting policies, presentation and disclosures

Our work included a review of the adequacy of disclosures in the financial statements and consideration of the appropriateness of the accounting policies adopted by the Funds.

There are no significant financial statements disclosures that we consider should be brought to your attention. All the disclosures required by relevant legislation and applicable accounting standards have been made appropriately. Overall, we found the disclosed accounting policies, and the overall disclosures and presentation to be appropriate.

Fraud and suspected fraud

We have previously discussed the risk of fraud with management and the Pensions Committee. We have not been made aware of any incidents in the period nor have any incidents come to our attention as a result of our audit testing.

Our work as auditor is not intended to identify any instances of fraud of a non-material nature and should not be relied upon for this purpose.

Non-compliance with laws and regulations

As part of our standard audit testing, we have reviewed the laws and regulations impacting the Funds. There are no indications from this work of any significant incidences of non-compliance or material breaches of laws and regulations.

Written representations

We will present written representations from management, and these will be approved at the same time as the financial statements were approved by the Pensions Committee, signed by the chief finance officer and to be returned to us before we complete our audit and issued our auditor's report.

Related parties

We are not aware of any related party transactions which have not been disclosed.

Confirmations from third parties

All requested third party confirmations have been received, apart from fund managers investment valuation reports.

Wider Scope

Financial management

Financial performance

The Funds have developed an annual Operating Plan which sets out the strategic aims of the Funds. A two-year budget to 2023/24 supports the delivery of the Plan which considers the Group as a whole.

Operating Plan updates are provided to each Pensions Committee meeting. The updates note progress of the Funds against the budget along with performance indicators and cashflow monitoring.

While the budget splits out the group into constituent components, budget reporting considers the Group as a whole. Due to the structure of the group, movements in year can affect performance of all group entities. The changes in financial performance for the group are supported by clear explanations.

Performance of the individual Funds can be scrutinised by the cashflow monitoring update provided in each Operating Plan update. This details the Funds' dealing with members for the year to date and the projected year end position on a cash basis.

While the information is presented such that it can be compared with the annual accounts, no information is provided on how performance to date compares with expectation, or prior year.

Lothian Pension Fund reported a net withdrawals position in dealings with members in line with forecast.

In line with forecast, Scottish Homes Pension Fund reported a net withdrawals position in dealings with members.

The small return on the Lothian Pension Fund and decrease in value of investments in the Scottish Homes Pension Fund were reflected in the net assets position for both. Consequently, LPF Fund's net assets have increased slightly while SHPF's decreased by 18% due to gilt market decreases.

The present value of the retirement benefit obligations are presented as a note to the accounts. A significant increase in the discount rate and minimum return on assets in the year have resulted in a lower obligation. This is despite a significant increase in pensions in April 2023 of 10.1% also taken into account by the actuary. This movement in the net asset position and present value of retirement obligations is shown in Exhibit 1.

Exhibit 1 – The Funds' Financial Position

	Net Assets	Present Value of Retirement Benefits
Lothian Pension Fund		
2022/23 (£million)	9,695	6,971
2021/22 (£million)	9,607	10,049
Movement (%)	1%	-31%
Scottish Homes Pension Fund		
2022/23 (£million)	126	95
2021/22 (£million)	154	116
Movement (%)	-18%	-18%

Source: Lothian Pension Funds Annual Report and Accounts

Withdrawal rates compare Funds income (contributions, transfers in) to its payments (pension related and transfers out). LPF recorded a higher withdrawal rates when compared to the forecast and to previous year. The higher 2022/23 withdrawal position resulted from a combination of lower income, higher pension payments and higher transfers out from the scheme. Scottish Homes Pension Funds withdrawal rate was below expected forecast. SHPF is a closed scheme therefore there is no income from contributions expected.

Exhibit 2 – Forecast versus Actual Net Withdrawals from the Funds

	2022/23 Forecast (£'000)	2022/23 Actual (£'000)	2021/22 Actual (£'000)
Lothian Pension Fund	(16,330)	(18,190)	(5,771)
Scottish Homes Pension Fund	(7,350)	(7,013)	(6,387)

Source: Lothian Pension Funds Annual Report and Accounts

Systems of internal control

We have evaluated the Funds' key financial systems and internal financial controls to determine whether they are adequate to prevent material misstatements in the annual accounts. Our approach has included documenting the key internal financial controls and performing walkthroughs to confirm that they are operating as intended.

As a part of this year's audit, and in accordance with the revised requirements of the International Standard on Auditing 315, we have assessed the control environment of General IT controls in relation to the pension payments, ledger and payroll systems and the overall environment.

No significant issues were identified from our audit work. We consider the system of control in place at the Funds to be satisfactory.

Prevention and detection of fraud and irregularity

Our audit was planned to provide a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud and irregularity.

Lothian Pension Fund was not required to participate in the National Fraud Initiative but has done so voluntarily. The Fund has completed work to provide data to the scheme.

The most recent NFI exercise commenced in 2022. LPF uploaded the data, investigated the matches and returned the results to its administering authority, The City of Edinburgh Council. There are no significant findings to note so far.

Overall, the LPF arrangements with respect to NFI are satisfactory.

Standards of Conduct

In our opinion the Funds' arrangements in relation to standards of conduct and the prevention and detection of bribery and corruption are adequate.

Our conclusion has been informed by a review of the arrangements for adopting and reviewing standing orders, financial instructions and the scheme of delegation and for complying with national and local codes of conduct.

Internal audit

An effective internal audit service is an important element of the Funds' governance arrangements. The City of Edinburgh Council provide the Funds' internal audit service. During our audit we considered the work of internal audit wherever possible to avoid duplication of effort and make the most efficient use of the Funds' audit resource.

Internal Audit presented a 'reasonable assurance', amber opinion to the Pensions Committee for the year to 31 March 2023. An amber opinion was given as Internal Audit reflected that LPF has generally sounds system of governance, risk management and control in place, with some issues of non-compliance and scope for improvement identified. The opinion is different from a 'Limited assurance' opinion from the previous year, but Internal Audit highlighted that direct comparison between the years might not be appropriate due to the different type of work being performed and different risk profiles in a year.

LPF has considered the assurances provided by Internal Audit as part of the Annual Governance Statement. The opinion is considered within the context of the wider assurance framework including assurances provided by the Section 95 Officer for the LPF Group and the Head of Finance at the City of Edinburgh Council.

In 2022/23 we did not place formal reliance on the work of internal audit; however, we have considered their findings in respect of our wider scope responsibilities and we are grateful to the internal audit team for their assistance during the course of our work.

Financial sustainability

Significant audit risk

Our audit plan identified a significant risk in relation to financial sustainability under our wider scope responsibilities:

Extract from External Audit Plan - Financial sustainability
The Funds held investments of £9.528 billion as at 31 March 2022. Investment strategies are in place for each of the funds which outline the Funds approach to ensure that all members and their dependents receive their benefits when they become payable. The investment strategy was updated and approved by the Pensions Committee in June 2021. The primary objective of the Funds is to ensure that there are sufficient funds available to meet all pension and lump sum liabilities as they fall due for payment. The funding objectives for each Fund are documented in the Committee's Funding Strategy Statement, which is reviewed at least triennially. The funding objectives, together with the rates of return being targeted and levels of risk to be tolerated, are central to each Fund's investment strategy and govern the allocation across various asset classes. The investment objectives of the Funds are to achieve a return on Fund assets which is sufficient over the long term to meet the funding objectives as outlined in the Funding Strategy Statement. Investment returns are generated by a combination of income (from dividends, interest and rents) and gains or losses on capital. While it is noted that the Funds investment strategy is designed in such a way as to withstand market volatility in the long term, we have noted that COVID-19, inflation levels and other worldwide political events had a significant impact on the market in the recent years. While the last two years saw a return to improved performance, a significant risk remains particularly in relation to impact of increased inflation, expected government monetary policies and uncertainties in relation to geopolitical situation. There is a risk that the value of investments is significantly impacted by events within the wider environment.

Our detailed findings on the Funds financial sustainability arrangements are set out below.

Funding Strategy

The Funds' objectives, as set out in the Funding Strategy Statement, are to generate sufficient long term returns to pay promised pensions. This must be balanced with making the scheme affordable to employers now and in the future.

Liabilities will be met by asset returns, resulting from the Investment Strategy, and contributions, resulting from the Funding Strategy. A core funding objective is to maximise asset returns, within reasonable and considered risk parameters, in order to minimise the cost to employers.

Funding levels can be volatile, due to intrinsic uncertainties over asset returns particularly when considered only in the short term. Minimising short term changes in contribution rates is an objective of the Funds'. Funding and investment strategies must be set with appropriate tolerances to adapt to market volatility.

Market Volatility

The previous year's market volatility created by recovery from COVID, inflation and the war in Ukraine continue into this year. The key factors impacting the markets were high inflation rates and the impact on government gilt prices. Central banks reacted to inflation with tighter monetary policies and interest rates increases.

When compared to the previous year, 2022/23 overall returns were lower. The UK Equities reported a -1.4% (2022: +14.5%) return for the 12 months, however this is in sterling, and when US dollar is used the decline of returns in equities was equal to -7.4%. Government bond prices fell during the year because of higher inflation and increasing interest rates. Returns on investments properties also weakened due to the impact of the increasing cost of borrowing.

Actuarial funding levels

The funding of Lothian Pension Fund was 106% at the last triennial valuation at the March 2020. The assets levels increased during the 2023/24 financial year, while liabilities decreased due to increasing discount rates. The results of the next triennial valuation at 31 March 2023 will be available in 2024. The draft results indicate a significantly increased level of funding, and well above 100%. This could mean potential changes to the employers' membership levels in the scheme, if for example, admitted employers elect to leave the Fund to take advantage of high funding levels.

We would encourage Lothian Pension Fund to consider the medium and longer term implications of the expected triennial valuation results, including potential exits from the Fund by smaller bodies, and the impact this might have on the Funds liability and net withdrawals.

Recommendation 1

The funding level of Scottish Homes Pension Fund at the 2020 Triennial Valuation was 117.7% (2017: 104.7%), reaching full funding faster than anticipated. The Scottish Government, as Guarantor, was consulted on future funding options. The decision reached was to maintain the current approach, which minimises investment risk.

While Scottish Homes Pension Fund holds mainly UK Gilts in line with the Fund's funding strategy, both Fund's hold significant cash reserves. For Scottish Homes Pension Fund, this was equivalent to two years' pension payments. This provides an important buffer against short term market volatility affecting meeting pension liabilities as they fall due.

Investment Strategy

Lothian Pension Fund has described their investment position as 'defensive'. The approach is generally expected to deliver outperformance when equity market returns are poor.

Lothian Pension Fund revised the investment strategy in June 2021. The improved position reported at the triennial valuation provided scope to reduce investment risk while generating sufficient returns to remain fully funded. The Fund's allocation of assets held in equities has decreased to 58.5% (2020: 60%).

Following its last triennial valuation the Fund set out a revised investment strategy in June 2021. The investment strategy has a significant impact on the investment performance, ultimately impacting the funding level and contribution rates. Hymans Robertson, as scheme actuary, undertook asset liability modelling to assess the impact of different investment strategies.

The modelling highlights the sensitivity of the funding level on gilt yields. While the investment risk is largely driven by equities, modelling illustrates that the Fund must invest in assets with returns above those of UK gilts to achieve its objectives. A revised strategy was therefore proposed which reduces the funds exposure to equities from a strategic allocation of 65% of assets to 60% (actual: 58.5%), with corresponding increases in real assets and gilts.

Investment Performance

Lothian Pension Fund aims to achieve a return in line with its strategic benchmark allocation, over the long term, with a lower-than-benchmark level of risk.

Annual performance to March 2023 was weaker than in previous year, with overall annual returns of 0.3% (2022: 10.8%). However, the performance was above the benchmark of -14.6% while maintaining investment in lower risk equities. Lothian Pension Fund's performance against benchmark and prior year is given at Exhibit 3.

Exhibit 3: Performance of Lothian Pension Fund against benchmark and prior year

Source: Unaudited Annual Report and Accounts

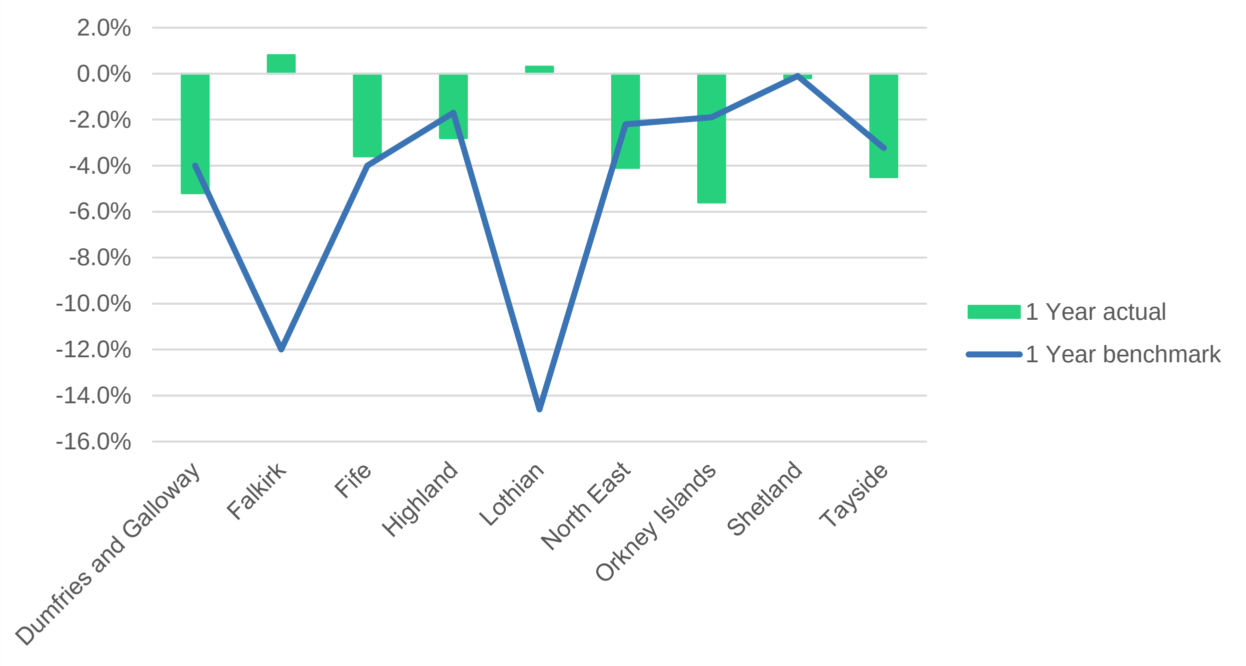
The impact of uncertain market conditions can be seen on the returns. Despite absolute performance being significantly lower than in 2021/22, the Fund's defensive market positioning helped the Fund outperform the annual benchmark.

There have been no changes to the overall Fund strategy during 2022/23. The main movements included the real assets allocation increase for new investments, a small decrease to non-gilt debt and the overall net reduction in cash, with no significant changes to the equities allocation.

Annual returns comparison

The Fund reported the second highest (2022: third highest) annual return and was one of only three LGPS to exceed annual benchmark returns. See Exhibit 4 for Lothian Pension Fund's annual performance against other Scottish LGPS Schemes.

Exhibit 4: Annual return across LGPS Scotland Funds against benchmark



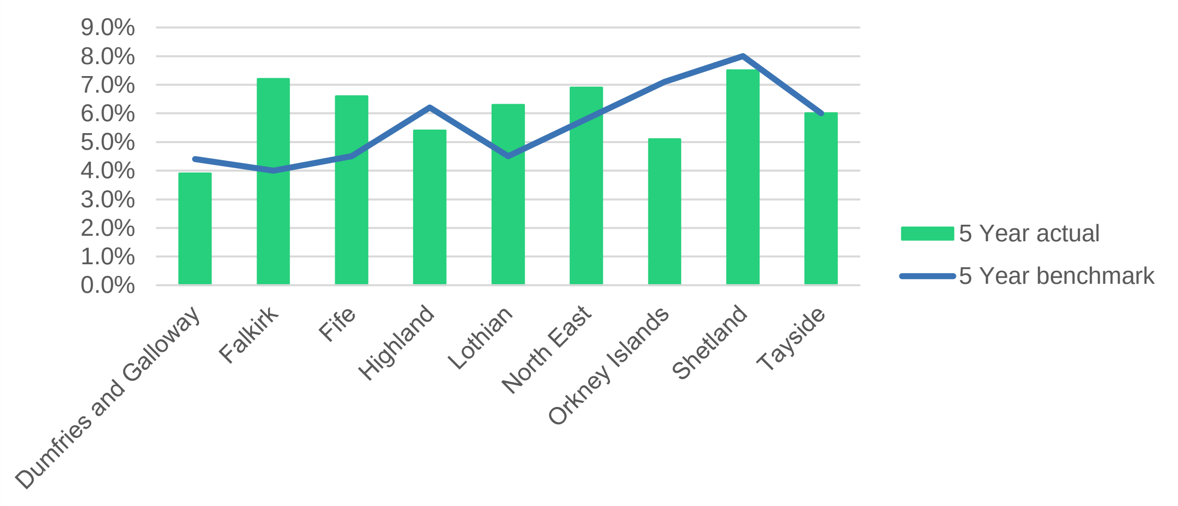
Source: Unaudited Annual Report and Accounts

5 year returns comparison

We have observed across our appointment that the gap between the return and 5 year benchmark continues to narrow and in 2022/23 LPF outperformed the benchmark. We do note that previous year's LPF return performance was positioned in the middle of the Scottish LGPS', while the benchmark was 2nd highest when compared to other pension funds. However, we understand that the benchmarks are based on many factors individual to investment types, pension fund and fund managers.

Comparison of Lothian Pension Fund's performance against other Scottish LGPS Schemes is given in Exhibit 5.

Exhibit 5: Annualised 5 year returns across LGPS Scotland Funds against benchmark



Source: Unaudited Annual Report and Accounts

Other factors

Lothian Pension Fund notes that it is absolute returns which allow the Fund to meet pension liabilities as they fall due. However, maximising asset returns within the risk tolerances reduces the cost to the members in the long term.

High levels of the UK inflation and continuing war in Ukraine have had impact on the investment returns. Pension benefits were also increased in April 2023 by 10.1% to reflect inflation impact, but the adverse impact of that increase on the funding level is not expected to be significant enough to outweigh increases in interest rates which in turn decrease the Funds' liabilities value.

The Fund divested any Russian directly linked investments in the previous years, leaving only trivial holdings in such investments. However, we noted that nearly £17 million is included in an investment kept in another fund, Macquarie Infrastructure and Real Assets (Europe) Limited, which invests in a company (EPIF) owning almost half of Eustream which in turn gets the majority of its revenues from payments from Gazprom. According to LPF:

- This investment is part of an Infrastructure portfolio, which is relatively illiquid and invested in 2016. According to LPF their interactions with the manager confirm that the company LPF invested in (and owning 49% of Eustream) has committed to achieve net zero emissions by 2050, in line with the Paris Accord, and more broadly, that the manager will play an important role in the energy transition.
- Neither EPIF nor Eustream have seen any of their clients become subject to any relevant sanctions and ultimately gas transit via the Eustream system and related services have been carved out from international sanctions. Both EPIF and Eustream continue to monitor international sanctions to ensure full compliance.

Vision, leadership and governance

Our detailed findings on the Funds' arrangements are set out below.

Vision

Lothian Pension Fund's Strategy document defines its vision 'to deliver outstanding pension and investment services for the benefit of members and employers'. The strategy document contains further information on purpose of the Fund and its core values. LPF is striving to be the best LGPS in Scotland, if not the UK, in terms of meeting the needs of members and employers, in using their influence as a leading responsible investor, and offering a superior employment proposition to their employees. The strategy goes into detail on the key goals of the Fund and of its more detailed objectives. These are accompanied by financial metrics, headcount, and the other essential components of a comprehensive business plan.

Project Forth

In September 2021, Lothian Pension Fund agreed in principle to merge Lothian Pension Fund with Falkirk Pension Fund, subject to further work including approvals by the City of Edinburgh Council and Falkirk Funds, as administering authorities. The intention to merge was publicly announced on 24th May 2022.

The aim and business case behind Project Forth is that a merger will result in substantial cost savings, achieve economies of scale and provide a future proofed best in class governance model fit for the increasing legal and regulatory landscape of the LGPS.

The proposed structure agreed by the Pensions Committee was a joint venture between the City of Edinburgh Council and Falkirk Funds, as administering authorities. This would be a company limited by guarantee holding nominal membership pro-rated to contributing assets.

Under the original timeline, the administering authorities were due to consider the proposal in February 2022 and then in December 2022, due to further due diligence checks required. The two Funds intended to align the timing of when the proposal is considered for approval. We noted further delays on progressing with the project and in June 2023 LPF decided to re-consider the merger proposal during the next meeting of the Pensions Committee in September 2023.

In the last three years the Funds have been focusing its strategic direction towards Project Forth and merger with the Falkirk Pension Fund. As this has now been subject to further considerations, we recommend that after three years of pursuing the project the Fund makes a clear decision as to its strategic direction. We would also expect this to be formally reflected in the Fund strategy and operational plans where appropriate.

Recommendation 2

Governance structure

The Pensions Committee has been delegated responsibility for governance of the Funds by the administering authority, the City of Edinburgh Council. The Pensions Committee is supported by an Audit Sub-Committee.

The Pensions Committee's responsibilities, as set out in the City of Edinburgh Council's Scheme of Delegation, include the administration and management of the Funds including setting the investment strategy.

In line with the requirements of the Public Service Pension Act 2013 the Pensions Committee is supported by a Pensions Board.

The Pensions Board is responsible for establishing arrangements that ensure proper conduct of the affairs of the Board and meet quarterly on a concurrent basis with the Pensions Committee.

The Funds complied with best practice and appointed an independent professional observer to the Board and Committee.

In line with legislation, if more than half of the members of the Pension Board disagree with a decision of the Pensions Committee then they can request in writing that the Committee review that decision. There have been no requests to review decisions in 2022/23.

Due to the specialised nature of the Funds, it is vital that members have the appropriate knowledge and understanding to provide appropriate challenge and operate effectively. Training is therefore seen as a fundamental requirement for all Committee and Board members.

Our review found that all, but one, current Pensions Committee and Board members met the requirement to have a minimum of 21 hours training. While the LPF Code of Conduct states that these requirements have to be met 'from time to time' we would encourage all the members to fulfil this obligation to allow an effective oversight of the Funds activities.

Recommendation 3

Joint Investment Strategy Panel

The Pensions Committee has delegated responsibility for investment strategy to the Executive Director of Resource who takes advice from a Joint Investment Strategy Panel made up of:

- the Chief Investment Officer, LPFI Ltd;

- a second senior investment officer of LPFI Ltd; and
- two external independent investment advisers.

The Joint Investment Strategy Panel covers joint working arrangement with Falkirk Pension Fund and Fife Pension Fund.

The Joint Investment Strategy Panel meets quarterly and considers the appropriate investment management structure required to implement the Funds' investment strategy. In addition, it is responsible for:

- making recommendations about investment strategy; and
- directing and monitoring strategy implementation and risk.

The primary focus of the panel during 2022/23 has been the implementation and monitoring of existing strategies for Lothian Pension Fund and Scottish Homes Pension Fund, as well as the implementation of the strategies of the collaborative partner funds.

Special areas considered by the panel in 2022/23 include:

- annual review of investment strategy;
- responsible investment principles; and
- the implications of a merger of the Lothian and Falkirk funds
- consideration of wider economic and political issues.

Lothian Pension Fund continues to operate four investment strategies recognising the different membership profiles and requirements of the admitted and scheduled employers.

Scottish Homes Pension Fund achieved full funding at the 2017 and 2020 actuarial valuations and therefore the strategy is low risk and designed to protect from short term market changes.

Cybersecurity

There continues to be a significant risk of cyber-attacks to public bodies, and it is important that they have appropriate cyber security arrangements in place. A number of recent incidents have demonstrated the significant impact that a cyber-attack can have on both the finances and operation of an organisation. We have considered risks related to cyber security at the Fund as part of our integrated audit as part of our understanding of the Fund's use of IT.

The revised ISA (UK) 315 includes enhanced requirements for auditors to understand a body's use of IT in its business, the related risks and the system of internal control addressing such risks. Our specialist IT auditors team have made an initial assessment of the IT environment and its key systems impacting preparation of the financial statements. Some of these systems are provided by the administering authority, which means reliance on a third party controls in place. We have however identified that these other IT systems possess ISO 27001 certification giving further assurance over information security arrangements. Conformity with this ISO means that Funds have put in place a system to manage risks related to the security of data owned or handled by the Funds, and that this system respects all the best practices and principles of the standard.

The client side IT management team are currently in the process of developing a suite of IT policies to support the Funds going forward.

We have noted that the Funds have not been subject to a successful cyberattack and we have noted that the key IT systems used and impacting on the financial statements possess relevant ISO certificates and appropriate arrangements are in place.

Use of resources to improve outcomes

Our detailed findings on the Funds arrangements are set out below.

Investment Manager Operations

Lothian Pension Fund operates two special purpose vehicles: LPFE Ltd and LPFI Ltd. Both companies are wholly owned and controlled by the Funds.

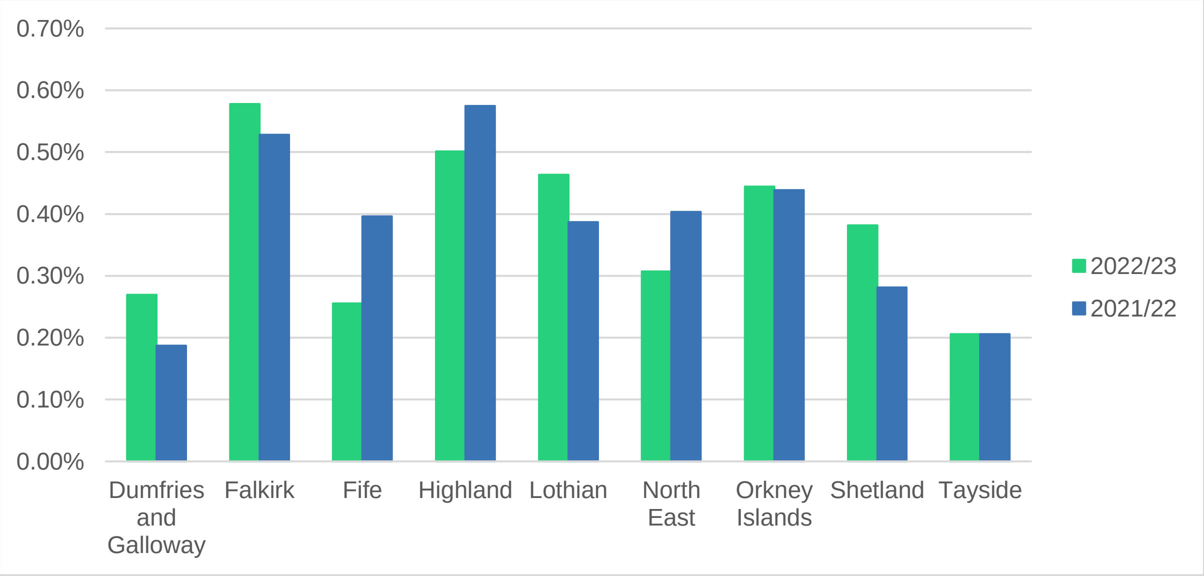
The special purpose vehicles were established to support the investment programme of the in-house investment team by providing organisational arrangements consistent with the capability, systems and controls of authorised investment companies.

In 2022/23, the proportion of funds managed internally remained at c.93%, with the last significant movement in 2019/20 when the transfer of the property portfolio management to an in-house team was undertaken. External investment managers are primarily used in the management of overseas equities and corporate bonds.

Lothian Pension Fund reported management expenses of £48.1 million in 2022/23, an increase of 20% on the prior year. Management expenses are split into three main categories: administrative costs; investment manager expenses and oversight and governance costs. Investment management expenses account for 86% of total management expenses.

In year, Lothian Pension Fund's investment manager expenses (excluding indirect expenses) increased marginally as a proportion of net assets. This is broadly in line with trends across the Local Government Pension Funds as shown in Exhibit 6.

Exhibit 6 – Management expenses as a proportion of net assets



Source: Unaudited Annual Report and Accounts

Investment manager expenses can vary due to a number of factors including actual returns on investments and the nature of the investment assets held.

The Funds include detailed analysis over investment expenses in the 2022/23 Annual Report. Disclosures on investment management expenses exceed the requirements of the CIPFA guidance on cost transparency as LPF consider that the CIPFA methodology would result in under-reporting of indirect management expenses.

The Funds undertake annual benchmarking exercises using externally provided data, covering 30 LGPS funds and a wider global universe of 299 funds. Analysis of investment costs is carried out by an independent provider, CEM Benchmarking Inc.

The benchmarking exercise reported in March 2023 covers investment performance in 2021/22. For this year, Lothian Pension Fund reported an actual investment cost of 0.29% of average assets which was below the benchmark of 0.50%.

The Funds credit the strong performance against benchmark to two factors. The first is the high percentage of assets managed internally which allows the Funds to control costs effectively. Additionally, the Funds have accessed private market investments at a lower fee than the benchmark group.

In relation to the pension administration benchmarking exercise undertaken by CEM, the Funds were categorised as 'low cost; high service standard'. The Funds' cost per member was £26.30 compared with a benchmark of £39.94. This was supported by an improved service score of 74 out of 100 driven by the Funds' noted speed at paying lump sums and strong social media presence.

Monitoring investment performance

There is an annual review of investment performance published in June for each of the Funds. The report provides a detailed analysis of each of the Fund's investment performance against its investment strategy. We concluded that the Pensions Committee and Board Members are engaged in monitoring the performance of investments.

In addition to monitoring at a Committee level the Funds' performance is calculated by an external provider on a monthly basis. The external provider compiles information covering monthly, quarterly, and 1, 3, 5, 10 yearly performance measures. This information is presented to the Joint Investment Strategy Panel to allow for scrutiny of the investment performance of the Funds.

Administration performance

The Funds have developed an annual Operating Plan which sets out the strategic aims of the Funds. The aims are supported by performance indicators which are reported to each Pensions Committee meeting as part of the Operating Plan Update.

The annual results for 2022/23 are presented in the Funds' Management Commentary. Performance remains strong in all ten performance measures met.

Climate change

Principal 11 of the Statement of Investment Principles notes the Funds' commitment to responsible investment, while stating that divestment is inconsistent with the Funds' fiduciary duties to members and employers. This covers the Funds' approach to climate change, amongst other significant areas.

The Investment Strategy review provided an opportunity for the impact of climate change on the Funds to be assessed. Uncertainty is high in climate modelling, but the modelling suggested that, on balance, there is a risk of deterioration of the financial position due to climate change. Reduction in exposures to equities was suggested as a prudent measure to mitigate the most pessimistic climate scenarios, which is being implemented.

Tackling climate change is one of the greatest global challenges. The Scottish Parliament has set a legally binding target of becoming net zero by 2045 and has interim targets including a 75 percent reduction in greenhouse gas emissions by 2030.

There are specific legal responsibilities placed on public bodies to contribute to reducing greenhouse gas emissions, to adapt to climate change, to act sustainably and to report on progress. All public bodies need to reduce their direct and indirect emissions and should have plans to do so. Many public bodies also have a role in reducing emissions in wider society, and in supporting activity to adapt to the current and potential future impact of climate change.

The key actions the Funds have taken to reduce climate change are set out in the table below:

What targets has the body set for reducing emissions in its own organisation or in its local area?	LPF supports the reduction in corporate emissions and the achievement of net zero targets.
Does the body have a climate change strategy or action plan which sets out how the body intends to achieve its targets?	LPF has a strategy on how it manages climate change risks within the investment portfolio. This is included within the Statement of Responsible Investment Principles available online.
How does the body monitor and report progress towards	There is regular reporting to the Pensions Committee. Whilst LPF does not set emissions targets the Fund will disclose the Weighted Average Carbon Intensity of

meeting its emission targets internally and publicly?	their investment portfolio (where data is available) and trend results over time.
Has the body considered the impact of climate change on its financial statements?	Yes, the Fund has engaged a consultant to undertake climate scenario analysis to aid understanding of the scale of the risks.
What are the areas of the financial statements where climate change has, or is expected to have, a material impact?	The value of the Funds investment portfolio and their liabilities might be materially impacted by the climate change.
Does the body include climate change in its narrative reporting which accompanies the financial statements and is it consistent with those financial statements?	Yes, the annual report and accounts have a separate section on climate change within the responsible investment part of the report. This is consistent with other parts of the accounts.

Appendices

Appendix 1: Responsibilities of the Funds and the Auditor

Responsibilities of the Funds

The Funds have primary responsibility for ensuring the proper financial stewardship of public funds, complying with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives.

Area	The Funds' responsibilities
Corporate governance	The Funds are responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Those charged with governance should be involved in monitoring these arrangements.
Financial statements and related reports	The Funds have responsibility for: • preparing financial statements which give a true and fair view of the financial position of the Funds and its group and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation; • maintaining accounting records and working papers that have been prepared to an acceptable professional standard and support the balances and transactions in its financial statements and related disclosures; • preparing and publishing, along with the financial statements, an annual governance statement, governance compliance statement, management commentary (or equivalent) and a remuneration report that is consistent with the disclosures made in the financial statements and prepared in accordance with prescribed requirements. The management commentary should be fair, balanced and understandable and also address the longer-term financial sustainability of the Funds. Management is responsible, with the oversight of those charged with governance, for communicating relevant information to users about the Funds and its financial performance, including providing adequate disclosures in accordance with the applicable financial

Area	The Funds' responsibilities
	reporting framework. The relevant information should be communicated clearly and concisely. The Funds are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of its objectives and safeguard and secure value for money from the public funds at its disposal. The Funds are also responsible for establishing effective and appropriate internal audit and risk-management functions.
Standards of conduct for prevention and detection of fraud and error	The Funds are responsible for establishing arrangements to prevent and detect fraud, error and irregularities, bribery and corruption and also to ensure that its affairs are managed in accordance with proper standards of conduct.
Financial position	The Funds are responsible for putting in place proper arrangements to ensure its financial position is soundly based having regard to: • Such financial monitoring and reporting arrangements as may be specified; • Compliance with statutory financial requirements and achievement of financial targets; • Balances and reserves, including strategies about levels and their future use; • Plans to deal with uncertainty in the medium and long term; and • The impact of planned future policies and foreseeable developments on the financial position.

Auditor responsibilities

Code of Audit Practice

The Code of Audit Practice (the Code) describes the high-level, principles-based purpose and scope of public audit in Scotland. The 2021 Code came into effect from 2022/23.

The Code of Audit Practice outlines the responsibilities of external auditors appointed by the Auditor General and it is a condition of our appointment that we follow it.

Our responsibilities

Auditor responsibilities are derived from the Code, statute, International Standards on Auditing (UK) and the Ethical Standard for auditors, other professional requirements and best practice, and guidance from Audit Scotland.

We are responsible for the audit of the accounts and the wider-scope responsibilities explained below. We act independently in carrying out our role and in exercising professional judgement. We report to the Funds and others, including Audit Scotland, on the results of our audit work.

Weaknesses or risks, including fraud and other irregularities, identified by auditors, are only those which come to our attention during our normal audit work in accordance with the Code and may not be all that exist.

Wider scope audit work

Reflecting the fact that public money is involved, public audit is planned and undertaken from a wider perspective than in the private sector.

The wider scope audit specified by the Code broadens the audit of the accounts to include additional aspects or risks in areas of financial management; financial sustainability; vision, leadership and governance; and use of resources to improve outcomes.

Financial management

Financial management means having sound budgetary processes. Audited bodies require to understand the financial environment and whether their internal controls are operating effectively.

Auditor considerations

Auditors consider whether the body has effective arrangements to secure sound financial management. This includes the strength of the financial management culture, accountability, and arrangements to prevent and detect fraud, error and other irregularities.

Financial sustainability

Financial sustainability means being able to meet the needs of the present without compromising the ability of future generations to meet their own needs.

Auditor considerations

Auditors consider the extent to which audited bodies show regard to financial sustainability. They look ahead to the medium term (two to five years) and longer term (over five years) to consider whether the body is planning effectively so it can continue to deliver services.

Vision, leadership and governance

Audited bodies must have a clear vision and strategy and set priorities for improvement within this vision and strategy. They work together with partners and communities to improve outcomes and foster a culture of innovation.

Auditor considerations

Auditors consider the clarity of plans to implement the vision, strategy and priorities adopted by the leaders of the audited body. Auditors also consider the effectiveness of governance arrangements for delivery, including openness and transparency of decision-making; robustness of scrutiny and shared working arrangements; and reporting of decisions and outcomes, and financial and performance information.

Use of resources to improve outcomes

Audited bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities. This includes demonstrating economy, efficiency and effectiveness through the use of financial and other resources, and reporting performance against outcomes.

Auditor considerations

Auditors consider the clarity of arrangements in place to ensure that resources are deployed to improve strategic outcomes, meet the needs of service users taking account of inequalities, and deliver continuous improvement in priority services.

Audit quality

The Auditor General and the Accounts Commission require assurance on the quality of public audit in Scotland through comprehensive audit quality arrangements that apply to all audit work and providers. These arrangements recognise the importance of audit quality to the Auditor General and the Accounts Commission and provide regular reporting on audit quality and performance.

Audit Scotland maintains and delivers an Audit Quality Framework.

The most recent audit quality report can be found at https://www.audit-scotland.gov.uk/publications/quality-of-public-audit-in-scotland-annual-report-202122

Independence

The Ethical Standards and ISA (UK) 260 require us to give the Funds full and fair disclosure of matters relating to our independence. In accordance with our profession's ethical guidance and further to our External Audit Annual Plan issued confirming audit arrangements we do not have any matters to not in that regard.

We confirm that Azets Audit Services and the engagement team complied with the FRC's Ethical Standard. We confirm that all threats to our independence have been properly addressed through appropriate safeguards and that we are independent and able to express an objective opinion on the financial statements.

Our period of total uninterrupted appointment as at the end of 31 March 2023 was seven years.

Audit and non-audit services

The total fees charged to the Funds for the provision of services in 2022/23 were as follows:

	Current year £	**Prior year £**
Audit of Lothian Pension Fund (Auditor remuneration)	53,633	42,579
Audit of components (as audited by Azets)	20,020	18,200
Total audit	**73,653**	**60,779**
Non-audit services - Funds	-	-
Non-audit services – wider group	8,020	7,866
Total fees	**81,673**	**68,645**

The FRC's Ethical Standard stipulates that where an auditor undertakes non audit work, appropriate safeguards must be applied to reduce or eliminate any threats to independence. We have detailed in the table below the non-audit services provided to both the Funds and the wider group, the threats to our independence and the safeguards we have put in place to mitigate these threats.

Non-audit service	**Service provided to**	**Type of threat**	**Safeguard**
Accounts preparation administration, Xero subscription	LPFE Ltd LPFI Ltd	Self-review	Management retains responsibility for decisions and judgments in preparation of the accounts.
Tax compliance	LPFE Ltd LPFI Ltd	Self-review	Management retains responsibility and judgments in relation to tax services. The services are provided by a team separate to the audit team and directed by a different partner.

Appendix 2: Action plan

Our action plan details the weaknesses and opportunities for improvement that we have identified during our audit.

Action plan grading structure

To assist the Funds in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated as follows:

Rating	Assessment rationale
High	An issue that results in a severe impact to the achievement of objectives in the area audited.
Medium	An issue that results in a moderate impact to the achievement of objectives in the area audited.
Low	An issue that results in a small impact to the achievement of objectives in the area audited.

Current year action plan

1. Future funding levels	Medium
Observation	The results of the next triennial valuation at 31 March 2023 will be available in 2024. The draft results indicate a significantly increased level of funding, and well above 100%. This could mean potential changes to the employers' membership levels in the scheme, if for example, admitted employers elect to leave the Fund to take advantage of high funding levels.
Implication	A wide range of implications are possible, including a potential reduction in contribution level required to sustain the fund, to the change of the employer's membership structure, or the administrative support levels required at the Fund.
Recommendation	We would encourage Lothian Pension Fund to consider medium- and longer-term implications of the expected triennial valuation results, including potential exits from the fund by smaller bodies, and the impact this will have on the Fund's liability.
Management response	LPF are creating processes for assessing the risk of employer who may seek to exit given the increased potential for surpluses post triennial valuation. This is likely to be an on-going process however once the initial assessment has been completed this will inform the leadership team of LPF around the potential quantum of the reduction in employers and members. **Responsible officer:** David Vallery **Implementation date:** 31 December 2023

2. Project Forth	High
Observation	After three years of pursuing Project Forth and a merger between Lothian Pension Fund and Falkirk Pension Fund, the project has been put on hold due to lack of clarity over the future of the merger.
Implication	The Fund will require to assess its strategic vision and consider cost involved in pursuing Project Forth.
Recommendation	We recommend that after three years of pursuing the project the Fund makes a clear decision as to its strategic direction and examines the financial cost of Project Forth incurred to date. We would also expect this to be formally reflected in the Fund strategy and operational plans where appropriate.
Management response	The Pension Committee of LPF is expected to make the decision to formally cease Project Forth at the meeting on 27th September 2023. The strategy of LPF will be amended to reflect the situation and will have a continued focus on the potential for consolidation both across LGPS in Scotland as well as the consolidation of multi fund employers into LPF. **Responsible officer:** David Vallery **Implementation date:** 31 December 2023

3. Members training	Medium
Observation	Our review found that all, but one, current Pensions Committee and Board members met the requirement to have a minimum of 21 hours training.
Implication	Lack of training might lead to less efficient oversight and scrutiny of the Funds activities.
Recommendation	While the LPF Code of Conduct states that these requirements have to be met 'from time to time' we would encourage all the members to fulfil this obligation to allow an effective oversight of the Funds activities.
Management response	The matter has been raised with the member in question and will be escalated to the Pension Committee convenor. The Fund continues to provide training to its committee and board members. Additional resources have been allocated to the Secretariat team which will provide additional support and scrutiny to ensure a standard of knowledge is maintained. A revised training and induction framework will be issued later in the year which will set clear expectations and provide clear guidance on training. **Responsible officer:** David Vallery **Implementation date:** 31 December 2023

Appendix 3: Follow up of prior year recommendations

We have followed up on the progress the Funds has made in implementing the recommendations raised by the previous auditor last year which were reported as either new or ongoing.

1. Bank accounts	Action raised in 2017/18
Recommendation	The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 require that after 1st April 2011 all pension fund monies are held in a separate bank account to the administering body and that all future monies received are directly to a pension fund bank account. There are a limited number of occasions where LPF needs to issue sales invoices to recover charges made to employers and members. The amounts involved are insignificant in comparison to the value of pension contributions. As the CEC finance system, as currently configured, does not allow LPF to raise sales invoices in its own name, the invoices go out under the name of CEC and payments are collected in a CEC bank account. However, the amounts involved are clearly identified and are held for the benefit of LPF. As regards purchase ledger payments, the CEC finance system, as currently configured, does not allow LPF to pay suppliers directly from an LPF bank account. However, the amounts involved are clearly identified and netted off against the sales ledger receipts mentioned above. Purchase ledger payments exceed sales ledger receipts by a considerable margin and LPF makes regular monthly payments to CEC. In LPF's opinion, the Regulations do not require payments to LPF suppliers to be made directly from an LPF bank account. As is typical within the Local Government Pension Schemes (LGPS), arrangements exist whereby unfunded benefits are paid to teachers and other people on behalf of employers as part of the LPF pension payroll. Based on LPF's current understanding, there is a danger that if the unfunded benefits were paid directly from an LPF bank

1. Bank accounts	Action raised in 2017/18
	account, HMRC could regard such payments as unauthorised. For that reason, all benefit payments are made from a CEC bank account with LPF paying the value of the funded benefits into that bank account and CEC covering the value of the unfunded benefits (the cost being recovered by CEC via sales invoices to employers). In LPF's opinion, the Regulations do not require payments to LPF pensioners to be made directly from an LPF bank account. We recommend the Funds put arrangements in place to ensure compliance with the regulations.
Implementation date	**As soon as possible**
Ongoing	Following a competitive procurement process for a new financial ledger system, LPF has identified a preferred tenderer and is liaising with the company to finalise suitable contractual terms. This will include recognition of a further assurance review stage to be undertaken by a specialist provider, prior to implementation of the new system. The tender specification addressed the requirement for suitable configuration to provide "stand alone" payment and sales invoicing for LPF, independent of the City of Edinburgh Council. In respect of payments to pensioners for "unfunded" discretionary awards by former employers, LPF has attained external legal advice which reconfirms its understanding that should unfunded benefits be paid directly from an LPF bank account, then HMRC would regard such payments as unauthorised. The use of a Fund bank account for these "unfunded transfer payments", therefore, is prohibited. Consequently, 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

1. Bank accounts	Action raised in 2017/18
	benefits. For the unfunded payments, these are recharged to the employer body (or successor) which originally granted the discretionary benefits. Accordingly, LPF has asked for a (further) response from SPPA for its clarification that the current payment methods, as adopted consistently across all Scottish LGPS administering authorities, should not be interpreted as being in conflict with regulations. LPF's rationale, as asserted to SPPA, is as follows: "LPF transfers the funds to the CEC bank account on the same day as the pensions are paid so there is no question of LPF money sitting in a CEC bank account. The 2010 Regulations require that an administering authority must hold in a separate bank account all monies received by it. There is no stipulation that an authority must pay benefits directly from its bank account to a beneficiary. At the point LPF is paying pensions and other benefits, it is not holding money in an account, it is carrying out a transaction for the purposes of the fund. On that basis, we believe that there is sufficient scope for the SPPA to clarify the interpretation of the Regulations so that is clear that an administering authority may use an intermediary bank account for the purpose of making fund payments." SPPA in their response confirmed that is appropriate to keep the CEC bank account for the unfunded payments. In respect of these mandatory and discretionary compensation payments made by LGPS administering authorities to retired teachers (Teachers' Scheme rather than Local Government Pension Scheme (LGPS)), along with other Scottish LGPS administering authorities, the Fund has requested that responsibility should transfer to the Scottish Public Pensions Agency (SPPA). SPPA has sought information on the relevant scope and scale of the payments being made across those administering authorities wishing to transfer. On

1. Bank accounts	Action raised in 2017/18
	receipt of such, SPPA has committed to consider the matter. **2022/23 update:** Management are now comfortable with the position from CEC regarding funded benefits payments. The transition of the general ledger to XLedger will allow LPF to make supplier payments directly from their own bank accounts.

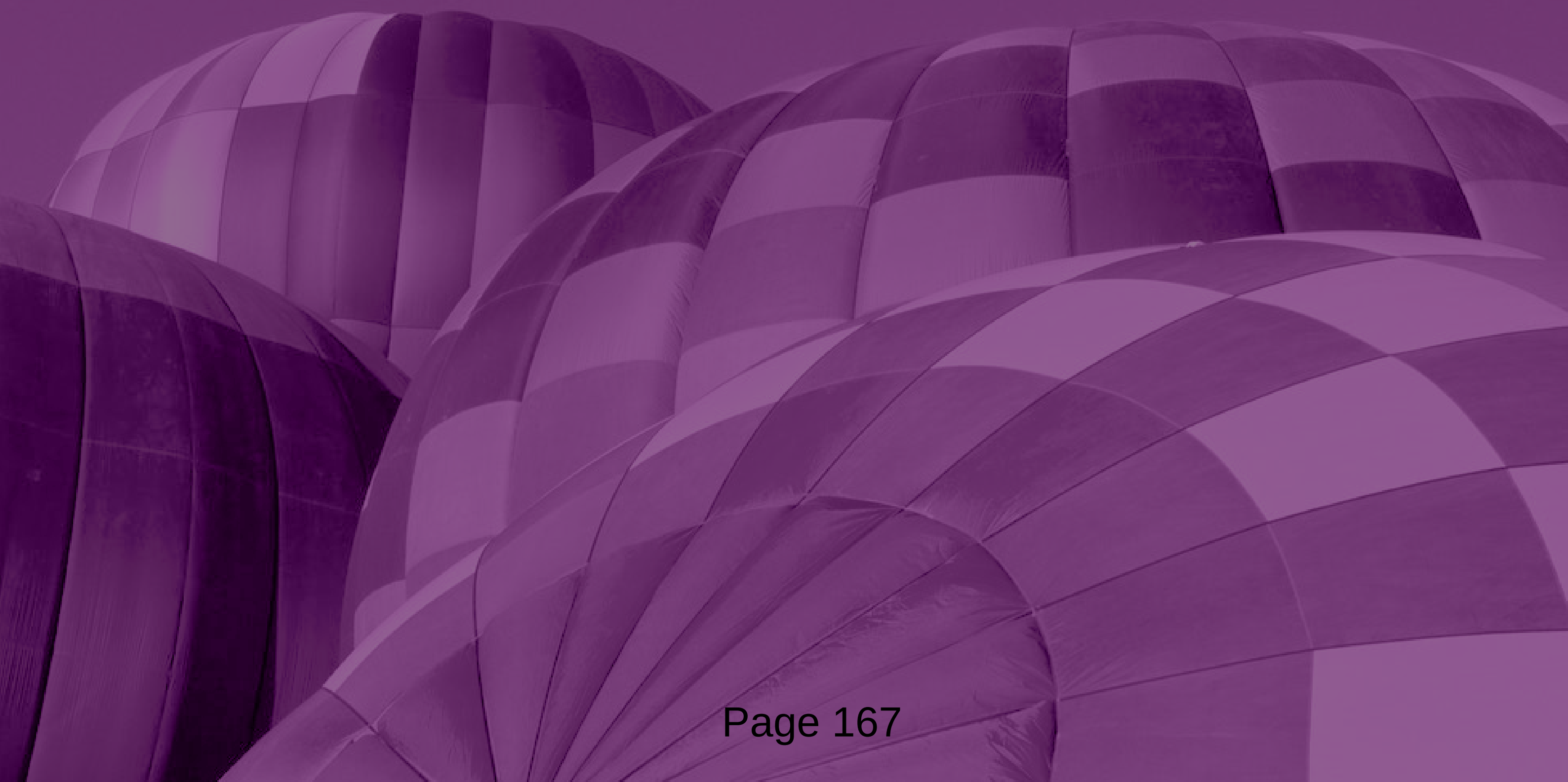
2. User access controls	Action raised in 2017/18
Recommendation	While our audit review in respect of the 2017/18 financial year did not identify any indications of user access being manipulated, we recommend that the Funds' officers in conjunction with City of Edinburgh Council review user access controls for the financial ledger.
Implementation date	**Initial target date March 2019**
Ongoing	This is an ongoing issue in 2022/23; however, we did not identify any instances where journals were posted by inappropriate users. **2022/23 update:** LPF are in the process of transitioning financial ledgers to XLedger which will be hosted by LPF. The project has focused on ensuring appropriate access rights as part of systems implementation this and an ongoing review of access rights should address potential concerns around access to the ledger.

Appendix 2

LOTHIAN
PENSION FUND

2022/23

AUDITED
ANNUAL REPORT
AND ACCOUNTS




AIR TICKET
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

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 £206,225,397 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 not only ensures 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 58-63.

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

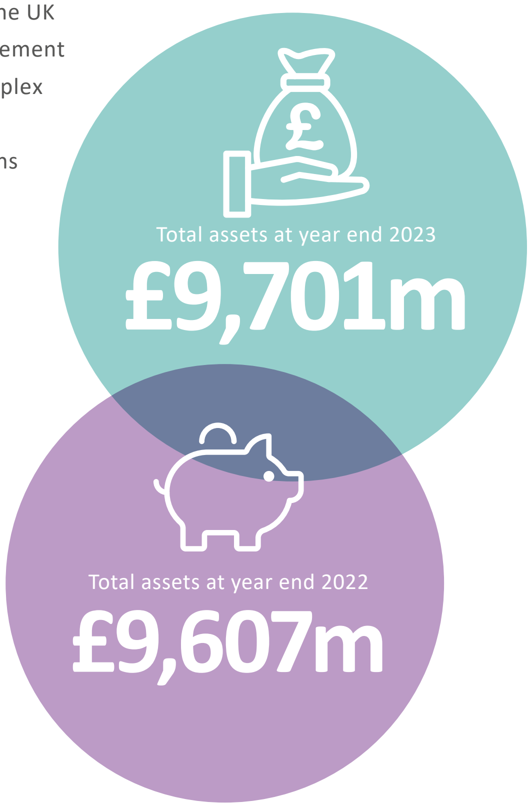
We published Issues 5 and 6 of our ESG ezine, *ENGAGE,* which gives detailed information on LPF's approach to ESG and our responsible investment activities.

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. The latest statement from Government advised that more time is needed to deliver this complex build, and for the pensions industry to help facilitate the successful connection of a wide range of different IT systems. Amended regulations are being laid which will include a revised connection deadline of 31 October 2026.



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.

A REVIEW OF 2022/23

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 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

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, five representatives appointed from the employer bodies (with one current vacancy), 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
Alan Williamson	Edinburgh College
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.

LOTHIAN PENSION FUND

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 includes 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.

LOTHIAN PENSION FUND

GOVERNANCE AND RISK

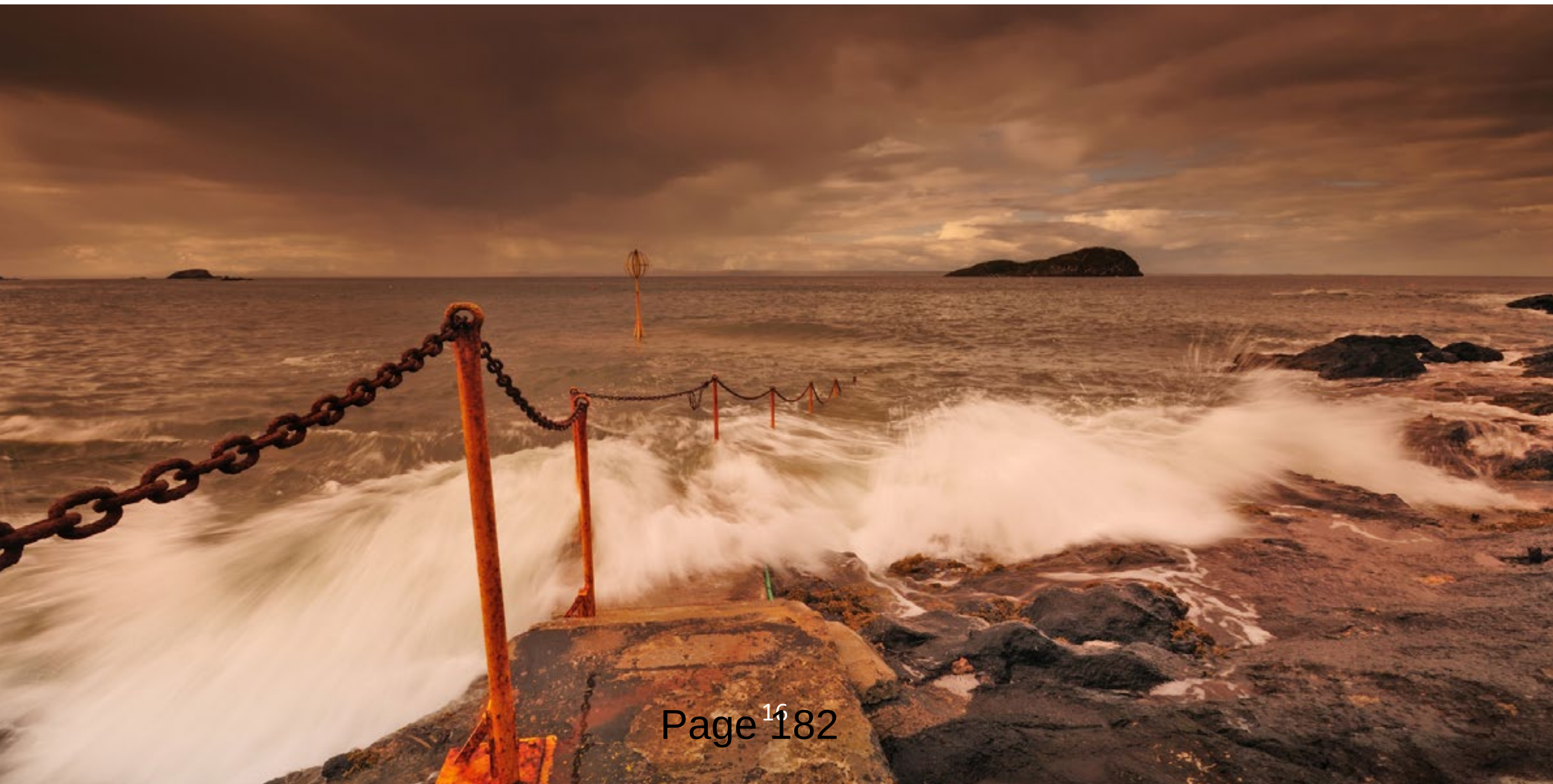
The Senior Leadership Team (SLT) of Lothian Pension Fund as at 31 March 2023 comprised:

- 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

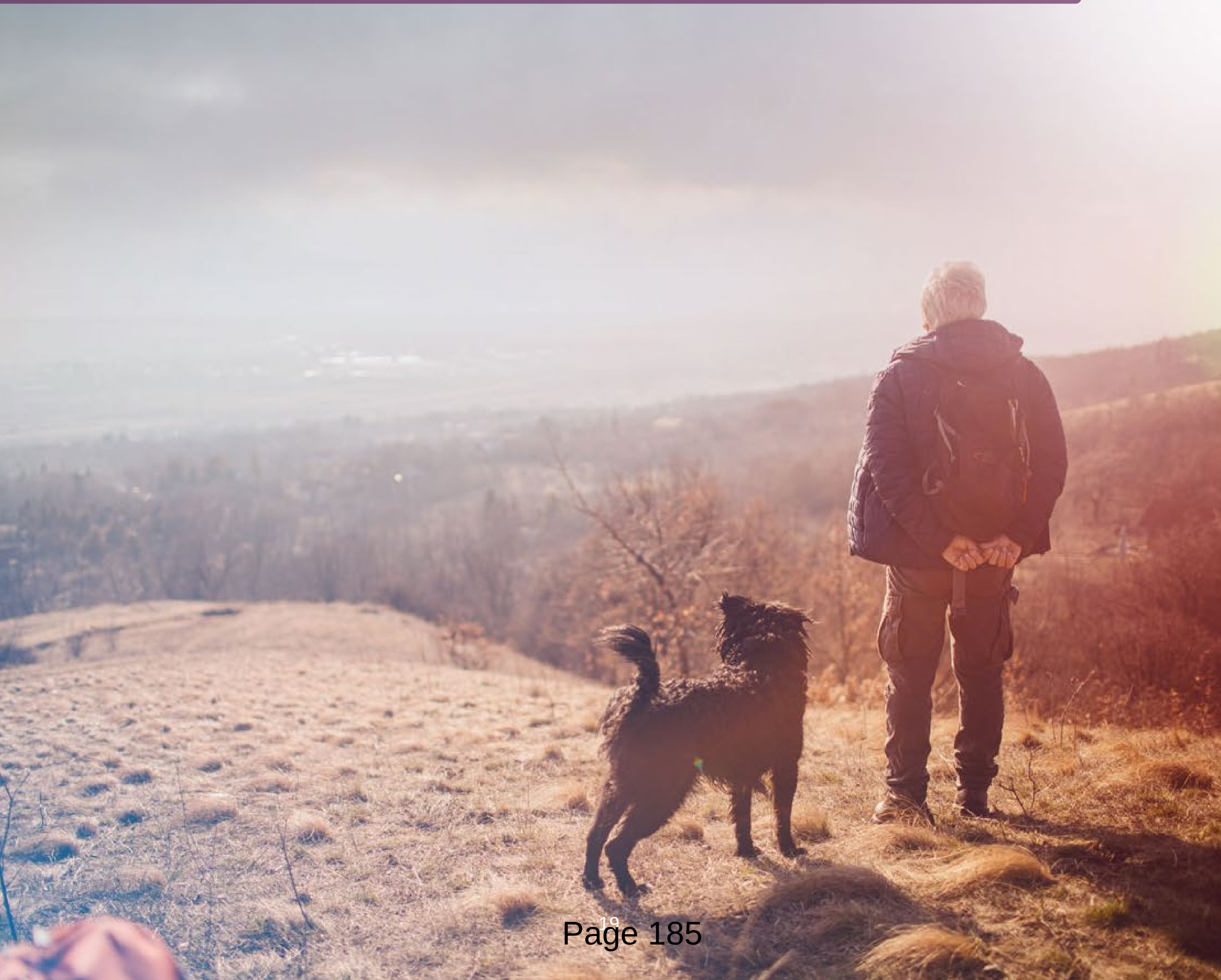
2. **Line 2:** Risk & Compliance function support the business in managing risks and achieving compliance, monitoring risk and compliance levels in the business and reporting on risk and compliance matters to management and governance forums

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

LOTHIAN PENSION FUND

OUTSTANDING SERVICE

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



LOTHIAN PENSION FUND

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

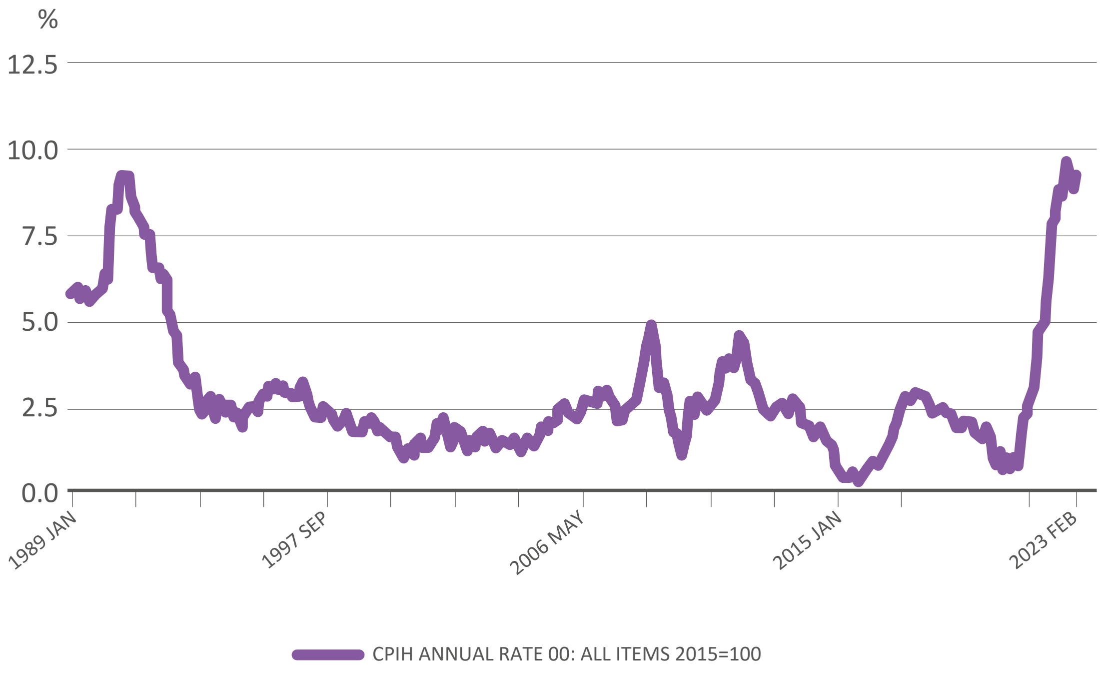
"This year the Audit Sub Committee has been engaged in assessing the effectiveness of LPFs audit, risk and compliance reporting. It has also taken steps to work closer with both the internal and external auditors. Effective oversight of internal and external auditors is key to the Audit Committee's ability to 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.

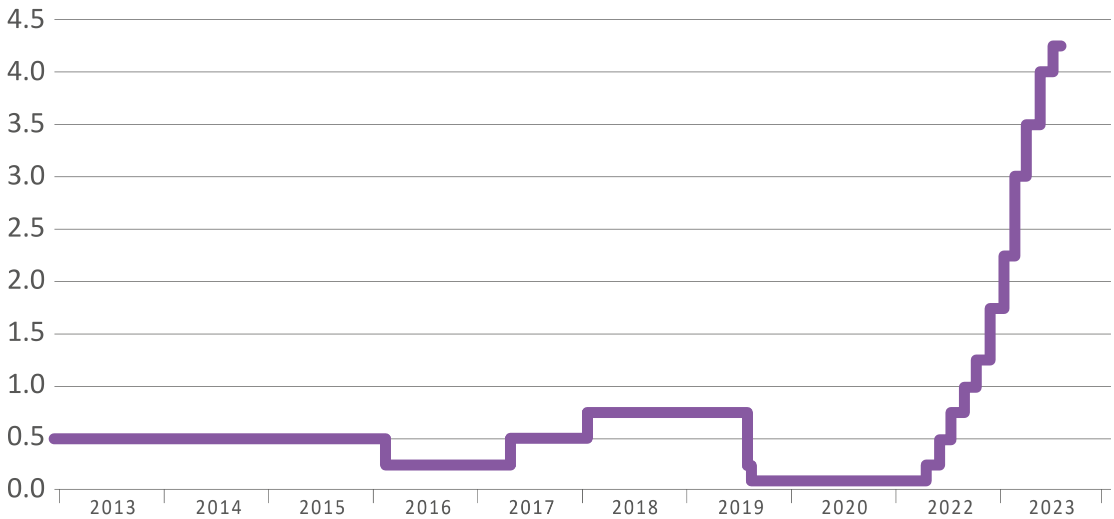
UK INFLATION (CPIH) - ANNUAL CHANGE



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

LOTHIAN
PENSION FUND

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."

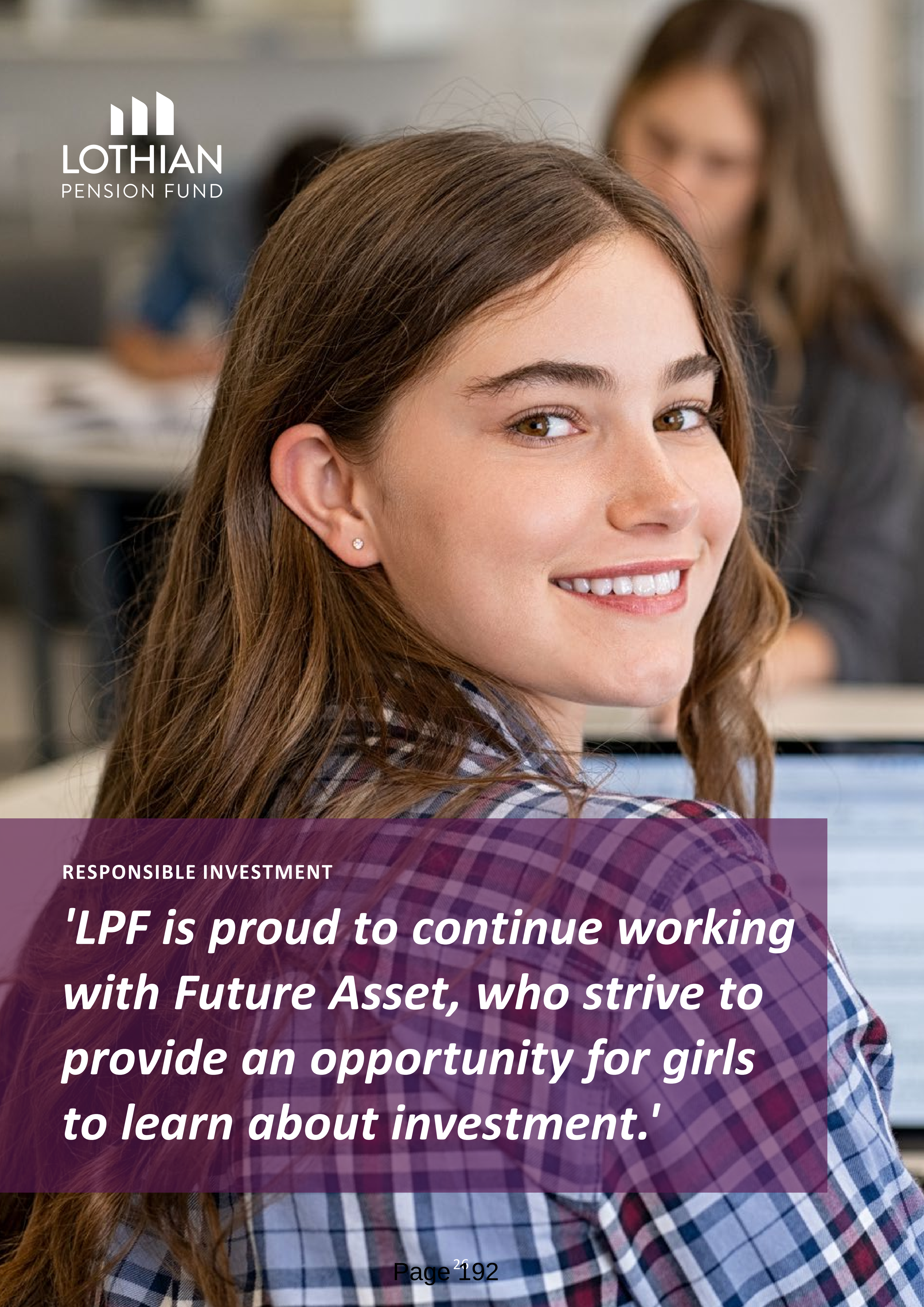
RESPONSIBLE INVESTMENT

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 LAPFF (Local Authority Pension Fund Forum), 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.



LOTHIAN PENSION FUND

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).

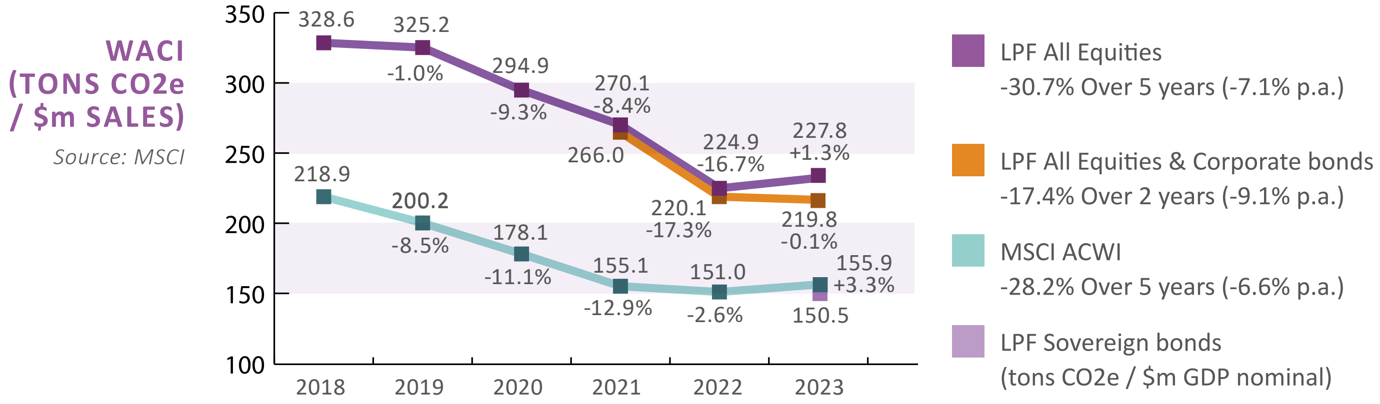
With a research budget specifically allocated to data services targeting ESG and climate-related risks and opportunities, we produce an annual carbon footprint for listed equities and corporate bonds. This measures the weighted average carbon intensity of the portfolio as a whole. More importantly, it 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.

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.

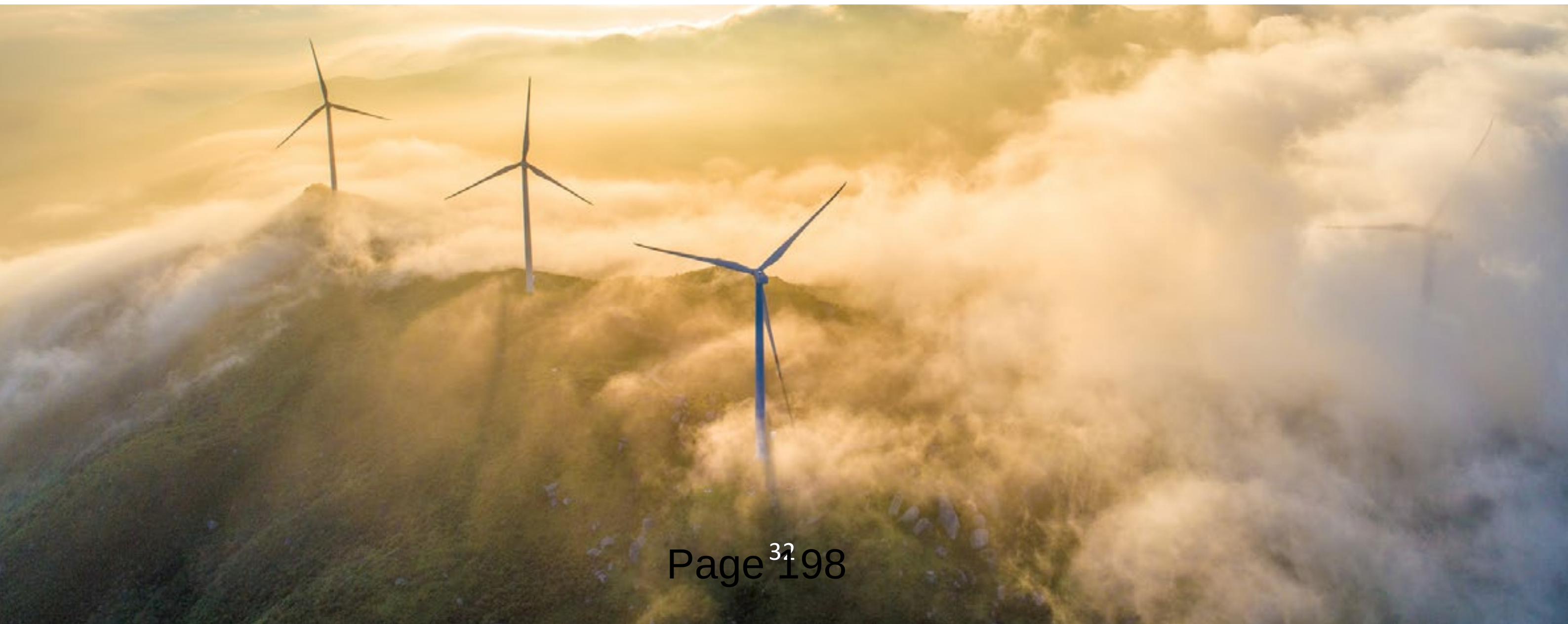
Paris alignment

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.



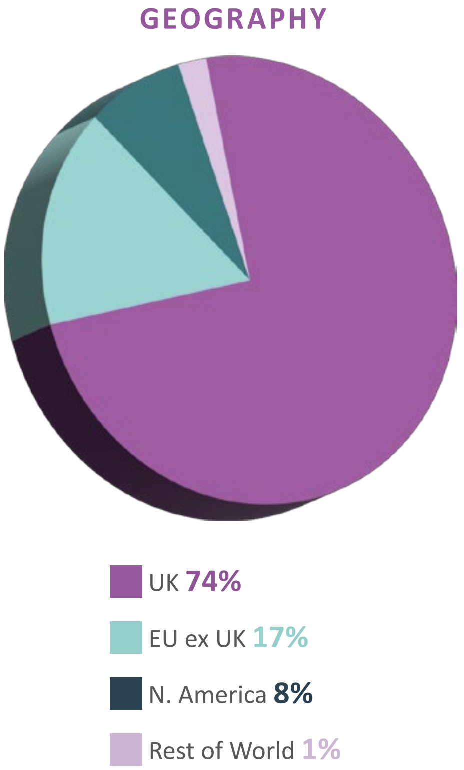
RESPONSIBLE INVESTMENT

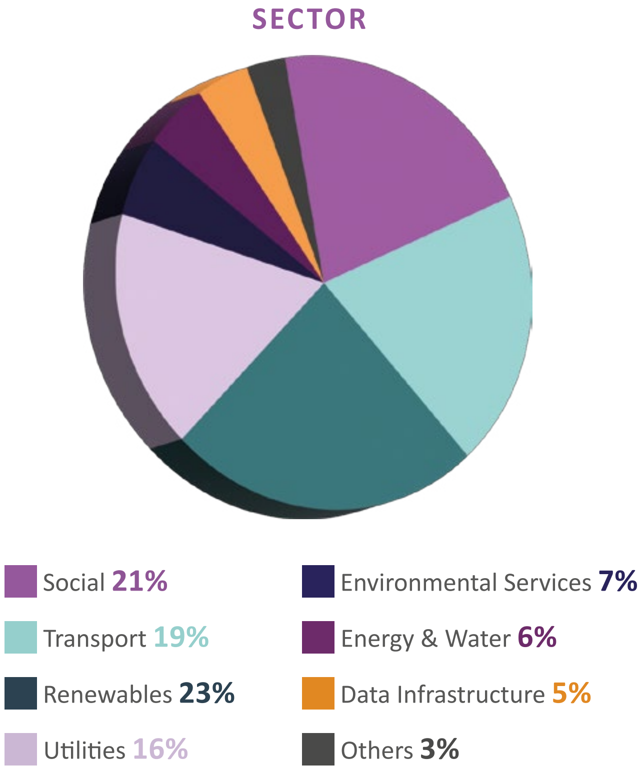
Climate solutions

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.





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.

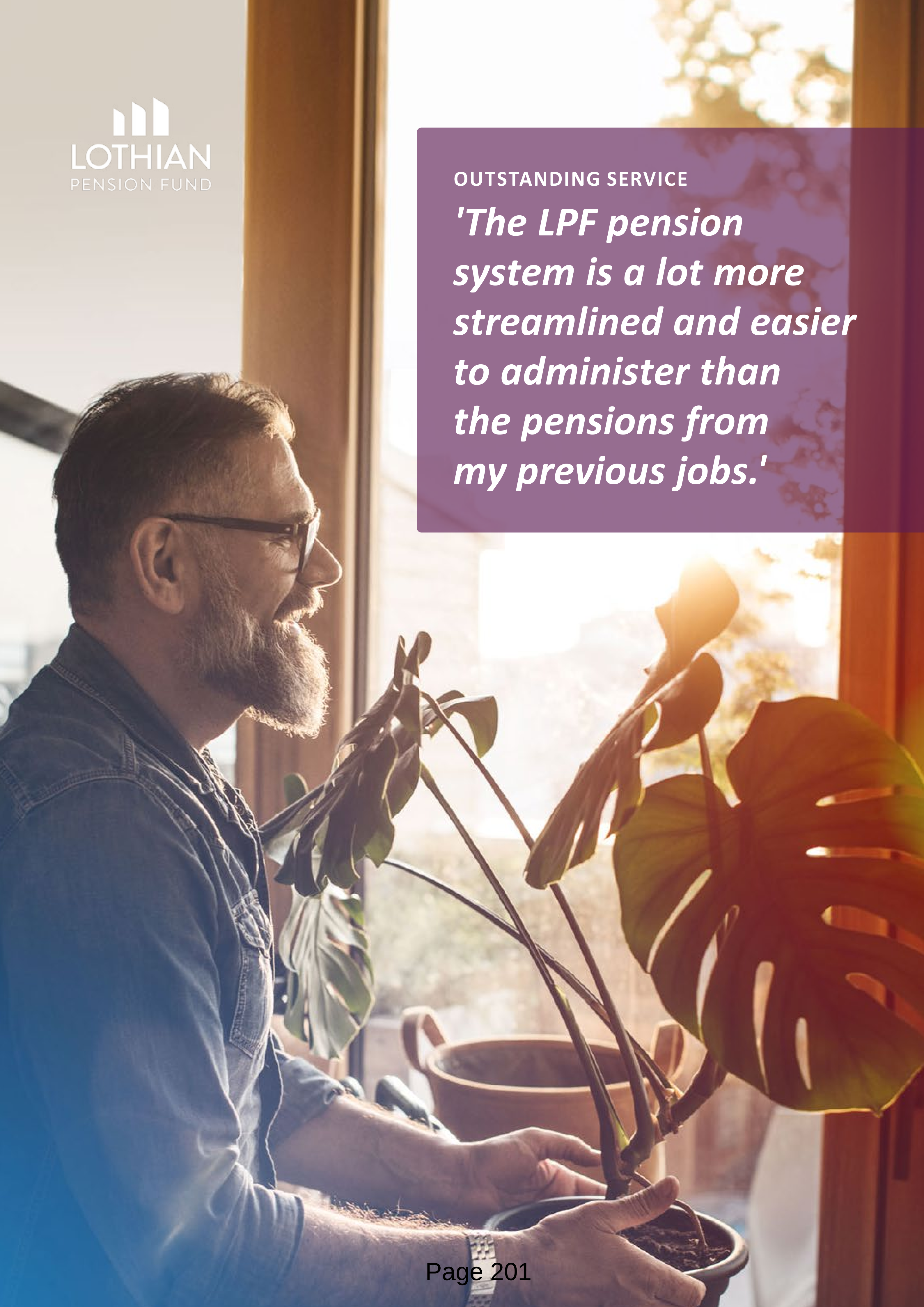
The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy), or asset returns (derived from the investment strategy). A formal review of the Fund's investment strategies is undertaken at least every three 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)	**40,736**
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)	(783)	(773)
Transfers to other schemes	(100)	(17)	(17)
Administrative expenses	(90)	(55)	(55)
	(7,440)	**(7,113)**	**(7,103)**
Net additions/(deductions) from dealings with members	**(7,350)**	**(7,023)**	**(7,013)**

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 /2033 £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	98	88
Investment management expenses per financial statements	37,183	44,942	98	88
Disclosure of management expenses in excess of CIPFA guidance	**827**	**606**	**-**	**-**

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 £26.30 is lower than the adjusted average of £39.94, and a service score of 74 out of 100, which is higher than the peer median of 67. 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."

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

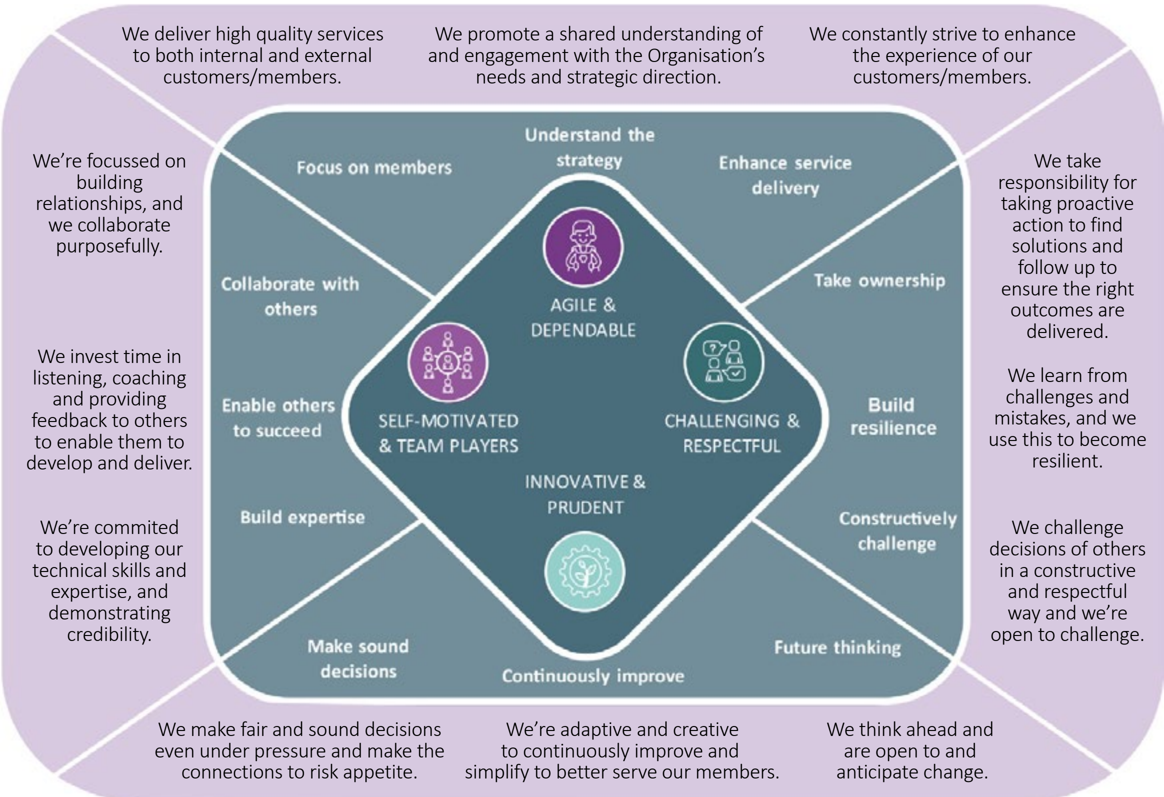
Our colleagues

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.

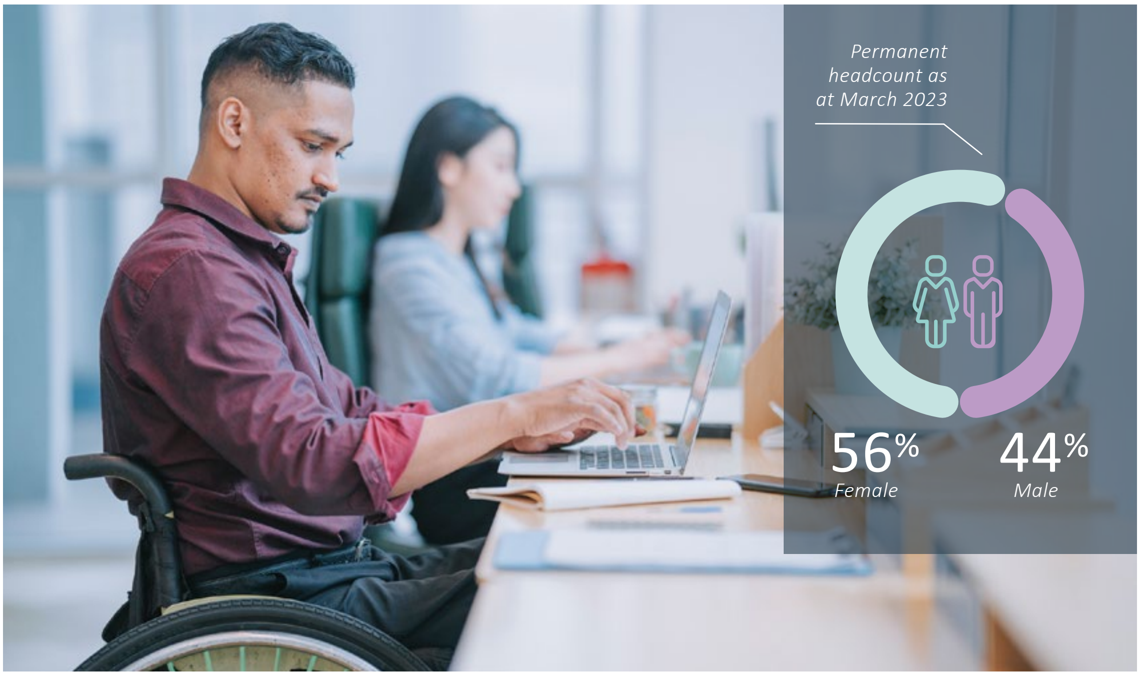
Our core values

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

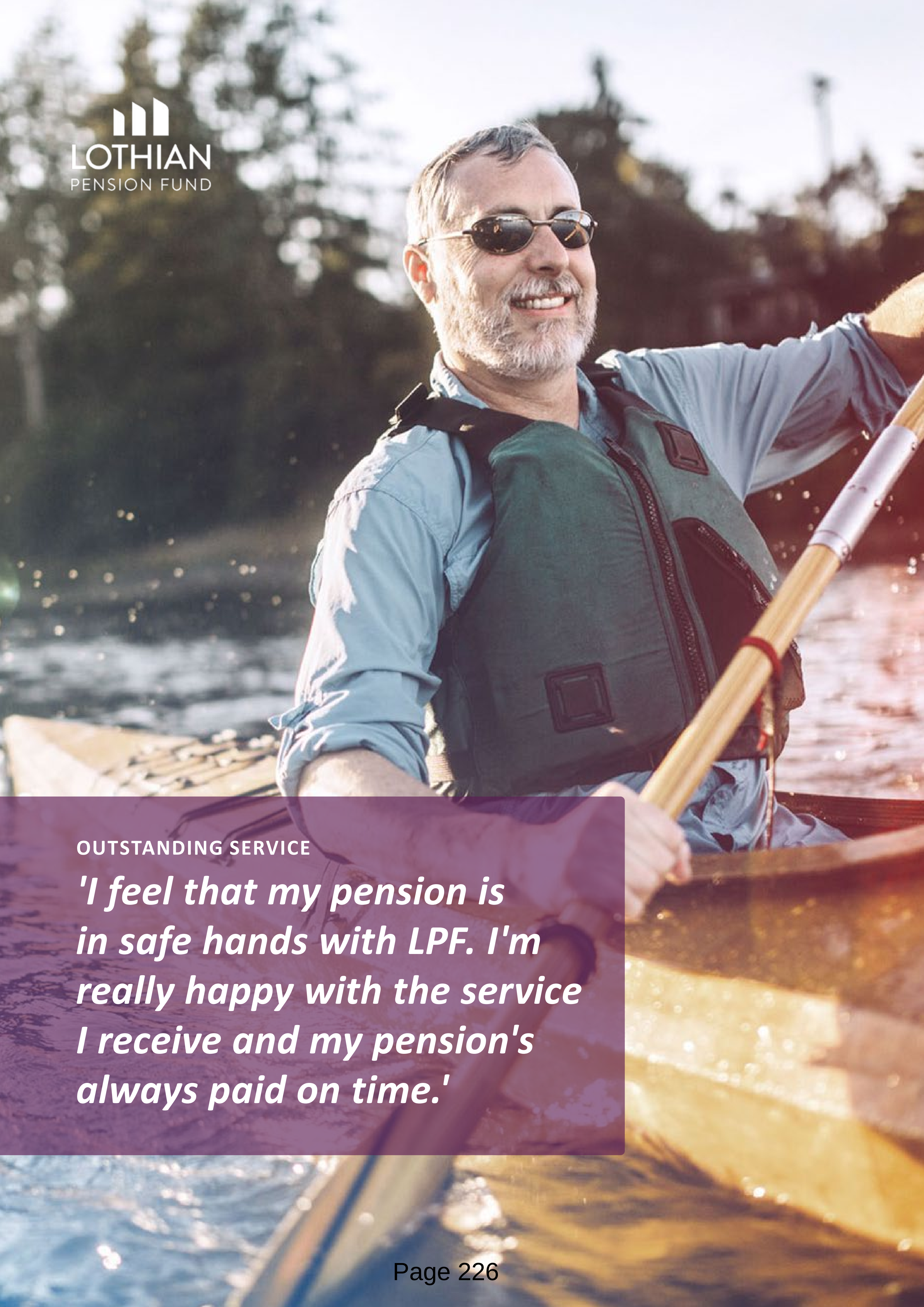


Inclusivity

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.



LOTHIAN
PENSION FUND

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:

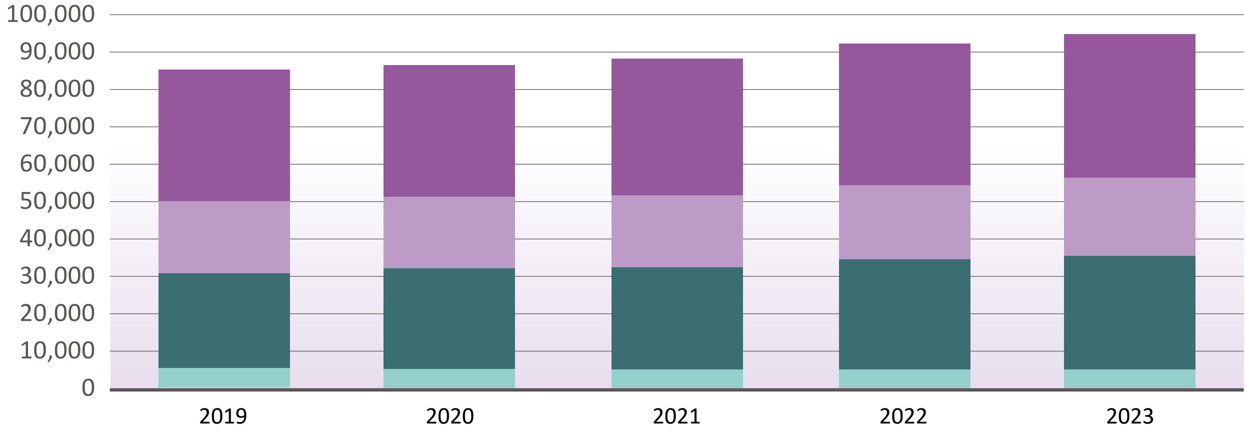
Andrew Kerr
Chief Executive Officer
The City of Edinburgh Council
27 September 2023

David Vallery
Chief Executive Officer
Lothian Pension Fund
27 September 2023

Hugh Dunn
Service Director: Finance and Procurement
The City of Edinburgh Council
27 September 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.

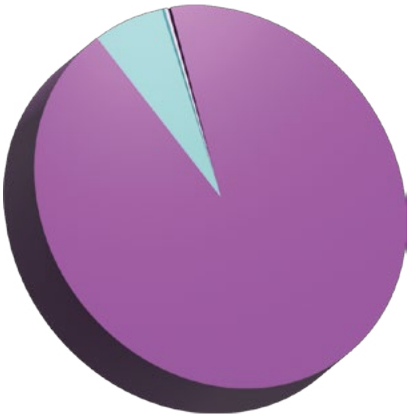
There were no changes to fund strategy over the year to end March 2023. The Total Fund Strategy percentages shown below are a weighted average of the employer strategies. Movements in the relative size of these strategies has resulted in modest changes to the Total Fund Strategy weightings.

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)

Employers fund their liabilities with the strategy that reflects their ability to tolerate risk within an appropriate time horizon, considering the maturity of their liabilities.

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

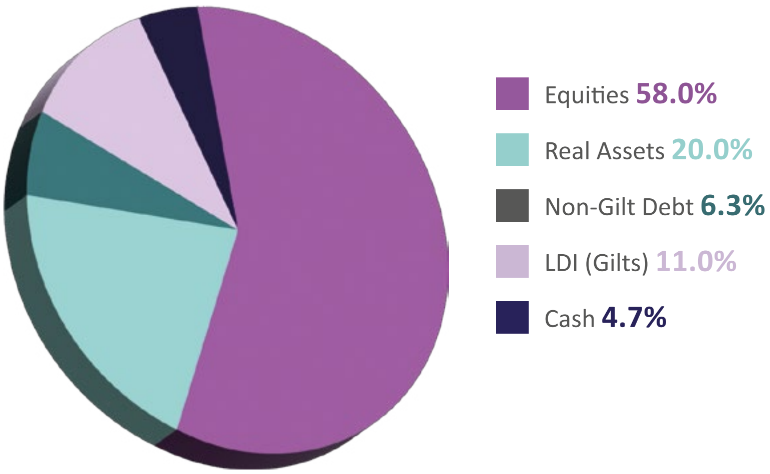
The LDI policy group comprises index-linked and nominal gilts. It does not use financial leverage, which caused some pension funds to become forced sellers of assets in the autumn of 2022. This is the lowest risk, lowest expected return policy group as it's possible to match the cash flows of gilts with 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

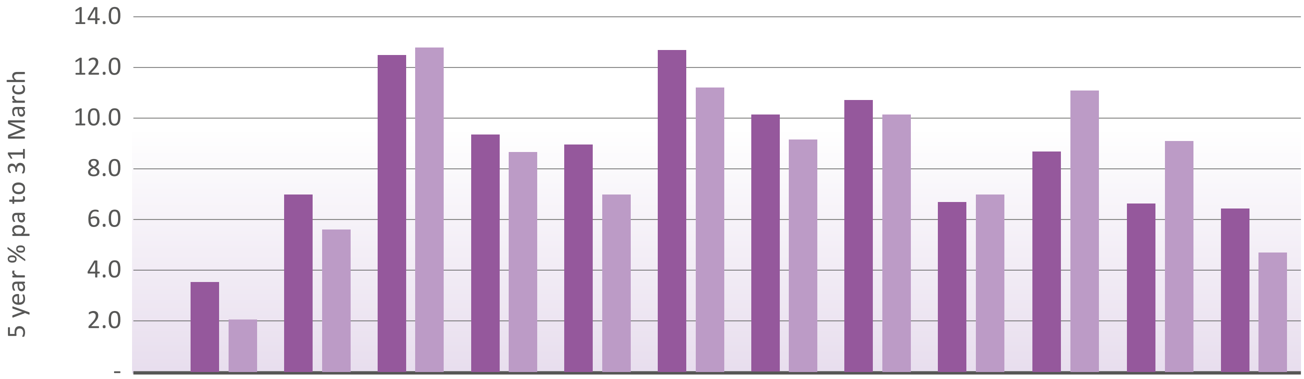
Abby joined us as a graduate trainee accountant in June 2019. Abby's role involves carrying out a wide variety of financial analysis and control tasks across the Fund, while also working towards her professional accountancy qualification.

"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.

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 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	28b	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 and the audited accounts were authorised for issue on 27 September 2023.

Hugh Dunn
Service Director: Finance and Procurement
The City of Edinburgh Council
27 September 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 or disclosures 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

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

7 Pensions payable

	2021/22	2022/23
By employer type	**£000**	**£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 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 contracts	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 contracts	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 11a and b 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

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 - 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 - 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**	**-**
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	Nominal gilts	-	-	51,285	0.5
In-house	Mature employer gilts	316,605	3.3	262,748	2.7
Total gilts		**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 property holdings were valued at fair value at 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).

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**	**1,631,477**	**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**	**1,631,477**	**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 27	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 179.

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. Since 2021 the two non-elected pension committee members also receive an honorarium of £2,250 per annum.

LPFE Limited & LPFI Limited – loan facility

LPFE & LPFI Limited are wholly owned by the City of Edinburgh Council as administering 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 debt and 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 various pension overpayments and a small amount of employer fees. There was also an impairment loss for 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

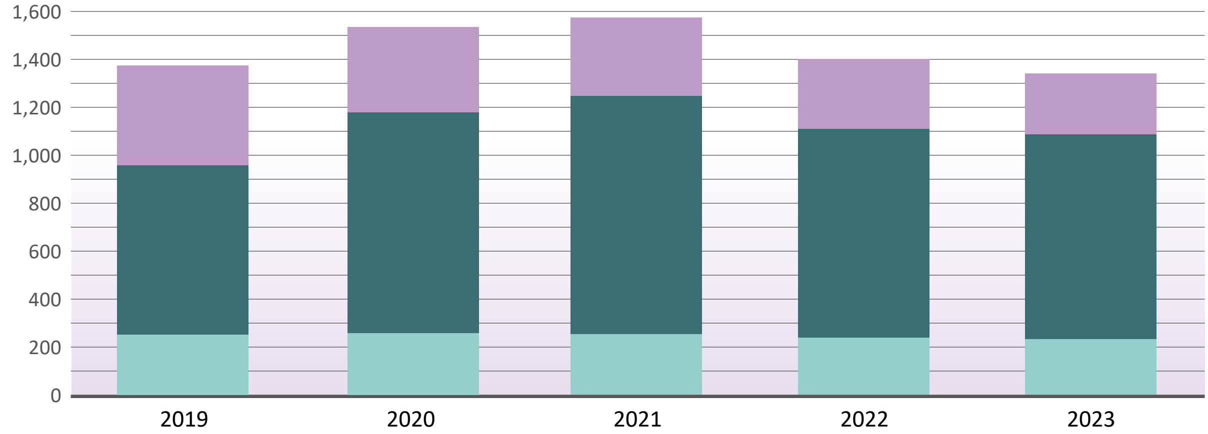
Scheduled Bodies	
City of Edinburgh Council (The)	Scottish Fire and Rescue Service
East Lothian Council	Scottish Police Authority
Edinburgh College	Scottish Water
Heriot-Watt University	SESTRAN
Lothian Valuation Joint Board	VisitScotland
Midlothian Council	West Lothian College
Scotland’s Rural College (SRUC)	West Lothian Council

LOTHIAN PENSION FUND
LIST OF ACTIVE EMPLOYERS AT 31 MARCH 2023

Admitted Bodies	
Audit Scotland	Improvement Service (The)
Baxter Storey	Lothian Buses
BEAR Scotland	LPFE Limited
Bellrock Property and Facilities Management	Melville Housing Association
Canongate Youth Project	Mitie PFI
Capital City Partnership	Morrison Facilities Services Ltd
CGI UK Ltd	Museums Galleries Scotland
Children's Hearing Scotland	Newbattle Abbey College
Children's Hospice Association Scotland	North Edinburgh Dementia Care
Citadel Youth Centre	NSL Services Ltd
Compass Chartwell	Pilton Equalities Project
Convention of Scottish Local Authorities	Queen Margaret University
Dacoll Limited	Royal Edinburgh Military Tattoo
Edinburgh Development Group	Royal Society of Edinburgh
Edinburgh Leisure	Scotland's Learning Partnership
Edinburgh Napier University	Scottish Adoption Agency
ELCAP	Scottish Futures Trust
Enjoy East Lothian	Scottish Schools Education Research Centre (SSERC)
Family Advice and Information Resource	Skanska UK
First Step	Sodexo Ltd
Forth and Oban Ltd	St Andrew's Children's Society Limited
Handicabs (Lothian) Ltd	Stepping Out Project
Health in Mind	University of Edinburgh (Edinburgh College of Art)
Heriot Watt University Students Association	West Lothian Leisure
Homes for Life Housing Partnership	

SCOTTISH HOMES PENSION FUND INVESTMENT STRATEGY

SCOTTISH HOMES PENSION FUND MEMBERSHIP DATA



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 latest available funding update at 31 March 2022. 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.

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.

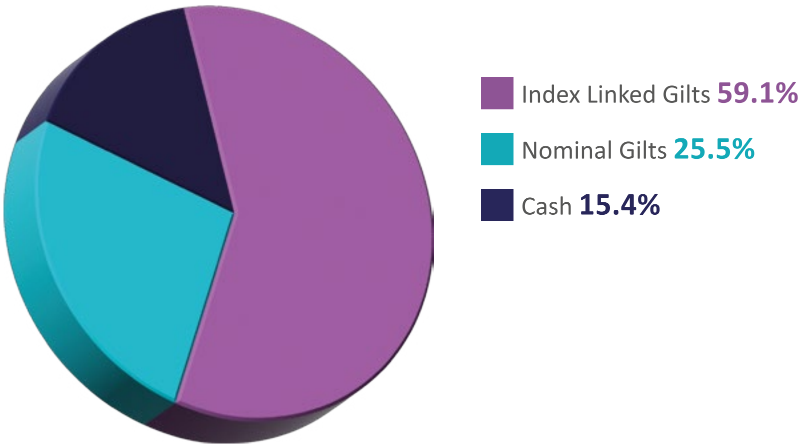
SCOTTISH HOMES PENSION FUND INVESTMENT STRATEGY

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, £7m 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		9c	**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 and the audited accounts were authorised for issue on 27 September 2023.

Hugh Dunn
Service Director: Finance and Procurement
The City of Edinburgh Council
27 September 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 £000	2022/23 £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 £000	2022/23 £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 £000	2022/23 £000
Employee costs	47	49
Custody fees	4	5
Engagement and voting fees	2	1
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 £000	2022/23 £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			-	447
	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 debt and 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 dependants 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	2,502
UK Short-Term Bills and Notes	Aa3	3,356	16,771
		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 179.

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.

LOTHIAN PENSION FUND

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.

LOTHIAN PENSION FUND

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 Audited Annual Accounts were approved for signature by the Lothian Pension Fund Committee at its meeting on 27 September 2023.

Hugh Dunn
Service Director: Finance and Procurement
The City of Edinburgh Council
27 September 2023

STATEMENT OF RESPONSIBILITIES FOR THE ANNUAL ACCOUNTS

The responsibilities of the Service Director: Finance and Procurement

The Service Director: Finance and Procurement, 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 Service Director: Finance and Procurement, 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 Service Director: Finance and Procurement, 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
27 September 2023

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE CITY OF EDINBURGH COUNCIL AS ADMINISTERING AUTHORITY FOR LOTHIAN PENSION FUND AND SCOTTISH HOMES PENSION FUND AND THE ACCOUNTS COMMISSION

Reporting on the audit of the financial statements

Opinion on financial statements

We certify that we have audited the financial statements in the annual report of Lothian Pension Fund (parent and group) and Scottish Homes Pension Fund (the Funds) for the year ended 31 March 2023 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Lothian Pension Fund Fund Account, the Lothian Pension Fund Net Assets Statement, Scottish Homes Pension Fund Fund Account, the Scottish Homes Pension Fund Net Assets Statement and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and UK adopted international accounting standards, as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2022/23 (the 2022/23 Code).

In our opinion the accompanying financial statements:

- give a true and fair view of the financial transactions of the funds during the year ended 31 March 2023 and of the amount and disposition at that date of their assets and liabilities;
- have been properly prepared in accordance with UK adopted international accounting standards, as interpreted and adapted by the 2022/23 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

Basis for opinion

We conducted our audit in accordance with applicable law and International Standards on Auditing (UK) (ISAs (UK)), as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report. We were appointed by the Accounts Commission on 3 November 2022. Our period of appointment is five years, covering 2022/23 to 2026/27. We are independent of the funds in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. Non-audit services prohibited by the Ethical Standard were not provided to the council as administering authority for the funds.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE CITY OF EDINBURGH COUNCIL AS ADMINISTERING AUTHORITY FOR LOTHIAN PENSION FUND AND SCOTTISH HOMES PENSION FUND AND THE ACCOUNTS COMMISSION

Conclusions relating to going concern basis of accounting

We have concluded that the use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the funds' ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from when the financial statements are authorised for issue.

These conclusions are not intended to, nor do they, provide assurance on the funds' current or future financial sustainability. However, we report on the funds' arrangements for financial sustainability in a separate Annual Audit Report available from the Audit Scotland website.

Risks of material misstatement

We report in our Annual Audit Report the most significant assessed risks of material misstatement that we identified and our judgements thereon.

Responsibilities of the Chief Finance Officer and the City of Edinburgh Council for the financial statements

As explained more fully in the Statement of Responsibilities, the Chief Finance Officer is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Chief Finance Officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Chief Finance Officer is responsible for assessing the funds' ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless there is an intention to discontinue the funds' operations.

The City of Edinburgh Council is responsible for overseeing the financial reporting process.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE CITY OF EDINBURGH COUNCIL AS ADMINISTERING AUTHORITY FOR LOTHIAN PENSION FUND AND SCOTTISH HOMES PENSION FUND AND THE ACCOUNTS COMMISSION

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of users taken on the basis of these financial statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities outlined above to detect material misstatements in respect of irregularities, including fraud. Procedures include:

- using our understanding of the local government sector to identify that the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, the Local Government in Scotland Act 2003, and The Local Government Pension Scheme (Scotland) Regulations 2018 as amended are significant in the context of the funds;
- inquiring of the Chief Finance Officer as to other laws or regulations that may be expected to have a fundamental effect on the operations of the funds;
- inquiring of the Chief Finance Officer concerning the funds' policies and procedures regarding compliance with the applicable legal and regulatory framework;
- discussions among our audit team on the susceptibility of the financial statements to material misstatement, including how fraud might occur; and
- considering whether the audit team collectively has the appropriate competence and capabilities to identify or recognise non-compliance with laws and regulations.

The extent to which our procedures are capable of detecting irregularities, including fraud, is affected by the inherent difficulty in detecting irregularities, the effectiveness of the funds' controls, and the nature, timing and extent of the audit procedures performed.

Irregularities that result from fraud are inherently more difficult to detect than irregularities that result from error as fraud may involve collusion, intentional omissions, misrepresentations, or the override of internal control. The capability of the audit to detect fraud and other irregularities depends on factors such as the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved.

A further description of the auditor's responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE CITY OF EDINBURGH COUNCIL AS ADMINISTERING AUTHORITY FOR LOTHIAN PENSION FUND AND SCOTTISH HOMES PENSION FUND AND THE ACCOUNTS COMMISSION

Reporting on other requirements

Other information

The Chief Finance Officer is responsible for the other information in the annual report. The other information comprises the Management Commentary, Annual Governance Statement, Governance Compliance Statement, Statement of Responsibilities and other reports included in the annual report other than the financial statements and our auditor's report thereon.

Our responsibility is to read all the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon except on the Management Commentary, Annual Governance Statement and Governance Compliance Statement to the extent explicitly stated in the following opinions prescribed by the Accounts Commission.

Opinions prescribed by the Accounts Commission on the Management Commentary, Annual Governance Statement and Governance Compliance Statement

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003;
- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016): and
- the information given in the Governance Compliance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with The Local Government Pension Scheme (Scotland) Regulations 2018.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE CITY OF EDINBURGH COUNCIL AS ADMINISTERING AUTHORITY FOR LOTHIAN PENSION FUND AND SCOTTISH HOMES PENSION FUND AND THE ACCOUNTS COMMISSION

Matters on which we are required to report by exception

We are required by the Accounts Commission to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Conclusions on wider scope responsibilities

In addition to our responsibilities for the annual report, our conclusions on the wider scope responsibilities specified in the Code of Audit Practice are set out in our Annual Audit Report.

Use of our report

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 108 of the Code of Audit Practice, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Nick Bennett, for and on behalf of Azets Audit Services
Exchange Place 3
Semple Street
Edinburgh
EH3 8BL

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 Effectiveness

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:** to continue to enhance cyber security within the organisation following achievement of 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
27 September 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

27 September 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	1	£220,000 - £224,999	-	-
£135,000 - £139,999	2	-	£225,000 - £229,000	-	1
			Total No. of Employees	**21**	**30**

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	**672**	**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.

HAPPY TO TRANSLATE

Accessibility

You can get this document on audio CD, in Braille, large print if you ask us. Please contact Interpretation and Translation Service (ITS) on its@edinburgh.gov.uk and quote reference number 23-8794.
ITS can also give information on community language translations. You can get more copies of this document at www.lpf.org.uk/publications.

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

Company registration number SC497543 (Scotland)

LPFE LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2023

LPFE LIMITED

COMPANY INFORMATION

Chairman	Mr H Dunn
Executive Directors	Mr D Vallery Ms M Watt
Non-Executive Directors	Mr A Marchant Mr L Robb
Company number	SC497543
Registered office	4th Floor Saltire Court 20 Castle Terrace Edinburgh Lothian EH1 2EN
	Azets Audit Services Exchange Place 3 Semple Street Edinburgh United Kingdom EH3 8BL

LPFE LIMITED

CONTENTS

LPFE LIMITED

DIRECTORS' RESPONSIBILITIES STATEMENT

FOR THE YEAR ENDED 31 MARCH 2023

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the United Kingdom. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, International Accounting Standard 1 requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company’s transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

LPFE LIMITED

DIRECTORS' REPORT

FOR THE YEAR ENDED 31 MARCH 2023

The directors present their annual report and financial statements for the year ended 31 March 2023.

Principal activities

The principal activity of the company is the provision of seconded staff to the City of Edinburgh Council acting in its capacity as the administering authority of the Lothian Pension Fund ("LPF") and LPFI Limited in support of the administration of the Lothian Pension Fund and the Scottish Homes Pension Fund ("the Funds") and separately (on a limited basis) to Falkirk Council in its capacity as the administering authority of the Falkirk Council Pension Fund. All pension funds are part of the Local Government Pension Scheme in Scotland (LGPS).

Results and dividends

The loss for the year after tax was £1,075,298 (2022 - £1,130,547 loss) and after allowing for items included under "Other comprehensive income" a gain of £7,428,341 (2022 - £1,992,483 gain). The directors do not recommend payment of dividend.

The company's aim is to make a modest trading surplus before adjustments required under IFRS. After allowing for a gain of £34,551 (2022: £34,564) in respect of accrued holiday and variable pay and additional cost of £1,228,000 (2022: £1,281,000) for adjustments to pension costs under IAS19, the underlying trading profit is £118,151(2022: £115,889). The gain recognised under "Other comprehensive income" amounting to £8,503,639 (2022: 3,123,030 gain) all relates to further adjustments required by IAS19 and the related deferred tax liability adjustment.

Under the mutual trading agreement with LPF, the company is required to consider if any of the profit arising from the mutual trade can be returned to the Council. Although there was an underlying trading profit of £118,151 (2022: £115,889), Company Law requires that only "distributable profits" are available for distribution and that the various adjustments required under IFRS must be taken into account when determining if profits are distributable. As a result, there are no distributable profits available for return to LPF in respect of the period.

Directors

The directors who held office during the year and up to the date of signature of the financial statements were as follows:

Mr. H Dunn	
Mr. A Marchant	
Ms K Miller	(Resigned 4 November 2022)
Mr L Robb	
Mr D S Vallery	
Mr R M Munn	(Resigned 5 May 2022)
Ms M Watt	(Appointed 30 August 2022)

Supplier payment policy

The company's current policy concerning the payment of trade creditors is to follow the CBI's Prompt Payers Code (copies are available from the CBI, Centre Point, 103 New Oxford Street, London WC1A 1DU).

The company's current policy concerning the payment of trade creditors is to:

- settle the terms of payment with suppliers when agreeing the terms of each transaction;
- ensure that suppliers are made aware of the terms of payment by inclusion of the relevant terms in contracts; and
- pay in accordance with the company's contractual and other legal obligations.

Trade creditors of the company at the year end were equivalent to 8 day's purchases, based on the average daily amount invoiced by suppliers during the year.

Statement of disclosure to auditor

Each director in office at the date of approval of this annual report confirms that:

- so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware, and
- the director has taken all the steps that he / she ought to have taken as a director in order to make himself / herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

On behalf of the board

....

Mr. H Dunn

Director

Date: ....

LPFE LIMITED

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF LPFE LIMITED

Opinion

We have audited the financial statements of LPFE Limited (the 'company') for the year ended 31 March 2023 which comprise the statement of comprehensive income, the statement of financial position, the statement of changes in equity, the statement of cash flows and notes to the financial statements, including significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and UK adopted international accounting standards.

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2023 and of its loss for the year then ended;
- have been properly prepared in accordance with UK adopted international accounting standards; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC’s Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Other information

The other information comprises the information included in the annual report other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of our audit:

- the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the directors' report has been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the directors' report. We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- the directors were not entitled to take advantage of the small companies exemption from the requirement to prepare a strategic report.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities is available on the Financial Reporting Council's website at: https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above and on the Financial Reporting Council's website, to detect material misstatements in respect of irregularities, including fraud.

We obtain and update our understanding of the entity, its activities, its control environment, and likely future developments, including in relation to the legal and regulatory framework applicable and how the entity is complying with that framework. Based on this understanding, we identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. This includes consideration of the risk of acts by the entity that were contrary to applicable laws and regulations, including fraud.

In response to the risk of irregularities and non-compliance with laws and regulations, including fraud, we designed procedures which included:

- Enquiry of management and those charged with governance around actual and potential litigation and claims as well as actual, suspected and alleged fraud;
- Reviewing minutes of meetings of those charged with governance;
- Assessing the extent of compliance with the laws and regulations considered to have a direct material effect on the financial statements or the operations of the company through enquiry and inspection;
- Reviewing financial statement disclosures and testing to supporting documentation to assess compliance with applicable laws and regulations;
- Performing audit work over the risk of management bias and override of controls, including testing of journal entries and other adjustments for appropriateness, evaluating the business rationale of significant transactions outside the normal course of business and reviewing accounting estimates for indicators of potential bias.

Because of the inherent limitations of an audit, there is a risk that we will not detect all irregularities, including those leading to a material misstatement in the financial statements or non-compliance with regulation. This risk increases the more that compliance with a law or regulation is removed from the events and transactions reflected in the financial statements, as we will be less likely to become aware of instances of non-compliance. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Nick Bennett ACA (Senior Statutory Auditor)
For and on behalf of Azets Audit Services

Date: ....

Chartered Accountants
Statutory Auditor

Exchange Place 3
Semple Street
Edinburgh
United Kingdom
EH3 8BL

LPFE LIMITED

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 MARCH 2023

	Notes	2023 £	2022 £
Revenue	3	7,309,586	5,853,139
Gross profit		7,309,586	5,853,139
Administrative expenses		(8,239,065)	(6,829,006)
Operating loss	4	(929,479)	(975,867)
Finance costs	8	(115,313)	(125,956)
Loss before taxation		(1,044,792)	(1,101,823)
Income tax expense	9	(30,506)	(28,724)
Loss for the year	15	(1,075,298)	(1,130,547)
Other comprehensive income:			
Items that will not be reclassified to profit or loss			
Actuarial gain on defined benefit pension schemes	13	9,592,000	3,296,000
Tax relating to items not reclassified		(1,088,361)	(172,970)
Total items that will not be reclassified to profit or loss		8,503,639	3,123,030
Total other comprehensive income for the year		8,503,639	3,123,030
Total comprehensive income for the year		7,428,341	1,992,483

LPFE LIMITED

STATEMENT OF FINANCIAL POSITION

AS AT 31 MARCH 2023

	Notes	2023 £	2022 £
Non-current assets			
Deferred tax asset	**12**	-	874,500
Retirement benefit surplus	**13**	4,866,000	-
		4,866,000	874,500
Current assets			
Trade and other receivables	**10**	1,023,229	774,443
Cash and cash equivalents		385,682	24,531
		1,408,911	798,974
Current liabilities			
Trade and other payables	**11**	817,058	369,628
Current tax liabilities		7,522	-
		824,580	369,628
Net current assets		584,331	429,346
Non-current liabilities			
Trade and other payables	**11**	16,061	13,778
Deferred tax liabilities	**12**	213,861	-
Retirement benefit obligations	**13**	-	3,498,000
		229,922	3,511,778
Net assets/(liabilities)		5,220,409	(2,207,932)
Equity			
Called up share capital	**14**	1	1
Retained earnings	**15**	5,220,408	(2,207,933)
Total equity		5,220,409	(2,207,932)

The financial statements were approved by the board of directors and authorised for issue on .... and are signed on its behalf by:

....
Mr. H Dunn
Director

Company registration number SC497543

LPFE LIMITED

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 MARCH 2023

	Share capital	Retained earnings	Total
	£	£	£
Balance at 1 April 2021	1	(4,200,416)	(4,200,415)
Year ended 31 March 2022:			
Loss for the year	-	(1,130,547)	(1,130,547)
Other comprehensive income:			
Actuarial gains on pensions scheme	-	3,296,000	3,296,000
Tax relating to other comprehensive income	-	(172,970)	(172,970)
Total comprehensive income for the year	-	1,992,483	1,992,483
Balance at 31 March 2022	1	(2,207,933)	(2,207,932)
Year ended 31 March 2023:			
Loss for the year	-	(1,075,298)	(1,075,298)
Other comprehensive income:			
Actuarial gains on pensions scheme	-	9,592,000	9,592,000
Tax relating to other comprehensive income	-	(1,088,361)	(1,088,361)
Total comprehensive income for the year	-	7,428,341	7,428,341
Balance at 31 March 2023	1	5,220,408	5,220,409

LPFE LIMITED

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 MARCH 2023

	Notes	2023 £	2023 £	2022 £	2022 £
Cash flows from operating activities					
Cash generated from/(absorbed by) operations	**20**		387,448		(272,079)
Interest paid			(3,313)		(956)
Income taxes paid			(22,984)		(14,877)
Net cash inflow/(outflow) from operating activities			361,151		(287,912)
Net increase/(decrease) in cash and cash equivalents			361,151		(287,912)
Cash and cash equivalents at beginning of year			24,531		312,443
Cash and cash equivalents at end of year			385,682		24,531

1 Accounting policies

Company information

LPFE Limited is a private company limited by shares incorporated in Scotland. The registered office is 4th Floor, Saltire Court, 20 Castle Terrace, Edinburgh, Lothian, EH1 2EN. The company's principal activities and nature of its operations are disclosed in the directors' report.

1.1 Accounting convention

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the United Kingdom and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS, except as otherwise stated.

The financial statements are prepared in sterling, which is the functional currency of the company. Monetary amounts in these financial statements are rounded to the nearest £.

The financial statements have been prepared under the historical cost convention. The principal accounting policies adopted are set out below.

1.2 Going concern

The directors have at the time of approving the financial statements, a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future.

LPFE is a wholly owned subsidiary of the City of Edinburgh Council and is responsible for providing the staffing resource to administer the Lothian Pension 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. As such the company income is guaranteed and will always have the ability to meet its outgoing expenses.

Thus the directors continue to adopt the going concern basis of accounting in preparing the financial statements.

1.3 Revenue

Revenue is recognised to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty.

Revenue is derived wholly from the provision of seconded staff in the United Kingdom. Revenue is recognised upon the delivery of the service to the customer.

All revenue is stated net of the amount of value added tax (VAT).

1.4 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities.

1.5 Financial assets

Financial assets are recognised in the company's statement of financial position when the company becomes party to the contractual provisions of the instrument. Financial assets are classified into specified categories, depending on the nature and purpose of the financial assets.

At initial recognition, financial assets classified as fair value through profit and loss are measured at fair value and any transaction costs are recognised in profit or loss. Financial assets not classified as fair value through profit and loss are initially measured at fair value plus transaction costs.

1 Accounting policies **(Continued)**

Financial assets held at amortised cost

Financial instruments are classified as financial assets measured at amortised cost where the objective is to hold these assets in order to collect contractual cash flows, and the contractual cash flows are solely payments of principal and interest. They arise principally from the provision of goods and services to customers (eg trade receivables). They are initially recognised at fair value plus transaction costs directly attributable to their acquisition or issue, and are subsequently carried at amortised cost using the effective interest rate method, less provision for impairment where necessary.

Impairment of financial assets

Financial assets carried at amortised cost and FVOCI are assessed for indicators of impairment at each reporting end date.

The expected credit losses associated with these assets are estimated on a forward-looking basis. A broad range of information is considered when assessing credit risk and measuring expected credit losses, including past events, current conditions, and reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the instrument.

Derecognition of financial assets

Financial assets are derecognised only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership to another entity.

1.6 Financial liabilities

The company recognises financial debt when the company becomes a party to the contractual provisions of the instruments. Financial liabilities are classified as either 'financial liabilities at fair value through profit or loss' or 'other financial liabilities'.

Financial liabilities at fair value through profit or loss

Other financial liabilities

Other financial liabilities, including borrowings, trade payables and other short-term monetary liabilities, are initially measured at fair value net of transaction costs directly attributable to the issuance of the financial liability. They are subsequently measured at amortised cost using the effective interest method. For the purposes of each financial liability, interest expense includes initial transaction costs and any premium payable on redemption, as well as any interest or coupon payable while the liability is outstanding.

Derecognition of financial liabilities

Financial liabilities are derecognised when, and only when, the company’s obligations are discharged, cancelled, or they expire.

1.7 Equity instruments

Equity instruments issued by the company are recorded at the proceeds received, net of direct issue costs. Dividends payable on equity instruments are recognised as liabilities once they are no longer at the discretion of the company.

1.8 Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The company’s liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting end date.

1 Accounting policies **(Continued)**

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting end date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity. Deferred tax assets and liabilities are offset when the company has a legally enforceable right to offset current tax assets and liabilities and the deferred tax assets and liabilities relate to taxes levied by the same tax authority.

1.9 Employee benefits

The costs of short-term employee benefits are recognised as a liability and an expense, unless those costs are required to be recognised as part of the cost of inventories or non-current assets.

The cost of any unused holiday entitlement is recognised in the period in which the employee’s services are received.

Termination benefits are recognised immediately as an expense when the company is demonstrably committed to terminate the employment of an employee or to provide termination benefits.

1.10 Retirement benefits

The cost of providing benefits under defined benefit plans is determined separately for each plan using the projected unit credit method, and is based on actuarial advice.

The change in the net defined benefit liability arising from employee service during the year is recognised as an employee cost. The cost of plan introductions, benefit changes, settlements and curtailments are recognised as an expense in measuring profit or loss in the period in which they arise.

The net interest element is determined by multiplying the net defined benefit liability by the discount rate, taking into account any changes in the net defined benefit liability during the period as a result of contribution and benefit payments. The net interest is recognised in profit or loss as other finance revenue or cost.

Remeasurement changes comprise actuarial gains and losses, the effect of the asset ceiling and the return on the net defined benefit liability excluding amounts included in net interest. These are recognised immediately in other comprehensive income in the period in which they occur and are not reclassified to profit and loss in subsequent periods.

The net defined benefit pension asset or liability in the balance sheet comprises the total for each plan of the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds), less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information, and in the case of quoted securities is the published bid price. The value of a net pension benefit asset is limited to the amount that may be recovered either through reduced contributions or agreed refunds from the scheme.

1 Accounting policies **(Continued)**

1.11 Foreign exchange

Transactions in currencies other than pounds sterling are recorded at the rates of exchange prevailing at the dates of the transactions. At each reporting end date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the reporting end date. Gains and losses arising on translation in the period are included in profit or loss.

2 Critical accounting estimates and judgements

In the application of the company’s accounting policies, the directors are required to make judgements, estimates and assumptions about the carrying amount of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The estimates and assumptions which have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities are outlined below.

Key sources of estimation uncertainty

Defined benefit pension obligation

The valuation of the defined benefit pension obligation is inherently subjective due to among other factors, future inflation, mortality rates and salary increases. As a result the valuation of the obligation is subject to a significant degree of uncertainty and is made on assumptions which may not prove to be accurate, particularly in periods of market volatility and fluctuating inflation.

The value of the defined benefit pension asset or obligation is appraised each year by an independent external actuary. This estimate uses assumptions based on payroll records for the year and known market trends.

3 Revenue

	2023	2022
	£	£
Revenue analysed by class of business		
Secondment costs for pension investment and administration services	7,309,586	5,853,139

4 Operating loss

	2023	2022
Operating loss for the year is stated after charging/(crediting):	£	£
Fees payable to the company's auditor for the audit of the company's financial statements	10,120	9,200

5 Employees

The average monthly number of persons (including directors) employed by the company during the year was:

	2023 Number	2022 Number
	98	83

Their aggregate remuneration comprised:

	2023 £	2022 £
Wages and salaries	5,299,244	4,239,580
Social security costs	661,322	498,693
Pension costs	858,700	715,958
	6,819,266	5,454,231

6 Directors' remuneration

	2023 £	2022 £
Remuneration for qualifying services	248,259	181,018

Three (2022: Four) directors received emoluments from the company during the period.

All other directors are employed by the City of Edinburgh Council.

7 Variable pay

The company runs three variable pay schemes, two of which have vesting periods. The Portfolio Manager and Senior Management schemes entitle staff to receive an assessed percentage of their salary as an additional variable pay award if they meet certain objectives during the year. The assessment year runs from 1 February to 31 January. The award then vests over three years. The first part is payable at the end of the first year if the objectives are met and the remaining two parts are payable in the following two years if the requirement that the employee is still employed by the company at such time is met. Payment one has been made in January 2023. A liability has been raised at 31 March 2023 for the two months of service which the employees have delivered with regards to the second and third payments in the scheme.

	2023	2022
	£	£
Brought forward	64,016	64,048
Current service cost	13,035	(32)
	77,051	64,016
Current liability	60,990	50,239
Non-current liability	16,061	13,777
	77,051	64,016

8 Finance costs

	2023	2022
	£	£
Net interest on net defined benefit liability	112,000	125,000
Other interest payable	3,313	956
Total interest expense	115,313	125,956

9 Income tax expense

	2023	2022
	£	£
Current tax		
UK corporation tax on profits for the current period	30,506	28,724

9 Income tax expense (Continued)

The charge for the year can be reconciled to the loss per the income statement as follows:

	2023 £	2022 £
Loss before taxation	(1,044,792)	(1,101,823)
Expected tax credit based on a corporation tax rate of 19.00% (2022: 19.00%)	(198,510)	(209,346)
Effect of expenses not deductible in determining taxable profit	229,016	238,437
Change in unrecognised deferred tax assets	-	(365)
Group relief	(22,984)	(28,726)
Deferred tax adjustments in respect of prior years	209,880	(209,880)
Temporary differences not recognised	664,620	382,850
Other intercompany adjustments	22,984	28,724
Deferred tax (charged)/credited directly to OCI	(874,500)	(172,970)
Taxation charge for the year	30,506	28,724

In addition to the amount charged to the income statement, the following amounts relating to tax have been recognised directly in other comprehensive income:

	2023 £	2022 £
Deferred tax arising on:		
Actuarial differences recognised as other comprehensive income	1,088,361	172,970

10 Trade and other receivables

	2023 £	2022 £
Trade receivables	73,831	15,802
VAT recoverable	-	1,390
Amounts owed by fellow group undertakings	934,366	755,467
Other receivables	712	-
Prepayments	14,320	1,784
	1,023,229	774,443

11 Trade and other payables

	Current		Non-current	
	2023	**2022**	**2023**	**2022**
	£	**£**	**£**	**£**
Trade payables	3,039	4,268	-	-
Amounts owed to fellow group undertakings	22,984	71,691	-	-
Accruals	134,565	166,555	16,061	13,778
Social security and other taxation	651,861	123,685	-	-
Other payables	4,609	3,429	-	-
	817,058	369,628	16,061	13,778

12 Deferred taxation

	2023	**2022**
	£	**£**
Deferred tax liabilities	213,861	-
Deferred tax assets	-	(874,500)
	213,861	(874,500)

Deferred tax assets are expected to be recovered after more than one year

The following are the major deferred tax liabilities and assets recognised by the company and movements thereon during the current and prior reporting period.

	Retirement benefit obligations	**Total**
	£	**£**
Asset at 1 April 2021	(1,047,470)	(1,047,470)
Deferred tax movements in prior year		
Charge/(credit) to profit or loss	172,970	172,970
Asset at 1 April 2022	(874,500)	(874,500)
Deferred tax movements in current year		
Charge/(credit) to profit or loss	1,088,361	1,088,361
Asset at 31 March 2023	213,861	213,861

Statutory database figures differ from the trial balance by:	
Deferred tax asset at 31 March 2023	213,861
Deferred tax liability at 31 March 2023	(213,861)

13 Retirement benefit schemes

13 Retirement benefit schemes **(Continued)**

Defined benefit scheme

The company operates a defined benefit pension scheme for all qualifying employees. The assets of the scheme are held separately from those of the company in the Lothian Pension Fund, an independently administered fund. The latest actuarial valuation of the fund was completed on 31 March 2020. At this date the funds assets were sufficient to meet 117.7% of the liabilities.

Valuation

Although LPFE is an "admitted" rather than "scheduled" body to LGPS, it is presumed that membership of LGPS would always be open to LPFE employees and therefore its employer membership of LPF would never terminate. Should, however, this not be the case and a future cessation of LPFE membership did occur, then a cessation valuation would be carried out in accordance with LPF's Funding Strategy Statement. The basis of such valuation by carried out by the Fund actuary would differ from IAS19 assumptions

	2023	2022
Key assumptions	%	%
Discount rate	4.8	2.8
Pension growth rate	3	3.2
Salary growth rate	3.5	3.7

	2023	2022
Mortality assumptions		
Assumed life expectations on retirement at age 65:	Years	Years
Retiring today		
- Males	19.9	20.3
- Females	22.9	23.1
Retiring in 20 years		
- Males	21.2	21.6
- Females	24.7	25

	2023	2022
Amounts recognised in the income statement	£	£
Current service cost	1,930,000	1,872,000
Net interest on defined benefit liability/(asset)	112,000	125,000
Total costs	2,042,000	1,997,000

13 Retirement benefit schemes **(Continued)**

Amounts recognised in other comprehensive income	2023 £	2022 £
Actuarial changes arising from changes in demographic assumptions	(119,000)	(119,000)
Actuarial changes arising from changes in financial assumptions	(10,309,000)	(1,894,000)
Actuarial changes related to plan assets	(22,000)	(1,316,000)
Other gains and losses	858,000	33,000
Total costs/(income)	(9,592,000)	(3,296,000)

The amounts included in the statement of financial position arising from the company's obligations in respect of defined benefit plans are as follows:

	2023 £	2022 £
Present value of defined benefit obligations	13,038,000	19,883,000
Fair value of plan assets	(17,904,000)	(16,385,000)
(Surplus)/deficit in scheme	(4,866,000)	3,498,000

Movements in the present value of defined benefit obligations	2023 £	2022 £
At 1 April 2022	19,883,000	19,361,000
Current service cost	1,930,000	1,872,000
Benefits paid	(124,000)	(67,000)
Contributions from scheme members	343,000	279,000
Actuarial gains and losses	(10,428,000)	(2,013,000)
Interest cost	576,000	418,000
Other	858,000	33,000
At 31 March 2023	13,038,000	19,883,000

The defined benefit obligations arise from plans funded as follows:	2023 £	2022 £
Wholly unfunded obligations	-	-
Wholly or partly funded obligations	13,038,000	19,883,000
	13,038,000	19,883,000

13 Retirement benefit schemes **(Continued)**

Movements in the fair value of plan assets:	2023 £	2022 £
At 1 April 2022	16,385,000	13,848,000
Interest income	464,000	293,000
Return on plan assets (excluding amounts included in net interest)	22,000	1,316,000
Benefits paid	(124,000)	(67,000)
Contributions by the employer	814,000	716,000
Contributions by scheme members	343,000	279,000
At 31 March 2023	17,904,000	16,385,000

Sensitivity of the defined benefit obligations to changes in assumptions

Scheme obligations would have been affected by changes in assumptions as follows:

		2023 £'000	2022 £'000
0.1% decrease in real discount rate	- increase	342	516
	- decrease	-342	-516
0.1% increase in the salary increase rate	- increase	56	89
	- decrease	-56	-89
0.1% increase in the pension increase rate	- increase	291	422
	- decrease	-291	-422

The fair value of plan assets at the reporting period end was as follows:

	Quoted 2023 £	Unquoted 2023 £	Quoted 2022 £	Unquoted 2022 £
Equity instruments	10,101,300	-	9,134,000	-
Debt instruments	2,728,700	-	1,738,200	-
Property	143,800	691,500	152,600	718,200
Investment funds and unit trusts	238,400	3,084,000	589,600	2,133,400
Derivatives	800	-	800	-
Private equity	11,200	58,700	1,700	75,300
Cash and cash equivalents	845,600	-	1,841,200	-
	14,069,800	3,834,200	13,458,100	2,926,900

14 Share capital

Ordinary share capital	2023 Number	2022 Number	2023 £	2022 £
Issued and fully paid				
of £1 each	1	1	1	1

14 Share capital **(Continued)**

15 Retained earnings

	2023	2022
	£	£
At the beginning of the year	(2,207,933)	(4,200,416)
Loss for the year	(1,075,298)	(1,130,547)
Actuarial differences recognised in other comprehensive income	9,592,000	3,296,000
Tax on actuarial differences	(1,088,361)	(172,970)
At the end of the year	5,220,408	(2,207,933)

16 Contingent liabilities

The company's variable pay arrangements are described in note 6 above. In the event that all the staff involved in the arrangements at 31 January 2023 remain in the company's employment there is 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.

17 Capital risk management

The company is not subject to any externally imposed capital requirements.

18 Related party transactions

Remuneration of key management personnel
The remuneration of key management personnel, including directors, is set out below in aggregate for each of the categories specified in IAS 24 *Related Party Disclosures*.

	2023	2022
	£	£
Short-term employee benefits	1,302,524	930,612
Post-employment benefits	118,910	111,372
	1,421,434	1,041,984

18 Related party transactions **(Continued)**

Other transactions with related parties

During the year the company entered into the following transactions with related parties:

	Sale of goods		Purchase of goods	
	2023	2022	2023	2022
	£	£	£	£
Lothian Pension Fund	5,899,190	4,857,001	-	-
LPFI Limited	1,026,314	826,353	-	-
	6,925,504	5,683,354	-	-

	Interest payable	
	2023	2022
	£	£
Parent company	3,313	956

The following amounts were outstanding at the reporting end date:

	2023	2022
Amounts due to related parties	£	£
Parent company	1,872	42,967
Entities with joint control or significant influence over the company	30,506	28,724
	32,378	71,691

At the balance sheet date the company owed £30,506 (*2022: £28,724*) to Edinburgh Trams Limited, a fellow group subsidiary, in relation to group tax relief payments.

The following amounts were outstanding at the reporting end date:

	2023	2022
Amounts due from related parties	£	£
Lothian Fund Pension	474,065	377,493
LPFI Limited	460,301	350,477
	934,366	727,970

19 Controlling party

19 Controlling party **(Continued)**

The City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund) owns all the issued share capital of the company. The company itself has been established to support the administration of the Lothian Pension Fund. Administering authorities are required to prepare separate financial statements for the Local Government Pension Scheme funds that they administer and so it is considered appropriate to consolidate the company's individual financial statements into Lothian Pension Fund's consolidated financial statements.

Group accounts are available to the public from the following address and will also be made available through the pension scheme website at www.lpf.org.uk:

Company Secretary
Lothian Pension Fund
Atria One
144 Morrison Street
Edinburgh
EH3 8EX

20 Cash generated from/(absorbed by) operations

	2023	2022
	£	£
Loss for the year before income tax	(1,044,792)	(1,101,823)
Adjustments for:		
Finance costs	115,313	125,956
Pension scheme non-cash movement	1,116,000	1,156,000
Movements in working capital:		
Increase in trade and other receivables	(250,176)	(40,943)
Increase/(decrease) in trade and other payables	451,103	(411,269)
Cash generated from/(absorbed by) operations	387,448	(272,079)

Company registration number SC497542 (Scotland)

LPFI LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2023

LPFI LIMITED

COMPANY INFORMATION

Chairman	Mr H Dunn
Executive Directors	Ms K Thirkell Mr J Burns Mr W B Miller Mr D S Vallery
Non-Executive Directors	Mr A Marchant Mr L Robb
Company number	SC497542
Registered office	4th Floor Saltire Court 20 Castle Terrace Edinburgh Lothian EH1 2EN
Auditor	Azets Audit Services Exchange Place 3 Semple Street Edinburgh United Kingdom EH3 8BL

LPFI LIMITED

CONTENTS

LPFI LIMITED

DIRECTORS' RESPONSIBILITIES STATEMENT

FOR THE YEAR ENDED 31 MARCH 2023

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the United Kingdom. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, International Accounting Standard 1 requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company’s transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors present their annual report and financial statements for the year ended 31 March 2023.

Principal activities

The current principal activity of the company is the provision of Financial Conduct Authority ("FCA") regulated investment services to the City of Edinburgh Council acting in its capacity as the administering authority of the Lothian Pension Fund) ("LPF") and other Local Government Pension Scheme funds in Scotland and Northern Ireland.

Results and dividends

The profit for the year after tax was £32,622 (2022: £32,459). The directors do not recommend payment of a dividend.

The company's aim is to make a modest trading surplus.

Under the mutual trading agreement with LPF, the company is required to consider if any of the profit arising from the mutual trade can be returned to LPF. Company Law requires that only "distributable profits" are available for distribution. None of the profit for the year is attributable to the mutual trade.

Directors

The directors who held office during the year and up to the date of signature of the financial statements were as follows:

Mr. H Dunn	
Mr. A Marchant	
Mr. S Fairbairn	(Resigned 14 September 2022)
Mr. J Burns	(Resigned 31 May 2023)
Mr. W B Miller	
Mr L Robb	
D S Vallery	
Ms K J Thirkell	(Appointed 16 September 2022)

Statement of disclosure to auditor

Each director in office at the date of approval of this annual report confirms that:

- so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware, and
- the director has taken all the steps that he / she ought to have taken as a director in order to make himself / herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

On behalf of the board

....

Mr. H Dunn

Director

Date: ....

INDEPENDENT AUDITOR'S REPORT
TO THE MEMBERS OF LPFI LIMITED

Opinion

We have audited the financial statements of LPFI Limited (the 'company') for the year ended 31 March 2023 which comprise the income statement, the statement of financial position, the statement of changes in equity, the statement of cash flows and notes to the financial statements, including significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and UK adopted international accounting standards.

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2023 and of its profit for the year then ended;
- have been properly prepared in accordance with UK adopted international accounting standards; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Other information

The other information comprises the information included in the annual report other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of our audit:

- the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the directors' report has been prepared in accordance with applicable legal requirements.

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

TO THE MEMBERS OF LPFI LIMITED

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the directors' report. We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- the directors were entitled to take advantage of the small companies exemption from the requirement to prepare a strategic report.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities is available on the Financial Reporting Council's website at: https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Extent to which the audit was considered capable of detecting irregularities, including fraud
Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above and on the Financial Reporting Council’s website, to detect material misstatements in respect of irregularities, including fraud.

We obtain and update our understanding of the entity, its activities, its control environment, and likely future developments, including in relation to the legal and regulatory framework applicable and how the entity is complying with that framework. Based on this understanding, we identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. This includes consideration of the risk of acts by the entity that were contrary to applicable laws and regulations, including fraud.

In response to the risk of irregularities and non-compliance with laws and regulations, including fraud, we designed procedures which included:

- Enquiry of management and those charged with governance around actual and potential litigation and claims as well as actual, suspected and alleged fraud;
- Reviewing minutes of meetings of those charged with governance;
- Assessing the extent of compliance with the laws and regulations considered to have a direct material effect on the financial statements or the operations of the company through enquiry and inspection;
- Reviewing financial statement disclosures and testing to supporting documentation to assess compliance with applicable laws and regulations;
- Performing audit work over the risk of management bias and override of controls, including testing of journal entries and other adjustments for appropriateness, evaluating the business rationale of significant transactions outside the normal course of business and reviewing accounting estimates for indicators of potential bias.

Because of the inherent limitations of an audit, there is a risk that we will not detect all irregularities, including those leading to a material misstatement in the financial statements or non-compliance with regulation. This risk increases the more that compliance with a law or regulation is removed from the events and transactions reflected in the financial statements, as we will be less likely to become aware of instances of non-compliance. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

Use of our report
This report is made solely to the company’s members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company’s members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company’s members as a body, for our audit work, for this report, or for the opinions we have formed.

Nick Bennett ACA (Senior Statutory Auditor)
For and on behalf of Azets Audit Services

Date: ....

Chartered Accountants
Statutory Auditor

Exchange Place 3
Semple Street
Edinburgh
United Kingdom
EH3 8BL

LPFI LIMITED

INCOME STATEMENT

FOR THE YEAR ENDED 31 MARCH 2023

	Notes	2023 £	2022 £
Revenue	**2**	1,873,534	1,515,239
Gross profit		1,873,534	1,515,239
Administrative expenses		(1,849,268)	(1,480,917)
Operating profit	**3**	24,266	34,322
Investment revenues	**5**	17,921	-
Finance costs	**6**	(1,913)	-
Profit before taxation		40,274	34,322
Income tax expense	**7**	(7,652)	(1,863)
Profit and total comprehensive income for the year	**12**	32,622	32,459

LPFI LIMITED

STATEMENT OF FINANCIAL POSITION

AS AT 31 MARCH 2023

	Notes	2023 £	2022 £
Current assets			
Trade and other receivables	**8**	725,218	505,145
Current tax recoverable		4,658	4,658
Cash and cash equivalents		1,092,784	832,340
		1,822,660	1,342,143
Current liabilities			
Trade and other payables	**10**	834,630	488,622
Current tax liabilities		1,887	-
Borrowings	**9**	100,000	-
		936,517	488,622
Net current assets		886,143	853,521
Net assets		886,143	853,521
Equity			
Called up share capital	**11**	690,378	690,378
Retained earnings	**12**	195,765	163,143
Total equity		886,143	853,521

The financial statements were approved by the board of directors and authorised for issue on .... and are signed on its behalf by:

....
Mr. H Dunn
Director

Company registration number SC497542

LPFI LIMITED

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 MARCH 2023

	Notes	Share capital £	Retained earnings £	Total £
Balance at 1 April 2021		590,378	130,684	721,062
Year ended 31 March 2022:				
Profit and total comprehensive income for the year		-	32,459	32,459
Transactions with owners in their capacity as owners:				
Issue of share capital	**11**	100,000	-	100,000
Balance at 31 March 2022		690,378	163,143	853,521
Year ended 31 March 2023:				
Profit and total comprehensive income for the year		-	32,622	32,622
Balance at 31 March 2023		690,378	195,765	886,143

LPFI LIMITED

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 MARCH 2023

	Notes	2023 £	2023 £	2022 £	2022 £
Cash flows from operating activities					
Cash generated from operations	**15**		148,759		156,829
Interest paid			(471)		-
Income taxes paid			(5,765)		(13,577)
Net cash inflow from operating activities			142,523		143,252
Investing activities					
Interest received		17,921		-	
Net cash generated from/(used in) investing activities			17,921		-
Financing activities					
Proceeds from issue of shares		-		100,000	
New borrowings		100,000		-	
Net cash generated from financing activities			100,000		100,000
Net increase in cash and cash equivalents			260,444		243,252
Cash and cash equivalents at beginning of year			832,340		589,088
Cash and cash equivalents at end of year			1,092,784		832,340

1 Accounting policies

Company information

LPFI Limited is a private company limited by shares incorporated in Scotland. The registered office is 4th Floor, Saltire Court, 20 Castle Terrace, Edinburgh, Lothian, EH1 2EN. The company's principal activities and nature of its operations are disclosed in the directors' report.

1.1 Accounting convention

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the United Kingdom and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS, except as otherwise stated.

The financial statements are prepared in sterling, which is the functional currency of the company. Monetary amounts in these financial statements are rounded to the nearest £.

The financial statements have been prepared under the historical cost convention. The principal accounting policies adopted are set out below.

1.2 Going concern

The directors have at the time of approving the financial statements, a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Thus the directors continue to adopt the going concern basis of accounting in preparing the financial statements.

1.3 Revenue

Revenue is recognised to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty.

Revenue is derived wholly from the provision of FCA-regulated service in the United Kingdom. Revenue from a contract to provide services is recognised by reference to the stage of completion of the contract. The stage of completion of the contract is determined with reference to contractual rates as labour hours and direct expenses are incurred.

All revenue is stated net of the amount of value added tax (VAT).

1.4 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities.

1.5 Financial assets

Financial assets are recognised in the company's statement of financial position when the company becomes party to the contractual provisions of the instrument. Financial assets are classified into specified categories, depending on the nature and purpose of the financial assets.

At initial recognition, financial assets classified as fair value through profit and loss are measured at fair value and any transaction costs are recognised in profit or loss. Financial assets not classified as fair value through profit and loss are initially measured at fair value plus transaction costs.

1 Accounting policies (Continued)

Financial assets held at amortised cost

Financial instruments are classified as financial assets measured at amortised cost where the objective is to hold these assets in order to collect contractual cash flows, and the contractual cash flows are solely payments of principal and interest. They arise principally from the provision of goods and services to customers (eg trade receivables). They are initially recognised at fair value plus transaction costs directly attributable to their acquisition or issue, and are subsequently carried at amortised cost using the effective interest rate method, less provision for impairment where necessary.

Impairment of financial assets

Financial assets carried at amortised cost and FVOCI are assessed for indicators of impairment at each reporting end date.

The expected credit losses associated with these assets are estimated on a forward-looking basis. A broad range of information is considered when assessing credit risk and measuring expected credit losses, including past events, current conditions, and reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the instrument.

Derecognition of financial assets

Financial assets are derecognised only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership to another entity.

1.6 Financial liabilities

The company recognises financial debt when the company becomes a party to the contractual provisions of the instruments. Financial liabilities are classified as either 'financial liabilities at fair value through profit or loss' or 'other financial liabilities'.

Financial liabilities at fair value through profit or loss

Other financial liabilities

Other financial liabilities, including borrowings, trade payables and other short-term monetary liabilities, are initially measured at fair value net of transaction costs directly attributable to the issuance of the financial liability. They are subsequently measured at amortised cost using the effective interest method. For the purposes of each financial liability, interest expense includes initial transaction costs and any premium payable on redemption, as well as any interest or coupon payable while the liability is outstanding.

Derecognition of financial liabilities

Financial liabilities are derecognised when, and only when, the company's obligations are discharged, cancelled, or they expire.

1.7 Equity instruments

Equity instruments issued by the company are recorded at the proceeds received, net of direct issue costs. Dividends payable on equity instruments are recognised as liabilities once they are no longer at the discretion of the company.

1.8 Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

1 Accounting policies **(Continued)**

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting end date.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting end date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity. Deferred tax assets and liabilities are offset when the company has a legally enforceable right to offset current tax assets and liabilities and the deferred tax assets and liabilities relate to taxes levied by the same tax authority.

1.9 Employee benefits

The costs of short-term employee benefits are recognised as a liability and an expense, unless those costs are required to be recognised as part of the cost of inventories or non-current assets.

The cost of any unused holiday entitlement is recognised in the period in which the employee's services are received.

Termination benefits are recognised immediately as an expense when the company is demonstrably committed to terminate the employment of an employee or to provide termination benefits.

1.10 Foreign exchange

Transactions in currencies other than pounds sterling are recorded at the rates of exchange prevailing at the dates of the transactions. At each reporting end date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the reporting end date. Gains and losses arising on translation in the period are included in profit or loss.

2 Revenue

	2023	**2022**
	£	**£**
Revenue analysed by class of business		
Investment advisory and management services	1,873,534	1,515,239

3 Operating profit

	2023	2022
Operating profit for the year is stated after charging/(crediting):	£	£
Fees payable to the company's auditor for the audit of the company's financial statements	9,900	9,000

4 Directors' remuneration

	2023	2022
	£	£
Remuneration for qualifying services	25,000	25,000

The aggregate payroll costs for the year consisted of fees paid to non-executive directors.

No pension benefits were accrued by the directors during the year. All other staff and directors are employed by LPFE Limited, a company under common control, and an appropriate portion of their employment costs recharged. The amounts of the recharge are disclosed in note 13 Related party transactions.

5 Investment income

	2023	2022
	£	£
Interest income		
Financial instruments measured at amortised cost:		
Other interest income on financial assets	17,921	-

Income above relates to assets held at amortised cost, unless stated otherwise.

6 Finance costs

	2023	2022
	£	£
Other interest payable	1,913	-

7 Income tax expense

	2023	2022
	£	£
Current tax		
UK corporation tax on profits for the current period	7,652	1,863

7 Income tax expense (Continued)

The charge for the year can be reconciled to the profit per the income statement as follows:

	2023 £	2022 £
Profit before taxation	40,274	34,322
Expected tax charge based on a corporation tax rate of 19.00% (2022: 19.00%)	7,652	6,521
Adjustment in respect of prior years	-	(4,658)
Taxation charge for the year	7,652	1,863

8 Trade and other receivables

	2023 £	2022 £
Trade receivables	677,035	453,531
Amounts owed by fellow group undertakings	41,907	49,650
Other receivables	3,822	254
Prepayments	2,454	1,710
	725,218	505,145

9 Borrowings

	2023 £	2022 £
Borrowings held at amortised cost:		
Loans from fellow group undertakings	100,000	-

This is an unsecured loan from LPF, this is payable on demand.

10 Trade and other payables

	2023 £	2022 £
Trade payables	7,451	6,837
Amounts owed to fellow group undertakings	787,260	415,891
Accruals	21,753	59,502
Social security and other taxation	16,724	6,392
Other payables	1,442	-
	834,630	488,622

11 Share capital

Ordinary share capital	2023 Number	2022 Number	2023 £	2022 £
Issued and fully paid				
Ordinary shares of £1 each	690,378	690,378	690,378	690,378

12 Retained earnings

	2023 £	2022 £
At the beginning of the year	163,143	130,684
Profit for the year	32,622	32,459
At the end of the year	195,765	163,143

13 Related party transactions

Remuneration of key management personnel

Compensation paid in relation to key management personnel during the period was as follows:

	2023 £	2022 £
Directors' remuneration (note 4)	25,000	25,000

All other key management personnel are employed by LPFE Limited, a company also under the control of Lothian Pension Fund (administered by the City of Edinburgh Council), and the City of Edinburgh Council. In addition to the compensation noted above, the company was also charged £114,512 (2022: £111,015) for services provided by key management personnel employed by LPFE Limited during the year.

Other transactions with related parties

During the year the company entered into the following transactions with related parties:

	Sale of goods		Purchase of goods	
	2023 £	2022 £	2023 £	2022 £
Lothian Pension Fund	386,817	284,161	321,194	217,407
LPFE Limited	-	-	1,026,315	826,353
	386,817	284,161	1,347,509	1,043,760

13 Related party transactions **(Continued)**

Amounts due to related parties	**2023 £**	**2022 £**
Lothian Pension Fund	421,194	31,396
Entities with joint control or significant influence over the company	-	6,521
LPFE Limited	460,301	377,974
	881,495	415,891

At the balance sheet date the company owed £6,521 (2021: £Nil) to Edinburgh Trams Limited, a fellow group subsidiary, in relation to group tax relief payments.

Amounts due from related parties	**2023 £**	**2022 £**
Lothian Pension Fund	41,907	49,650

14 Controlling party

The City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund) owns all the issued share capital of the company. The company itself has been established to support the administration of the Lothian Pension Fund. Administering authorities are required to prepare separate financial statements for the Local Government Pension Scheme funds that they administer and so it is considered appropriate to consolidate the company's individual financial statements into Lothian Pension Fund's consolidated financial statements.

Group accounts are available to the public from the following address and will also be made available through the pension scheme website at www.lpf.org.uk:

Company Secretary
Lothian Pension Fund
Atria One
144 Morrison Street
Edinburgh
EH3 8EX

15 Cash generated from operations

	2023	2022
	£	£
Profit for the year before income tax	40,274	34,322
Adjustments for:		
Finance costs	1,913	-
Investment income	(17,921)	-
Movements in working capital:		
(Increase)/decrease in trade and other receivables	(220,073)	51,947
Increase in trade and other payables	344,566	70,560
Cash generated from operations	148,759	156,829

Appendix 5

Azets Audit Services Limited

Exchange Place 3

Semple Street

Edinburgh

EH3 8BL

Re: Lothian Pension Fund and Scottish Homes Pension Fund

Dear Sirs

This representation letter is provided in connection with your audit of the Lothian Pension Fund and Scottish Homes Pension Fund ('the Funds') Annual Report and Accounts for the year ended 31 March 2023 for the purpose of expressing an opinion as to whether the financial statements show a true and fair view of the financial transactions of the Funds during the year to 31 March 2023 and of the amount and disposition at that date of its assets and liabilities (other than liabilities to pay pensions and benefits after the end of the period) in accordance with Part VII of the Local Government (Scotland) Act 1973 and International Financial Reporting Standards as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting 2022/23 in the United Kingdom and making a statement about contributions.

By a resolution of the board, passed today, I am directed to confirm to you, in respect of the financial statements of the Funds (and its group) for the period ended 31 March 2023, the following:

GENERAL

1. We have fulfilled our responsibilities for preparing financial statements in accordance with the Local Government (Scotland) Act 1973, the Code of Practice on Local Authority Accounting in the United Kingdom, and International Financial Reporting Standards and for being satisfied that they give a true and fair view and for making accurate representations to you.
2. All the transactions undertaken by the Funds have been properly reflected and recorded in the accounting records.
3. All the accounting records have been made available to you for the purpose of your audit. We have provided you with unrestricted access to all appropriate persons within the Funds, and with all other records and related information requested, including minutes of all management and Committee meetings.

ADJUSTMENTS & DISCLOSURES

4. The financial statements are free of material misstatements, including omissions.
5. The effects of uncorrected misstatements are immaterial, both individually and in aggregate, to the financial statements as a whole. (See appendix 1 for details of such uncorrected misstatements).
6. We have reviewed and approved all disclosures made in the financial statements and we are not aware of any other matters which require disclosure in order to comply with the requirements of the Local Government (Scotland) Act 1973, the Code of Practice on Local Authority Accounting in the United Kingdom, and International Financial Reporting Standards.

INTERNAL CONTROL AND FRAUD

7. We acknowledge our responsibility for the design, implementation and maintenance of internal control systems to prevent and detect fraud and error. We have disclosed to you the results of our risk assessment that the financial statements may be misstated as a result of fraud.
8. We have disclosed to you all instances of known or suspected fraud affecting the Funds involving management, employees who have a significant role in internal control or others that could have a material effect on the financial statements.
9. We have also disclosed to you all information in relation to allegations of fraud or suspected fraud affecting Funds' financial statements communicated by current or former employees, analysts, regulators or others.

10. We have disclosed to you any significant changes in our processes, controls, policies and procedures that we deem necessary to address the likely effects of the COVID-19 pandemic on our system of internal controls.

ASSETS AND LIABILITIES

11. The Funds have satisfactory title to all assets and there are no liens or encumbrances on the Funds' assets except for those that are disclosed in the notes to the financial statements.
12. There were no changes in investment assets or fixed assets during the period ended 31 March 2023 other than those disclosed in the accounts.
13. The assumptions that have been used in determining fair values, whether such values are disclosed or applied in the financial statements, are reasonable and reflect our ability and intent to carry out specific courses of action, where this is relevant to the determination of those values.
14. Where required, the value at which assets and liabilities are recorded in the net assets statement is, in our opinion, the market value. We are responsible for the reasonableness of any significant assumptions underlying the valuation, including consideration of whether they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the Funds. Any significant changes in those values since the accounting reference date have been disclosed to you.
15. The following have been properly recorded and, when appropriate, adequately disclosed in the financial statements:
    a. losses arising from sale and purchase commitments;
    b. agreements and options to buy back assets previously sold;
    c. assets pledged as collateral.
16. We have reviewed the residual values attached to fixed assets and confirm they are still appropriate and reasonable reflections of these assets' condition and usage.
17. All actual liabilities, contingent liabilities and guarantees given to third parties have been recorded or disclosed as appropriate.
18. We have no plans or intentions that may materially alter the carrying value and, where relevant, the fair value measurements or classification of assets and liabilities reflected in the financial statements.
19. We confirm that all bank accounts have been disclosed to you and are included within the financial statements.
20. We confirm that the Funds have not contracted for any capital or investment expenditure other than as disclosed in the financial statements.

ACCOUNTING ESTIMATES

21. The methods, data and significant assumptions used by us in making accounting estimates, and their related disclosures, are appropriate to achieve recognition, measurement and disclosure that is reasonable in the context of the applicable financial reporting framework.

LEGAL CLAIMS

22. We have disclosed to you all claims in connection with litigation that have been, or are expected to be, received and such matters, as appropriate, have been properly accounted for and disclosed in the financial statements.

LAWS AND REGULATIONS

23. We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements and disclosures, including non-compliance matters:
    a. Involving financial impropriety;
    b. Related to laws or regulations that have a direct effect on the determination of material amounts and disclosures in the Funds' financial statements;
    c. Related to laws and regulations that have an indirect effect on amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operations of the Funds' business, its ability to continue in business, or to avoid material penalties; and
    d. Involving management, or employees who have significant roles in internal control, or others.
24. We are unaware of any known or probable instances of non-compliance with the requirements of regulatory or governmental authorities, including their financial reporting requirements, and there have been no communications from regulatory agencies, Scottish Government or Scottish Ministers concerning investigations or allegations of non-compliance, other than those already disclosed.

RELATED PARTIES

25. Related party relationships and transactions have been appropriately accounted for and disclosed in the financial statements. We have disclosed to you all relevant information concerning such relationships and transactions and we confirm that such information is complete. We are not aware of any other matters which require disclosure in order to comply with the requirements of company law or accounting standards.
26. All transactions undertaken with group companies, including management charges, are at arm's length.

SUBSEQUENT EVENTS

27. All events subsequent to the date of the financial statements which require adjustment or disclosure have been properly accounted for and disclosed.

GOING CONCERN

28. We believe that the Funds' financial statements should be prepared on a going concern basis on the grounds that sufficient funding is available to the Funds to support the anticipated continuation of the provision of services.
29. We also confirm our plans for future action(s) required to enable the Funds to continue as a going concern are feasible.
30. We have considered a period of twelve months from the date of approval of the financial statements. We believe that no further disclosures relating to the Funds' ability to continue as a going concern need to be made in the financial statements.
31. The implications of the Covid-19 pandemic continue to create uncertainty and it is therefore difficult to evaluate the likely effect on the Funds' activities and the wider economy. Our assessment at the date of approval of these accounts is that the pandemic does not create a material uncertainty related to going concern. Note 1 to the financial statements discloses matters of which we are aware that are relevant to the Funds' ability to continue as a going concern, including significant conditions and events, our plans for future action, and the feasibility of those plans.

DISCLOSURE OF INFORMATION TO THE AUDITOR

32. We acknowledge our legal responsibilities regarding disclosure of information to you as auditor and confirm that so far as we are aware, there is no relevant audit information needed by you in connection with preparing your audit report of which you are unaware.

33. Each member of the Pensions Committee has taken all the steps that they ought to have taken as a member in order to make themself aware of any relevant audit information and to establish that you are aware of that information.

Yours faithfully

....

Signed on behalf of the Funds' by:

Hugh Dunn

Service Director: Finance and Procurement, The City of Edinburgh Council

(Section 95 Officer for the Pension Funds)

Date: 27 September 2023

The above director is signing this letter on behalf of all directors confirming that:

so far as they are each aware, there is no relevant audit information of which the Funds' auditors are unaware; and each Director has taken all the steps that ought to have been taken as a director, including making appropriate enquiries of the Funds' auditors for that purpose, in order to be aware of any information needed by the Funds' auditors in connection with preparing their report and to establish that the Funds' auditors are aware of that information.

Appendix 1

SCHEDULE OF UNCORRECTED MISTATEMENTS

Journals				Net Assets Statement		Fund Account Statement	
				Increase (£'000)	Decrease (£'000)	Decrease (£'000)	Increase (£'000)
	1	Dr	Actuarial gains/losses			4,866	
		Cr	Retirement benefit asset		4,866		
P.100		Being:	Reduction of LPFE pension asset to the asset ceiling value				
			Total	-	4,866	4,866	-
			Net effect	-	4,866		4,866

Pensions Committee

2.00pm, Wednesday, 27 September 2023

Stewardship Report

Item number 6.7

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the Stewardship Report.

Bruce Miller

Chief Investment Officer, Lothian Pension Fund

Contact: Gillian de Candole, Portfolio Manager, Lothian Pension Fund

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

Stewardship Report

2. Main Report

2.1 The Financial Reporting Council's (FRC) UK Stewardship Code (2020) requires signatories to detail annually how they have exercised stewardship in relation to the Code's 12 principles.

2.2 Appendix 1 contains our Stewardship Report covering the period from 1 January 2022 to 31 March 2023 in compliance with the UK Stewardship Code (2020). The period being reviewed in this report is 15 months rather than the typical 12 months as we have moved (with FRC approval) from reporting on the calendar year to align with the Fund's financial year.

2.3 We believe we have complied with all the requirements to demonstrate our application of the Code's principles and continue to meet the criteria to retain signatory status. Beyond the change to 15-month period, there have been no changes to the structure of the report, nor to our overall stewardship approach.

2.4 The report is updated with new examples of our application of the principles (case studies) and new voting and engagement data over the period. We have also expanded areas of the report in response to specific feedback received from the FRC on the previous report: in Principle 2 we have enhanced disclosure on our team and its skills, to indicate the qualifications and experience held both internally and by our external voting and engagement provider; and in Principle 3 we have provided a new example of managing conflicts of interest relating to exercising voting rights.

2.5 This Stewardship Report will be submitted to the FRC by 31 October 2023 and published on the Fund's website.

3. Appendices

Appendix 1 – Stewardship Report 2023

Appendix 1

LOTHIAN PENSION FUND

Covering the period 1 January 2022 to 31 March 2023

THE STEWARDSHIP REPORT

LOTHIAN PENSION FUND

CONTENTS

Introduction

Our Principles

LOTHIAN
PENSION FUND

A MESSAGE FROM OUR PENSIONS COMMITTEE

The role of the Pensions Committee is to ensure that the pension fund is run in a sound and sustainable manner that guarantees we deliver on our pensions promise to our beneficiaries. We do this by investing prudently and carefully. We also do this by striving to ensure that the companies and assets we invest in are well governed and well managed, that they minimise their negative impacts on society and the environment, and that they make a positive contribution to our societies and our communities.

This doesn't happen by accident. It requires us to use our voice and influence, to challenge companies when they fall short of the standards that we expect, and to stand with them and support them when they're developing and implementing strategies that enhance their long-term sustainability and resilience.

Our work to support good governance and engagement is underpinned by our belief in the power of our voice, often alongside others, to lead to positive change that sustains and drives value for our stakeholders today and in the future.

The Pensions Committee has a critical role to play. We want Lothian Pension Fund (LPF) to take meaningful action on a range of issues, notably corporate governance and climate change. We've encouraged the fund to be at the vanguard of asset owners who are committed to moderating climate change. To communicate this to our stakeholders and to policymakers around the world, we became a signatory to the 2022 Global Investor Statement to Governments on the Climate Crisis, an investor initiative (supported by investors managing $42 trillion of assets) that urged governments to commit to real-world decarbonisation policies to limit global warming.

The Pensions Committee welcome this report as a record of LPF's past efforts, outcomes and future areas of focus for improvement. The report provides practical examples that demonstrate LPF's commitment to responsible investment. We continue to encourage, support and commend LPF's work in this critically important area for our members and employers, for a resilient financial system, and for a better world.

A MESSAGE FROM OUR CEO

As a responsible investor, LPF has a long-established commitment to stewardship. This is our third report prepared in accordance with the standards of the Stewardship Code 2020. As a leader in responsible investment amongst Local Government Pension Scheme (LGPS) funds, we've chosen to prepare and submit this report to demonstrate the nature of our commitment to stewardship, for the benefit of our stakeholders.

In the context of a complex and unpredictable world, we think hard about our approach to stewardship and regularly reassess how we should exert our influence as assets owners in an appropriate and consistent manner. First and foremost, we own assets to fund our members' income in retirement, an important social responsibility in its own right, but with ownership comes the opportunity to encourage positive corporate behaviour for the benefit of society. We see this as an additional responsibility, which we address through our voting and engagement activities that are explained in the following pages. This report confirms our adherence to the standards of the UK Stewardship Code. Our commitment is to amplify our influence as a £9.7bn pension fund in an industry measured in the trillions, by working with other asset owners to drive the long-term value of our investment portfolio, and contribute to the long-term health of the financial system.

David Vallery
CEO, Lothian Pension Fund

STEWARDSHIP IN PRACTICE: CREATING LONG-TERM INVESTMENT VALUE

Our Purpose, Vision and Duty

Our Purpose is to administer the LGPS in Edinburgh and the Lothians. By paying pensions and benefits to members, we contribute to the financial well-being of members and their families in retirement.

Our Vision is to deliver outstanding pension and investment services for the benefit of members and employers.

LPF is the second largest LGPS in Scotland. It's a funded, defined benefit, statutory occupational pension scheme.

LPF’s stakeholders are the people and entities with an interest in the assets and activities of LPF. They include the members of the pension scheme (existing and future), their dependants and beneficiaries, as well as the participating employers who contribute to the assets of the fund, and our governing bodies. Legally, and morally, we have a fiduciary duty to act in a financially prudent manner and to act in the best interests of our stakeholders.

It's this duty that defines our approach to stewardship. We need to manage our investments responsibly and sustainably so that we can pay pensions and benefits because they’ll fall due over many decades to come.

We need to ensure that the risks to our investments are effectively managed and we know that Environmental, Social and Governance (ESG) factors are fundamental considerations in driving the long-term value of our investment portfolio. They matter to society, so they matter to us.

Stewardship as an Investment Function

So, what does this mean in practice? At its heart, it means that we see stewardship as an investment function. Our core responsibility is to invest in a way that takes full account of the downside risks and the upside opportunities presented by ESG factors. We need to be properly compensated for risks, avoid over-paying for opportunities, and we need to manage and mitigate these risks in our investment portfolio.

This emphasis on the investment implications of ESG issues is reflected in our approach to stewardship. We’re unusual among UK asset owners in that responsibility for stewardship sits with our investment teams. It's our portfolio managers and investment analysts who are responsible for engaging with companies and with investment managers. It's our portfolio managers who lead our work with collaborative initiatives, such as with Climate Action 100+.

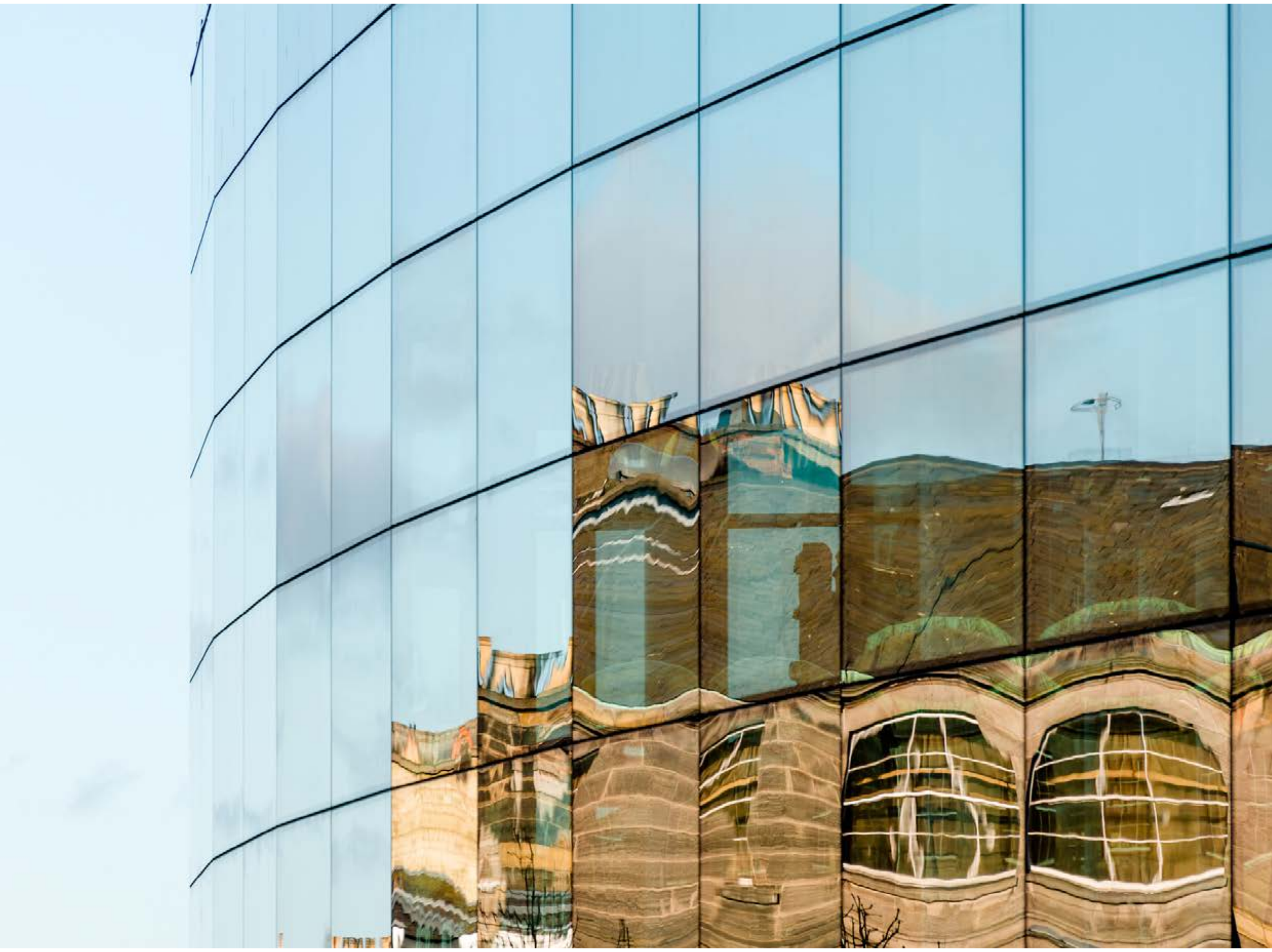
Stewardship as a Collaborative Activity

As an asset owner acting alone, our potential for direct influence is relatively modest. While direct company engagement is important and can be influential in situations where we have a significant holding, our biggest impact comes through working with others.

STEWARDSHIP IN PRACTICE: CREATING LONG-TERM INVESTMENT VALUE

Our approach to stewardship therefore includes:

- Collaboration with our industry peers
- Engagement with our investment managers. We challenge our managers on their approach to responsible investment and ESG
- Supporting collaborative engagement and escalations through Federated Hermes EOS (EOS), which derives considerable influence from representing owners of assets worth more than $1.3tn.



LOOKING FORWARD

Our aim, in all our stewardship efforts, is to ensure that the companies we invest in are sustainable and successful over the long-term and create enduring value for us as investors. We have a long track record of voting and engaging on what are often referred to as the traditional corporate governance issues, such as executive remuneration and board independence. These issues remain of central importance. Governance failures can lead to major financial losses for investors, to avoidable job losses or harm to employees or to unpaid suppliers and creditors.

However, the world is changing profoundly. Environmental and social issues have risen up the agenda that shapes our present and our future: the threat of climate change; the harm caused to our environment by plastics and pollution; and the social and political tensions resulting from armed conflict, inflation, inequality and discrimination. These issues and our collective response to them will affect our ability to deliver retirement savings for our existing and future members. As asset owners with a long-term horizon, we take these global issues seriously, we exercise our ability to vote and engage and we exhort others to do the same. We believe the most effective way is to: 'Engage Your Equity, Deny Your Debt'.

Engage Your Equity, Deny Your Debt

As an organisation, we've outlined our ambition to avoid providing any new financing to companies which aren't aligned with the goals of the Paris Agreement on Climate Change. While the trading of equities (shares) doesn't affect the capital position of a company, subscribing to new bonds and new equity does provide companies with funding. Within our equity portfolio we engage with our holdings, and that engagement includes using the tools and strategies we have at our disposal to influence companies to commit to align with the goals of the Paris Agreement. In our debt portfolios, we aim to deny funding to those non-aligned companies.

OUR PRIORITIES FOR 2023 AND 2024

Our main stewardship priority is to continue strengthening our stewardship approach on environmental and social issues, in particular climate change, while maintaining our focus on ensuring that companies are well governed and well managed. In 2022 we set up our Climate Disclosure and Strategy project to review our approach to climate change and support alignment with evolving regulatory requirements and best practice frameworks. With the Taskforce for Nature-related Financial Disclosures due to publish its recommendations in September 2023, we'll also be looking for companies and investors to improve their understanding of the importance of addressing biodiversity loss alongside climate change.

This is our third stewardship report, and it's intended to meet the principles of the Financial Reporting Council's (FRC) Stewardship Code 2020. We were pleased to be early adopters to the updated Code in 2021 as it provides a context for and a description of our activities with a focus on outcomes. We'll continue to report on our stewardship efforts, and we invite and welcome feedback on our approach.

LOTHIAN
PENSION FUND

PRINCIPLE 1: PURPOSE, STRATEGY AND CULTURE

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.

OUR PURPOSE

Our purpose is to administer the LGPS in Edinburgh and the Lothians. By paying pensions and benefits to members, we contribute to the financial well-being of members and their families in retirement. For that reason, our primary objective is to ensure that there are sufficient funds available to meet all pension and lump sum liabilities as they fall due for payment. This means we need to generate the necessary long term cash flow returns to pay promised pensions and to make the scheme affordable to participating employers, now and in the future, while minimising the risk of having to increase contribution rates in the future.

In this report, we set out our assessment of how our purpose, strategy and culture meet the needs of our stakeholders.

Our investment beliefs

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

As required by LGPS legislation, we maintain a Statement of Investment Principles (SIP) which articulates the investment principles which guide our strategies and decision-making. In terms of those principles, which enable stewardship and lead to sustainable benefits for the economy, the environment and society, we believe:

- Responsible investment supports our purpose and that through robust stewardship and an effective approach to ESG issues, we should reduce the risk associated with the invested assets that LPF owns to pay pensions when they become due
- As a provider of responsible capital, LPF should be an agent for positive change, engaging with companies to help them maintain or adopt best business practices and sustainable business models
- In being transparent about the methods we use to foster responsible investment as an organisation and being accountable for our responsible investment strategy and approach
- Successful engagement adds value to our investment process; and that divestment has no effect on company finances in the long term and can produce perverse incentives in the short term
- As responsible owners we should engage with our investee companies and appointed managers, either directly or via collaborative partners. However, we also believe that this engagement must lead to action and where we feel progress is too slow, and the prospect of financial risk to us increases as a result, we're willing to withdraw our support and end our investment.

PRINCIPLE 1: PURPOSE, STRATEGY AND CULTURE

Finally, we believe that Climate Change is one of the defining issues of our time. We believe that asset owners are uniquely positioned to drive changes in governmental and corporate behaviour to bring about an acceleration in the sustainable energy transition and a decarbonisation of the global economy.

We reiterated this to policymakers around the world by signing the 2022 Global Investor Statement to Governments on the Climate Crisis.

> "By signing the 2022 Global Investor Statement to Governments on the Climate Crisis, we're joining the call for all governments to commit to ambitious climate policy action as we approach COP27. This collaborative engagement activity is aligned with our focus on real world decarbonisation."
>
> **David Vallery**, Chief Executive Officer

OUR STRATEGY

Introducing our Statement of Responsible Investment Principles

To reflect our belief in the importance of responsible investment, we published a Statement of Responsible Investment Principles (SRIP). This describes our sustainable investing beliefs and commitments, and our strategy for integrating those with our investment activities.

Responsible investment remains a core part of the Statement of Investment Principles (SIP), which is required under LGPS legislation. However, in view of the growth in our responsible investment and stewardship activities across all asset classes, we released the first version of LPF's SRIP in June 2020 to inform members and employers more fully. This document is reviewed annually and updated to reflect how we evolve our responsible investment practices.

The SRIP explains how we incorporate ESG issues into investment analysis and decision-making processes, as well as how we seek appropriate disclosure on ESG issues from any entities in which we invest. It also publicly confirms our approach to climate change and the carbon transition.

The SRIP allows us to communicate with our stakeholders to explain our strategy in detail. It sets out how we implement responsible investment on an asset class by asset class basis, as well as detailing how we utilise all the tools at our disposal to achieve our stewardship aims.

Our SRIP supports conversations with external managers and other institutional investors on evolving best practice in responsible investment as well as on implementation challenges and approaches to systemic issues. From oversight and monitoring, to affirming our position on climate change and the carbon transition, we'll provide examples of how we implement the SRIP throughout this report.

PRINCIPLE 1: PURPOSE, STRATEGY AND CULTURE

Case study

CLIMATE CHANGE: OUR ROLE IN REAL WORLD CHANGE

As a pension fund with liabilities stretching out decades into the future, we believe that climate change is not only a defining issue of our time but also a threat to our ability to fund pension payments. For the sake of society and our portfolio of assets, we have a responsibility to mitigate the risks associated with global warming, which scientists attribute to greenhouse gas emissions caused by human activities. Ours is a small voice but we contribute it in an attempt to mitigate this systemic risk.

We believe that asset owners are uniquely positioned to drive changes in governmental and corporate behaviour to bring about an acceleration in the sustainable energy transition and a decarbonisation of the global economy. We recognise the critical importance of limiting climate-related emissions and the role that financial institutions can play in helping to achieve that goal, and how this will in turn, contribute to a well-functioning financial system.

Action on Climate Change

Engaging with policy makers: By becoming a signatory to the 2022 Global Investor Statement to Governments on the Climate Crisis, LPF added its voice, and this was amplified by 603 other institutional investors around the world managing almost $42 trillion in assets (around 40 per cent of global assets under management). The Statement urges governments to raise their climate ambition to limit global warming to no more than 1.5 degrees, implement domestic emissions reduction policies, support effective implementation of the Global Methane Pledge to reduce methane emissions by at least 30% from 2020 levels by 2030, scale up the provision of climate finance for mitigation, adaptation and resilience, and strengthen climate disclosures across the financial system.

Engaging with investee companies: In Principle 9, we provide more information on our engagement with investee companies, including through our voting and engagement service provider and through our external managers. In Principle 10, we highlight collaborative engagement activities through Climate Action 100+ and in Principle 11, we provide an example of escalation of engagement in this thematic area.

PRINCIPLE 1: PURPOSE, STRATEGY AND CULTURE

Case study

CLIMATE CHANGE: OUR ROLE IN REAL WORLD CHANGE *(CONTINUED)*

Voting our shares: In Principle 12, we provide details on our voting policies and how we voted, with a case study on “Say on Climate” votes.

Assessment of Effectiveness

LPF's signature on the 2022 Global Investor Statement contributes a relatively small amount of assets to the total, but it demonstrates our awareness of the need to manage climate risks, our support for global policy action and our intention to participate in the potentially enormous investment opportunities created by the global net-zero emissions transition. It supports our communication with our stakeholders and investee companies regarding the importance of real-world decarbonisation.

Similarly, our ability to influence investee companies through voting and engagement is limited as a minority investor. However, by collaborating with like-minded investors on engagement and being transparent about our voting actions, we can amplify our influence to drive the long-term value of our investment portfolio and contribute to the long-term health of the financial system.

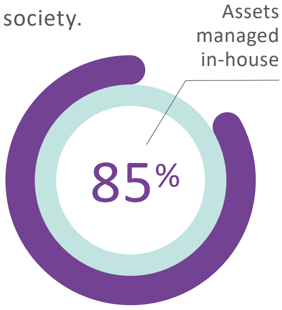
Next Steps

The companies in which we invest need a clear legal and regulatory framework in which to operate. We will continue to call on governments to deliver consistent policies to support a well-functioning market and an energy transition that mitigates risk. These policies need to adequately discourage the production and consumption of fossil fuels. We will continue to engage with and encourage our investee companies to develop and implement credible plans consistent with the Paris Agreement. And, as part of our diversified portfolio, we will continue to make investments where we believe they will generate both a sufficient return and support the energy transition and avoid financing non-Paris aligned investments.

PRINCIPLE 1: PURPOSE, STRATEGY AND CULTURE

OUR CULTURE

Operating within the public sector means that we're subject to applicable public sector regulations and relevant public law duties. These require LPF to act fairly and transparently and brings us in-scope of the Freedom of Information regime. This promotes a strong degree of discipline and accountability across the organisation. We're always mindful of fulfilling our duties to stakeholders and serving their expectations regarding sustainable benefits for the economy, the environment and society.



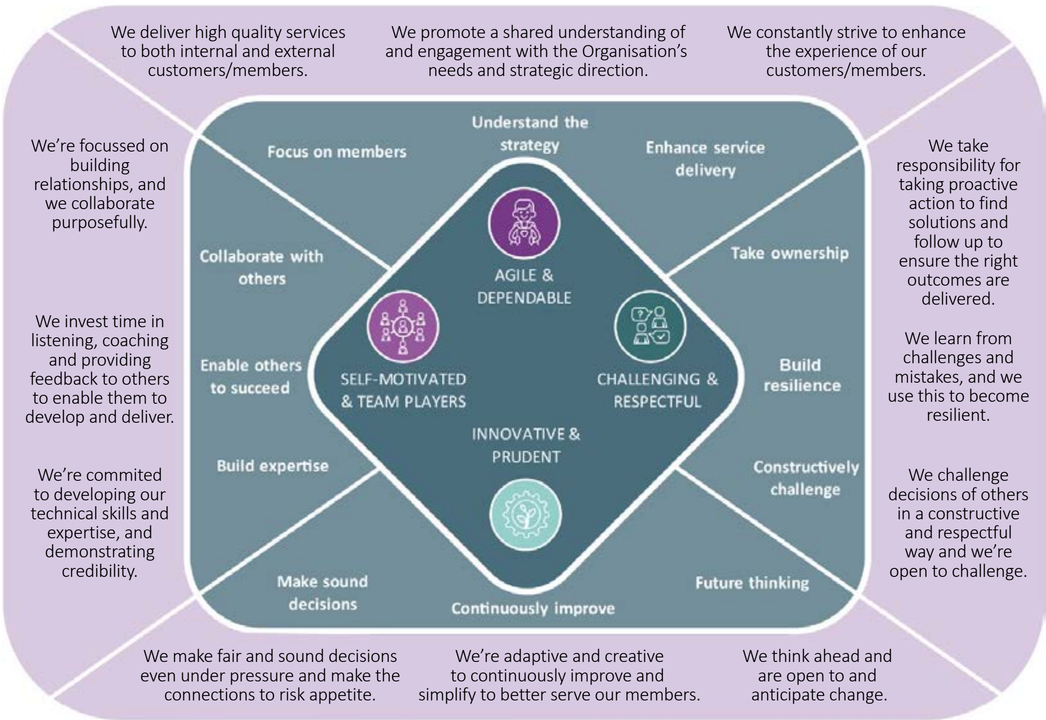
We manage over 85% of assets in-house, through internal equity, bonds and certain real asset portfolios. This aligns our investment decision-makers with the fund's best interests.

As explained in relation to Principle 2 (Governance), operating an FCA-authorised vehicle within the group influences the culture throughout LPF. It allows LPF to build on the in-house investment expertise and promotes accountability and responsibility amongst individuals.

In March 2017, we became the first UK Local Government pension fund to be awarded accreditation by the Pensions Administration Standards Association and have held the Customer Service Excellence Award for the last 10 years. Whilst these accreditations aren't directly relevant to stewardship, they reflect LPF's stakeholder orientated culture.

VALUES THAT SUPPORT OUR PURPOSE

We're passionate about enabling desirable and sustainable pensions, and our values are the enduring principles that inform, inspire and instruct the day-to-day behaviour of individuals working for LPF.



PRINCIPLE 1: OUR CULTURE

These values drive our active stance to stewardship and responsible investment and inform our approach to ESG. For example, our belief in the power of company engagement and the way in which we engage with companies and stakeholders, is relevant to our values of being 'Self Motivated and Team Players' and being 'Challenging and Respectful'.

Our value of being 'Innovative and Prudent' means that we focus on future thinking, which is critical in managing ESG risks today for positive outcomes for current and future beneficiaries.

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.

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 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 continue our work with the Scotland chapter of the Diversity Project and the Asset Owner Diversity Charter (See Case Study in Principle 4), which aims to accelerate progress toward a more inclusive culture in the investment and savings sectors across all demographics, including gender, ethnicity, sexual orientation, age and disability.

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

- As of 31 March 2023, we have, in 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 to 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. This includes our inclusive gender-neutral parent policy covering maternity, paternity, surrogacy and adoption, which we launched in 2021
- In 2022/23 we recruited 26 colleagues, 58% of these were women.

We're proud to partner with both Future Asset and Girls Are Investors (GAIN). Future Asset is an organisation in Scotland that aims to raise aspirations and confidence in girls in the senior phase of high school, encouraging them to choose ambitious career paths, and informing them about rewarding opportunities in investment.

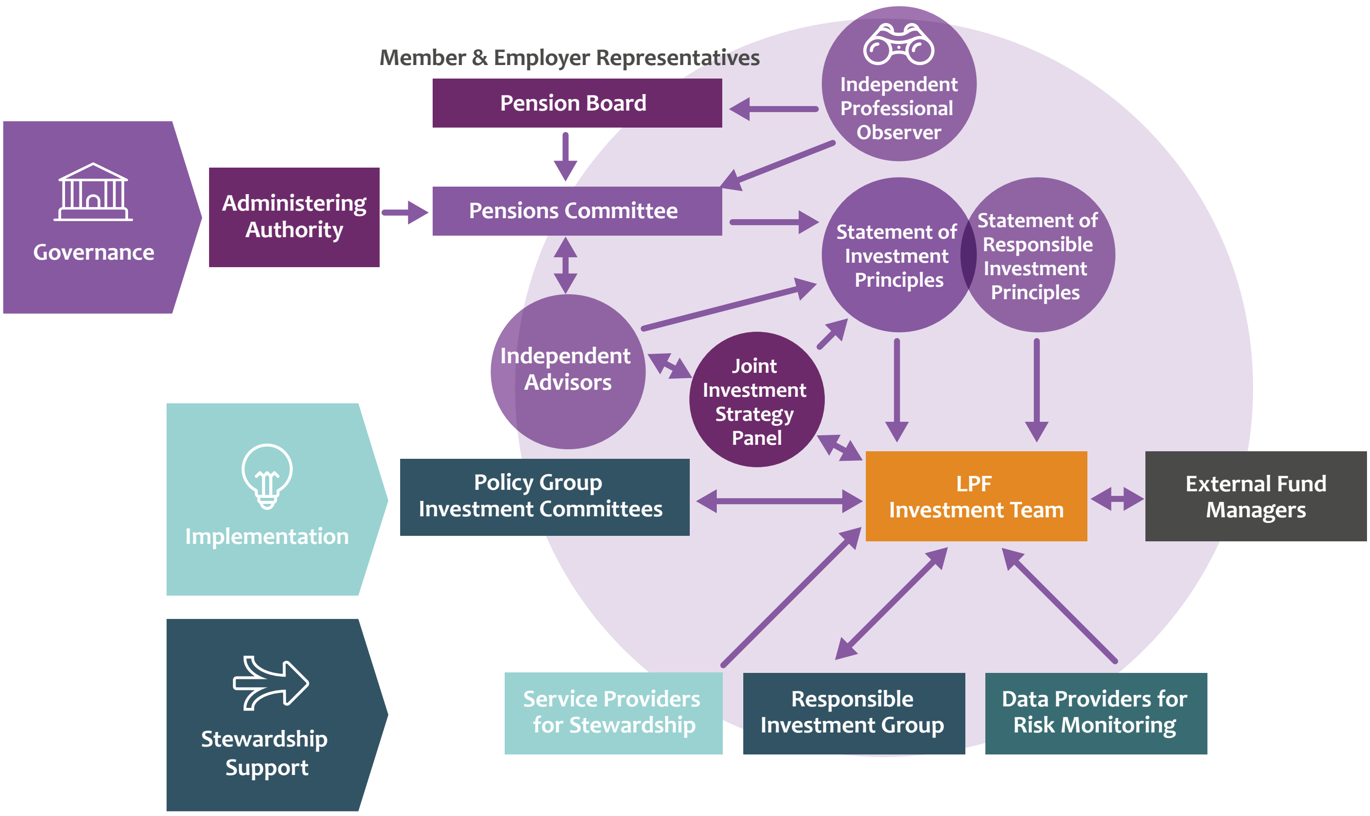
GAIN is a charity set up by investment professionals to improve gender diversity in investment management by building a talent pipeline of entry-level female and non-binary candidates.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Signatories' governance, resources and incentives support stewardship.

A ROBUST GOVERNANCE FRAMEWORK

Relevant to stewardship, LPF has developed a focused and effective governance framework, tailored to the needs and activities of the organisation.



PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Pension Board

Our Pension Board, established in accordance with the Public Service Pensions Act 2013, consists of five member representatives and five employer representatives. The Pension Board's role is to provide oversight of the Pensions Committee to ensure that the pension scheme is meeting its legal and administrative requirements and is being operated in the best interest of its stakeholders.

Pensions Committee

The City of Edinburgh Council (CEC) is the administering authority of LPF. Functions relating to pensions matters are delegated to CEC's Pensions Committee. The Pensions Committee oversees LPF's officers who carry out the operational activities of LPF. The members of the Pensions Committee act as 'quasi trustees' and meet at least four times a year. The Pensions Committee is made up of five elected councillor members (from the administering authority) and two non-councillor members are appointed for a three-year term.

The Pensions Committee is responsible for setting LPF's investment strategy. It formally reviews and agrees the SIP and the SRIP annually. The implementation of the strategy, through more granular investment decisions, and monitoring of investments, is delegated to suitably qualified and experienced individuals employed by LPF, with sufficient time and other resources at their disposal. Reporting to the Pensions Committee focuses on the long-term objectives of LPF and how delegated decisions have contributed to these.

Joint Investment Strategy Panel

Investment strategy guidance is provided to the Pensions Committee by a Joint Investment Strategy Panel (JISP) of advisers, working in collaboration with the Falkirk Council and Fife Council Pension Funds, with input from the internal Asset Allocation Investment Committee. The JISP meets quarterly with senior officers of the three Funds. The external advisers bring significant experience in the investment industry and are used both to complement the skills and experience of the internal investment team, and to provide independent challenge. They provide trusted advice to the officers of the three administering authorities to enable them to fulfil their delegated powers effectively.

Portfolio Managers and Policy Group Investment Committees

The day-to-day management of LPF's assets is performed by internal and external professional portfolio managers. Pension fund officers monitor the assets including mandate and policy group performance quarterly with the support and advice of the JISP and report to the Pensions Committee at its regular meetings. Portfolio manager activities are defined by investment management agreements detailing the portfolio objectives and constraints. Portfolio managers may have discretion to buy and sell investments within the terms of their mandates, or they may require approval from the relevant equity, debt, or real asset policy group investment committee.

Case study

INVESTMENT SERVICES REVIEW

Context

LPF collaborates with other LGPS funds across a range of activities. It provides investment services through LPFI Limited, which is regulated by the FCA. Management initiated a review of these investment services in 2022 to identify any areas for improvement in governance and operations.

How

Two external consultants with relevant regulatory, governance and operational expertise were engaged to undertake the work.

Outcome

A number of recommendations were made to consider changes to governance or operational structure. The resulting project plan is currently implementing suggested enhancements, including minor changes to governance and general upgrades to process documentation through 2023.

Assessment

The review supports the effective stewardship of the assets of LPF and its collaborative partners by focusing on good governance and the efficiency of its operating model.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Fiduciary responsibilities

LPF's activities are guided by the legal principle of fiduciary duty. A legal opinion on the nature and extent of LPF's fiduciary responsibilities was obtained by the Scheme Advisory Board for the Scottish LGPS in 2016. LPF regularly reviews this analysis and monitors legal and regulatory developments as they relate to responsible investment.

Staff resourcing

To support the distinction between LPF's purpose and the functions and responsibilities of City of Edinburgh Council (the administering authority for LPF), in 2015 LPF set up:

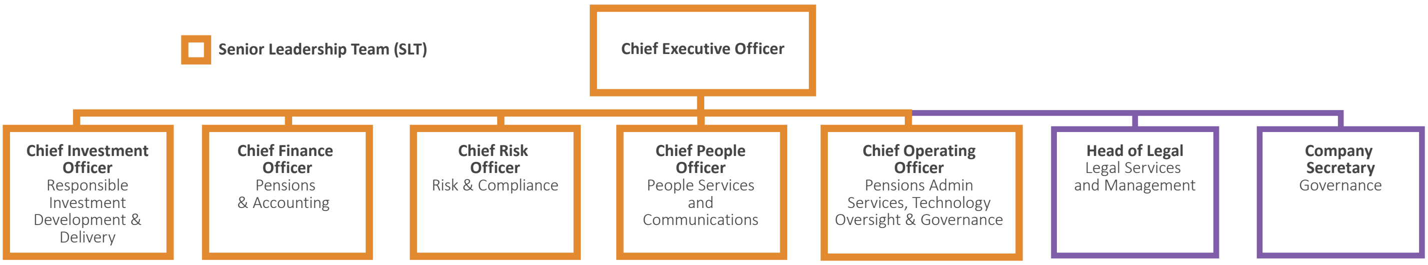
- An employment services company to establish people and cultural controls appropriate to the specialist business LPF carries out (LPFE Limited) and;
- An investment company that would enable the delivery of regulated investment services to other pension funds and institutional investors, whilst also more generally aligning LPF to higher FCA standards (LPFI Limited).

We've built out a staff structure to best resource our activities and allow us to enhance the exercise of our stewardship. Our headcount of 98 (as at 31 March 2023) includes dedicated teams which support our communication with stakeholders, good governance, stable ICT systems, effective HR and financial management and delivery of legal services.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

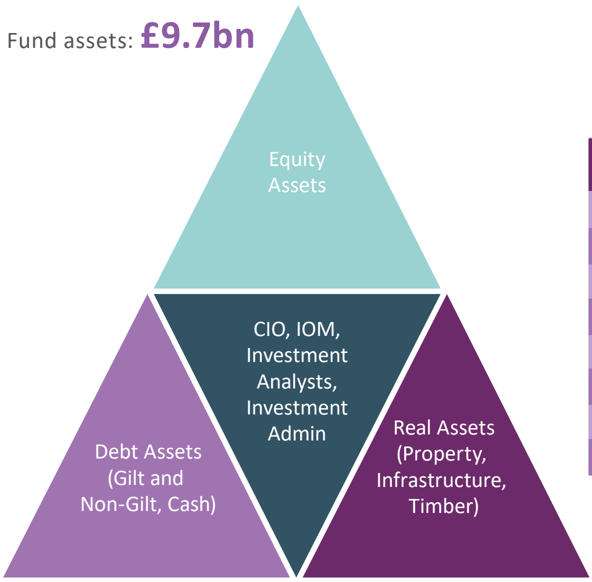
STAFF STRUCTURE

Senior Leadership Team (SLT) as at March 2023



Internal Investment Team as at March 2023

Fund assets: **£9.7bn**



Internal Investment Team of 20	
Chief Investment Officer (CIO):	1
Investment Operations Manager (IOM):	1
Portfolio Manager:	10
Deputy Portfolio Manager:	1
Property Asset Manager:	1
Senior Investment Analyst:	1
Investment Analyst:	3
Investment Administrator:	2

All Portfolio Managers are subject to annual fit and proper assessments and all LPF staff are subject to a code of conduct, which sets the minimum expected standards of individual behaviour. A range of relevant professional qualifications are held across the team, including from CFA Institute, MRICS and CISI. At least eight of the internal investment team have over 20 years of experience in investing, which supports a long-term, through market-cycle perspective. We encourage and support members of the team to gain experience, both through professional development and professional qualifications: three of our analysts are part-way through the CFA program. In 2021 the CIO and four portfolio managers completed the Climate Curriculum run by Columbia University's Earth Institute and another portfolio manager completed the Climate Change Risk in Finance course run by Edinburgh University. We monitor the experience and qualifications of external managers as part of our due diligence process.

Furthermore, senior managers have a duty of responsibility to take reasonable care to avoid and / or stop a breach from occurring in the business area that they're responsible for, and such duty is formalised by regulation. All SLT appointments at LPF are subject to the FCA's Senior Managers and Certification Regime.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Internal Stewardship Resource and Responsible Investment Group

At LPF we see stewardship as an integrated element of the investment function. Our core aim is to exercise our rights and responsibilities as investors; our entitlement to vote provides an opportunity to engage to enhance both corporate governance and investee company prospects. Analysis of ESG factors supports investment decision-making, shedding light on downside risks and upside opportunities.

So, it's our portfolio managers who lead on collaborative initiatives, such as Climate Action 100+ for which we are a co-lead engager, and it's our portfolio managers and analysts who are responsible for engagement and escalation activities with investee companies. These activities are undertaken directly or through our external managers or through our engagement and voting provider (see External Stewardship Resource below).

However, we also utilise stewardship knowledge from LPF's other functional teams. In 2001, our Senior Leadership Team (SLT) undertook a review of individual roles and made an organisational change to ensure that responsible investment activities were owned, championed and implemented more effectively. It established the Responsible Investment Group (RIG) to bring together members of the different functional teams formally and regularly to share diverse perspectives sourced from experience in: ESG investment analysis and research, public policy and advocacy, thematic investment, investment management, investment consultancy, law, actuarial advice and pension trusteeship.

The SLT oversees the RIG, which is comprised of:

- Chief Investment Officer
- Portfolio Managers as Responsible Investment Leads for all the major asset classes
- Representatives from the Legal, Compliance & Risk, Finance and Communications teams

The inter-disciplinary group enables the sharing of knowledge, experience and insight relevant to other areas, while improving the governance and oversight of stewardship activities. By providing stewardship advice to LPF officers and the Pensions Committee, the RIG aims to mitigate risk and identify opportunity, for example by supporting internal and external managers in navigating regulatory changes and shareholder actions.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Members of the RIG have extensive experience in responsible investment roles and have relevant qualifications, undertaking continuing professional development and participating in industry Responsible Investment groups to maintain and build best practice knowledge. Through 2022 the RIG logged over 70 hours of continuing professional development across a range of themes including climate risk, living wage, transition finance, human rights, Russia/Ukraine conflict, sustainable development goals, sustainability in real assets, sustainable securities lending, net zero and biodiversity. The Responsible Investment Lead also led training sessions for the internal investment team and the Pension Committee on responsible investment topics. The combination of skill sets, backgrounds and practical experience of team members is well suited to the development and execution of our responsible investment policy and integration into LPF's wider investment approach.

Our Responsible Investment Lead's investment expertise and specialist knowledge across the asset classes in which we invest is essential to delivering effective stewardship. They manage the relationships with our voting and engagement supplier and ESG data providers and work with our other internal portfolio managers to ensure material ESG risks are identified, monitored and managed throughout the investment process. They support the oversight and monitoring of external managers, and champion LPF's responsible investment beliefs and stewardship activity in the wider investment industry.

LPF also allocates a budget for the procurement of ESG data to support our integration of these factors into our investment process, including the analysis of climate-related risks and opportunities.

External Stewardship Resource

To adequately resource our stewardship activities, LPF contracts an external voting and engagement provider, Federated Hermes EOS (EOS) to undertake much of LPF's voting and engagement activities. Engagement focuses on company strategy covering many ESG issues, such as climate change, plastic usage, diversity and labour practices. LPF engages with companies on these issues because they can create significant risks which, if not appropriately addressed, threaten investments with material and permanent capital impairment.

Our investment team interacts with EOS to contribute to the work plan and access the body of knowledge that resides with their engagement professionals. EOS represents owners of assets with a total worth of more than $1.3tn, which creates more influence than LPF would have engaging on its own. In addition, EOS is structured to undertake multi-year engagements, often leveraging its access to engage across multiple themes.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

The EOS team draws on a wide range of skills and backgrounds: senior engagers come from a range of backgrounds including banking, academia, law, corporate governance, sciences, corporate strategy and climate change. The engagement team consists of 30 people (March 2023), supported by four voting specialists, three senior advisers and ten client service professionals. EOS undertakes a skills gap analysis of the wider team with reference to the thematic and sectoral issues covered, to ensure EOS has the right mix of professionals who can represent EOS and its clients' views in engagements with companies. Furthermore, it delivers training to share knowledge across different sectors and themes to facilitate cross-pollination of expertise. EOS has intentionally built a diverse team (63% female/37% male for permanent staff as at 31 December 2022) of experienced and international professionals who have the expertise, language skills (fluency in 18 different languages) and cultural knowledge to access and maintain constructive relationships with company boards across the globe to deliver real beneficial change at companies.

EOS reports on voting and engagement activity across LPF’s assets every quarter, as well as annually. Through this regular reporting and dialogue, we’re able to ensure that the service is being delivered as expected and in alignment with our responsible investment policies. EOS also engages with regulators, industry bodies and other standard setters to shape capital markets and the environment in which companies and investors operate. We present voting and engagement case studies in relation to Principle 9 (Engagement) and Principle 12 (Exercising rights and responsibilities), later in this report.

External managers

We expect our external managers to engage investee companies on our behalf on material issues including ESG issues and opportunities. We encourage our external managers to enhance stewardship by participating in collaborative engagements (see Principles 9 and 10) and to support best practice disclosure. We receive quarterly updates from our external fund managers, which include updates on company engagements and stewardship initiatives.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Learning and development to support our responsible investment beliefs

Members of the Pensions Committee are required to undertake a minimum of 21 hours training per year. This supports them in fulfilling their role and managing the lobbying they may receive, as elected officers, on a wide range of issues (including aspects of LPF's investment activities).

During 2022, the Pensions Committee received training on a number of stewardship topics including: climate change related risks and opportunities, climate-risk reporting, exposure to and implications of Russia's invasion of Ukraine, and a review of the voting and engagement activities undertaken by EOS on our behalf.

The fund's officers also access a range of resources to support learning and development across responsible investment themes through our membership of collaborative initiatives such as CA100+, IIGCC, PRI, EOS. More details on these are provided in Principle 10 (Collaboration), later in this report.

Performance and reward

We recognise the importance of our people in achieving our responsible investment commitments and stewardship aims, and the need to develop, reward and support them in their roles, within their teams and as individuals.

In terms of staff performance, the role profile for each member of our investment team includes explicit reference to LPF's responsible investment and ESG aims. This makes each person involved in LPF's investment decision-making individually accountable for furthering LPF's responsible investment aims.

The annual performance review for portfolio managers and deputy portfolio managers looks at how they "ensure compliance with the Fund's policies and procedures, including its commitment to responsible investment, which involves company engagement and voting and integration of ESG analysis into investment decision-making."

LPF's remuneration scheme is deliberately structured to align staff with LPF's long-term aims and to avoid incentivising inappropriate risk-taking.

LOTHIAN PENSION FUND

PRINCIPLE 3: MANAGING CONFLICTS OF INTEREST

Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

Our commitment to managing conflicts of interest

In all its activities, LPF acts honestly, fairly and professionally. This approach is aligned to our values of being ‘Agile and Dependable’, and ‘Innovative and Prudent’. As described in relation to Principle 2 (Governance), LPF has adopted the FCA standards across its investment operations, and this includes standards in relation to conflict identification and management. This response focuses on LPF’s own investment operations (distinct from any client services delivered by LPFI).

We’re aware of the duties owed to our various stakeholders and the range of actual or potential conflicts of interest that may arise while carrying out investment activities. We recognise that effective management of conflicts of interest is fundamental to the effective stewardship of our assets. It also protects the best interests of LPF, our staff and our stakeholders.

Our Conflicts of Interest Policy sets out how we implement and maintain effective arrangements. The policy specifies the required standards and procedural controls for identifying, recording, monitoring and preventing conflicts of interest.

The LGPS Structure

One of the most significant conflicts of interest is inherent to our structure, under which a local authority administers a multi-employer pension fund. As administering authority of LPF, CEC acts in a separate statutory capacity which is distinct from its role and responsibilities as a local authority. Pension fund assets are ringfenced from CEC’s operating budget and LPF’s operations are entirely funded by pension fund assets.

The objectives of the administering authority, and those of the pension fund, aren’t always aligned. For example, CEC (as a local authority) may have an objective to promote jobs and prosperity within Edinburgh. This may conflict with our investment objective of delivering sustainable returns across a diversified range of assets, in line with our fiduciary duty and as reflected in our SIP.

The extent of delegation and separation between CEC and LPF within our governance structure supports the effective management of this conflict.

PRINCIPLE 3: MANAGING CONFLICTS OF INTEREST

Identifying other types of conflicts

Other types of conflicts which may arise are where LPF:

- Is likely to make a financial gain, or avoid a financial loss, at the expense of a stakeholder
- Has an interest in the outcome of a service provided for the benefit of LPF or of a transaction carried out on behalf of LPF, which is distinct from LPF's interest in that outcome
- Has a financial or other incentive to favour the interest of one stakeholder or group of stakeholders over the interests of another stakeholder or group of stakeholders
- Receives or will receive from a third party an inducement in relation to a service provided to LPF, in the form of monies, goods or services other than the standard fee for that service (if any).

The following are non-exhaustive examples of "typical" conflicts of interest that could arise for LPF employees:

- Where a private interest of the employee, a family member or a personal contact influences a decision or recommendation the employee makes in the course of their employment
- Interests or involvement in a business outside LPF, without permission
- Accessing information at work which may assist in a private venture
- Receiving substantial gifts or hospitality in relation to services to be provided to or by LPF, to obtain preferable terms
- Conflicting views on the financial materiality of ESG issues for an investee company.

PRINCIPLE 3: MANAGING CONFLICTS OF INTEREST

OUR STRATEGY

At the organisation level, we use the following measures to support the overall management of actual and potential conflicts of interest:

- The members of our governing bodies (including the Pensions Committee and Pension Board and the corporate boards of LPFI and LPFE) are subject to a Code of Conduct and LPF policies and procedures which set out considerations relevant to managing conflicts. Each member is asked to consider and declare any conflicts of interest at the beginning of any meeting
- The oversight exercised by our Senior Leadership Team supports the operation of independent functions with segregated duties. Management information and reporting procedures are used to deliver effective oversight
- Information barriers are in place to restrict access to records where necessary.

Within LPF, we use the following controls to support the overall management of actual and potential conflicts of interest by individuals:

- Restrictions and procedures relating to personal account dealing, restricted dealing /insider trading, gifts and hospitality, and whistle-blowing
- Maintaining an `external bodies' register (which records details of any services provided to, or roles held with, organisations outside LPF)
- Maintaining a `connected persons' register (which captures organisations that LPF may directly transact with, and which may have a material involvement, in the business of the pension fund)
- Providing employees with relevant training, at induction and periodically: LPF Officers are required to set out an accurate explanation of any potential Conflict of Interest to a member of the Senior Leadership Team or the Risk & Compliance Manager. This requirement applies to all situations where they, a family member, or a personal contact, has a private, personal or financial interest or involvement in outside activities, which may relate to their work and could result in a perceived or actual Conflict of Interest.

We're clear that it's incumbent on all our people to be alert to potential conflicts of interest and act accordingly. We provide compulsory 'Managing Conflicts of Interest' training for all colleagues. This was most recently completed in Q2 2023 and is part of our annual refresher training.

Case study

IDENTIFICATION AND MANAGEMENT OF POTENTIAL CONFLICTS IN EXERCISING VOTING RIGHTS

Context

LPF manages over 85% of its equities in house and retains voting rights for the majority of its externally managed equities. Where a stock is held in more than one portfolio, there is potential for a diversity of views to be held by the different portfolio managers (PMs) on the prospects for a stock, including different assessments of the financial materiality of identified ESG issues for a specific stock. These different views can be expressed through taking different investment decisions related to the stock in the context of different portfolio mandates. However, when it comes to exercising our voting rights, we seek to maximise benefits to members through consistent application of voting policies and by avoiding dilution/ off-setting of our votes.

How

In Q1 2023 we formalised our Equity Voting Process:

1. Our voting and engagement partner, EOS, reviews ISS Institutional Shareholder Services Inc. proxy recommendations, overlays their ESG policies and knowledge of ongoing engagement activities to provide their voting recommendation. EOS provides alerts to our PMs on potentially controversial or finely balanced issues. All resolutions are voted in line with EOS recommendations by default unless this recommendation is overridden by our PMs. While this is expected to happen only very rarely, significant consideration is given to each issue
2. EOS voting alerts are reviewed by the equity team and escalated to our Responsible Investment Group (RIG) where necessary (for complex situations, or if there is disagreement within the team for stocks owned by multiple PMs). We communicate with EOS about the resolution, to understand the context and rationale for the recommendations being made
3. RIG reviews any escalated vote recommendations to provide a consistent 'house' recommendation. The relevant PMs are notified of the decision and requested to alter the proxy vote instruction if necessary.

Outcome & Assessment

While it's too early to make a full assessment of the outcome of the formalisation of our equity voting process, the internal discussions that led to the formalisation, together with the application of a more systematic way of documenting the equity team's discussions about voting alerts, provide more rigour to the important process of exercising our shareholder rights.

PRINCIPLE 4: PROMOTING WELL-FUNCTIONING MARKETS

Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

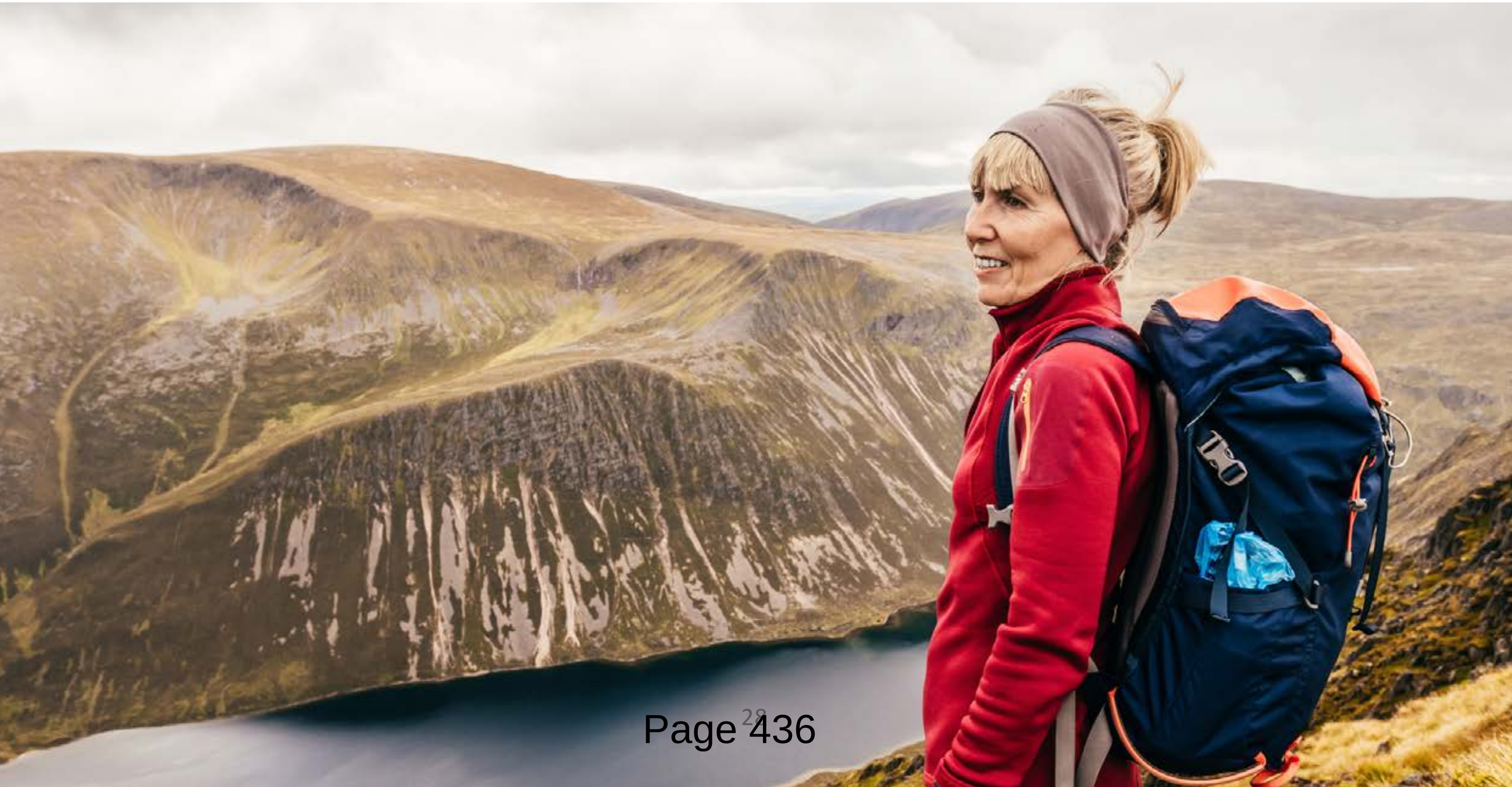
IDENTIFYING AND ADDRESSING MARKET AND SYSTEMIC RISKS

As a long-term investor, sustainable, well-functioning markets are essential to our purpose of delivering a valued retirement savings product for our members. They will enable us to pay pensions and benefits when they fall due over the next several decades.

We ensure that the risks to our investments are effectively managed as we know that Environmental, Social and Governance (ESG) factors are fundamental considerations in driving the long-term value of our investment portfolio.

We're very aware that investment markets can go down as well as up and market conditions can change rapidly. Uncertainties that affect the behaviour of markets within the macroeconomic environment can affect the value of the assets held within a portfolio. When considering or reviewing investments we look at factors such international political developments, market sentiment, economic conditions, circumstances where markets aren't allowed to freely move (due to government controls), changes in government policies, restrictions on foreign investment and currency repatriation, currency fluctuations and other developments in the laws and regulations of countries in which investment may be made.

Given the potential impact on our investment returns, we closely monitor market-wide and systemic risks. We collect information from many sources.



PRINCIPLE 4: PROMOTING WELL-FUNCTIONING MARKETS

External advisers

- LPF uses the JISP to gain insights on market trends and conditions
- LPF's external managers include market commentary within their periodic investment reports, which LPF reviews in detail
- LPF's actuary may comment on general investment issues as part of the valuation work they do for LPF.

External providers

- EOS supports us in identifying systemic and emerging risks as well as mitigating these risks through engagement. Our Internal Equities team work closely with EOS in our collective approach to engagement, reflecting the areas of stakeholders' interest and concern. We undertake to utilise our voting rights, including those exercised through proxy, to engage with the management of companies in whom we invest, to promote appropriate standards of corporate governance that safeguard shareholder interests and respect stakeholder interests
- The organisations which support LPF's portfolio monitoring for shareholder litigation share insights on market-wide issues relevant to risk.

Reviews

- LPF monitors its counterparties and suppliers to ensure they remain creditworthy and suitably authorised to provide services
- Our investment team monitors the creation of debt within the financial system to identify systemic and non-systemic vulnerabilities.

Collaboration

- Collaborative initiatives are a valuable source of intelligence on emerging risks and ways to mitigate these risks. We have a long track record of collaborating with other investors, asset owners and organisations. By participating in its signatory consultation in Q2 2022, we supported the development of the strategy renewal for the second phase of the Climate Action 100+ initiative, which aims to address systemic climate risk by engaging with the world's largest corporate greenhouse gas emitters to encourage necessary action on real world emissions reduction. We also continued as an active participant in the Occupational Pensions Stewardship Council (OPSC) during 2022, including supporting the development and prioritisation of its work plan as a member of the Engagement Group.

LOTHIAN PENSION FUND

Case study

THE ASSET OWNER DIVERSITY CHARTER - UPDATE

Background

In mid-2021, we were delighted to be part of a group of UK asset owners inviting others to sign the new Asset Owner Diversity Charter to tackle a lack of diversity across the fund management industry.

By signing the Charter, signatories commit to take account of diversity and inclusion records from fund managers when choosing new partners. Diversity questions form part of the overall assessment scores for each bidder. Fund managers have to disclose information and demonstrate how they're tackling diversity and inclusion within their workforce. Signatories also commit to including diversity as part of ongoing manager monitoring, providing a questionnaire to managers annually for completion.

The Asset Owner Diversity Charter is part of the Diversity Project, championing a diverse and inclusive UK investment and savings industry. The Diversity Project now has over 100 members across asset owners, investment managers, fund selectors, investment consultants, family offices, actuaries, trustees and wealth managers.

LPF Action on Diversity

In 2022 LPF partnered with both Future Asset, an organisation in Scotland that enables girls in the senior phase of high school to explore how investment can change the world for the better, gain valuable, transferable skills and consider the benefits of possible future careers and Girls Are Investors (GAIN), a charity set up by investment professionals to improve gender diversity in investment management by building a talent pipeline of entry-level female and non-binary candidates. LPF staff have volunteered as Judges for the Future Asset competition over the last 2 years and LPF has hosted successful teams to undertake work experience at our office. In summer 2023 LPF will be welcoming two summer interns to our investment team, including one recruited through the GAIN internship programme for young women & non-binary students, who aspire to have a career in investment management.

Assessment of Effectiveness

While the reception of this initiative has been positive, leading to commitment and implementation of additional reporting on diversity by many large asset managers, it's too soon to assess overall effectiveness. It may take years for actions taken now to address barriers to recruitment and retention of women and minority groups to achieve the aim of a more representative industry. Regular annual collection of data should enable trend analysis and indicate effective practices which can be shared more widely, to accelerate industry wide progress.

Objectives of the Diversity Project for 2021-2026

Gender

- To achieve 20% female fund managers named as the manager of a specific portfolio
- Gender pay gaps reduced by one third from 2019 levels
- Equality in graduate and school leaver recruitment.

Ethnicity

- 90% ethnicity disclosure rate
- Ethnicity goals to be set after review of disclosure rates by gender.

Socio-Economic

- Collection of socio-economic data
- Support of one or more graduate/school leaver recruitment programmes focused on socioeconomic diversity

https://diversityproject.com/about-us/

PRINCIPLE 4: PROMOTING WELL-FUNCTIONING MARKETS

UNDERSTANDING MARKET AND SYSTEMIC RISKS

We discuss the materiality of each potential risk and agree an action plan for addressing it, including:

- Responding to consultations: engaging with government and industry bodies, for example:
    - We responded to the November 2022 Department of Levelling Up, Housing and Communities (DLUHC) consultation on Local Government Pension Schemes (England & Wales): Governance and Reporting of Climate Change Risks. Having voluntarily reported in line with the guidelines produced by the Taskforce for Climate Related Financial Disclosure (TCFD) framework for several years, we supported the intention to introduce a largely similar framework to that already in place for most UK private sector pension schemes. We provided specific feedback to the consultation questions, noting the evolving understanding of climate risk to financial institutions and data challenges. Unfortunately, feedback from the consultation has been delayed, which has led to some uncertainty in both the timing and content of our future reporting requirements. However, the direction of travel remains clear
- Direct dialogue:
    - Engaging directly with policymakers: through the Scottish Scheme Advisory Board, we've participated in a working group on TCFD reporting and the proposed introduction of more stringent mandatory reporting requirements on climate change risks for the LGPS
    - Engaging directly with companies as part of Climate Action 100+ (CA100+)
- Collaborative initiatives: this includes our membership of IIGCC, CA100+, PRI, OPSC and LAPFF [More details provided in Principle 10]
- Throughout 2022, we participated in workshops organised through the Occupational Pensions Stewardship Council (OPSC) to better understand the implementation of TCFD reporting guidelines for UK occupational pension schemes regulated by the Department of Work and Pensions. More details on our collaboration activities are provided in Principle 10
- Advocating for better standards through engagement with our external managers: in 2022 we communicated with our external managers to outline our commitments to responsible investment, introduce enhanced monitoring of primary investments, request updates on their net zero commitments and plans for product-level TCFD reporting, and request completion of the Diversity and Inclusion Questionnaire.

LOTHIAN PENSION FUND

Case study

NAVIGATING GEO-POLITICAL AND MACRO-ECONOMIC CRISES

January 2022: New Year Uncertainty
As the year began, capital markets were focused on persistent inflationary pressures, the prospects for rate hikes and strict lockdowns in China, all of which threatened a global economic slowdown.

February: Russian Invasion of Ukraine
Neither we nor capital markets in general had anticipated the destruction and human suffering that was unleashed by the Russian invasion of Ukraine, nor the policy actions of governments around the world. In the immediate aftermath of the invasion we reviewed our investment exposures to affected markets. This confirmed very minimal exposure to Russia, Ukraine and Belarus across our diverse investment portfolio. It also confirmed that those companies amongst our equity holdings that undertook business connected to Russia generated less than 10%, and in the majority of cases, less than 5% of revenues there. We also focused on ensuring that we complied with all relevant sanction regimes.

Meantime, our engagement provider, EOS, engaged with companies with material connections to Russia, mapped supply chains or partners that could be involved in supporting the conflict, either through products, services or finance, taking into consideration the public need for the product/service. Most investment managers took the approach of writing down any remaining Russian stock investments to zero.

Whilst the impact on individual stocks was in some cases significant, our Fund wasn't directly impacted to any great extent. However, we remained alert to the social and governance issues highlighted by these events, as well as the broader impacts on global supply chains, commodity prices, inflation and prospects for economic growth in the heavily intertwined global economy.

September: UK Political and Financial Turmoil
UK financial markets were rocked after the Chancellor announced a series of unfunded tax cuts. The pound rapidly plummeted close to an all-time low versus the US dollar and yields on longer dated gilts skyrocketed, necessitating intervention by the Bank of England. Gilts are UK government bonds, which are issued to help finance public spending.

Some UK pension funds were impacted by the sudden reduction in value of their “risk-free” gilt holdings, particularly if they had used leverage (i.e. borrowed to enable a larger gilt holding while also maintaining holdings in higher yielding assets such as equities). These Liability Driven Investment (LDI) strategies are designed to maintain a cushion between the value of their assets and liabilities, with the intention of absorbing any losses on the gilts. If losses exceed this cushion, the pension fund is asked to provide additional funds to it. However, many pension schemes did not have sufficient liquid assets to meet their provider's (very urgent) calls to restore their LDI cushion. This meant that many had to sell gilts, thereby reducing their value further.

While LPF holds gilts as part of our diversified portfolio, we do not use leverage and as such, we did not suffer from liquidity issues. Indeed, we saw the reduction in the price of gilts as an opportunity to increase the size of our investment in this asset class, which now offered more attractive returns.

The turmoil prompted freshly elected UK Prime Minister Liz Truss to resign after just 45 days in office, paving the way for Rishi Sunak to be named her successor, which restored confidence across financial markets.

Case study

NAVIGATING GEO-POLITICAL AND MACRO-ECONOMIC CRISES

(CONTINUED)

December: Stabilisation
A welcome deceleration in the inflation rate in the US and improved investor sentiment surrounding the relaxation of China's "zero-COVID" policy contributed to more stable markets later in the year. Geopolitics and government policy actions are difficult to predict, but we remain alert to the risks and opportunities that may arise in the future. As we started 2023, the depth and duration of an economic recession in 2023 or 2024 was a hotly debated topic for market forecasters, with expectations of further interest rate hikes in the near term, to be followed by cuts when inflation has been "tamed".

Assessment of the effectiveness of our approach
2022 was a challenging year for many investors, as fixed income and property investments provided little counterweight to weakness in global equity markets. While we don't attempt to predict short-term market movements, our long-term approach and focus on delivering good risk-adjusted returns as a responsible investor enabled us to navigate these stormy waters.

Our long-standing focus on good governance, consideration of relative value across asset classes (which was the basis for our underweight position to LDI), and deliberate bias to low volatility and value equities supported performance. Our actions to assess and mitigate exposure to geopolitical risk, while also retaining the agility to seek out opportunities during market dislocations served us well.

While past performance is no guide to the future, we continue our approach to responsible investment which is informed by our investment beliefs, policies, and priorities, together with regulations and statutory guidance. We note that there are multiple facets to responsible investment. Sometimes it appears to be reactive, coalescing collaborative engagement or implementing new policies after an event has occurred (with the laudable aim of reducing a recurrence). The process of identifying environmental, social and governance risks (and therefore avoiding or minimising exposure) before they lead to material financial events or impacts is harder to evidence, particularly for risks that are expected to play-out over the longer term, and we remain humble in the knowledge that we can't predict all geopolitical or macroeconomic crises.

PRINCIPLE 4: PROMOTING WELL-FUNCTIONING MARKETS

HOLDING COMPANIES TO ACCOUNT

In addition to our engagement activities supported by EOS, we recognise shareholder action as another way that we, as an institutional investor, can promote good corporate governance and therefore contribute to well-functioning markets.

Where it's economical to do so, our fiduciary duty may require us to take action to recover funds lost through investments in companies as the result of corporate mismanagement, but we wish to highlight how this can also reduce some systemic risk where corporate reforms can be secured alongside financial recovery. This may be important where there's a void in the role of industry regulators, (due to constrained resources for example) or where changes in political administration can impact the willingness of regulators to take enforcement actions.

We use third party providers to support our portfolio monitoring, to collect information and to undertake legal analysis necessary to make informed decisions about the best options for asset recovery and the wider benefits of participating in potential claims. We have an internal policy to guide our actions, and this considers the significance of a company's wrongdoing, and the wider context of our stakeholder expectations.

Confidentiality restrictions limit how much detail we can provide about specific actions, but LPF continues to actively monitor its loss exposure in relation to class actions, and has previously taken `lead plaintiff' status for US-based actions.

OUR APPROACH TO CLIMATE CHANGE RISK

In Principle 7 we identify Climate Change as our Top Priority for engagement, as a key systemic risk, and stated (in Principle 1) that asset owners are uniquely positioned to drive changes in governmental and corporate behaviour to bring about an acceleration in the sustainable energy transition and a decarbonisation of the global economy. The case study on page 11 (Principle 1) describes how we seek to engage with policymakers on this systemic risk, while further details on how we address climate change risks in our portfolio is covered on page 60 (Principle 7).

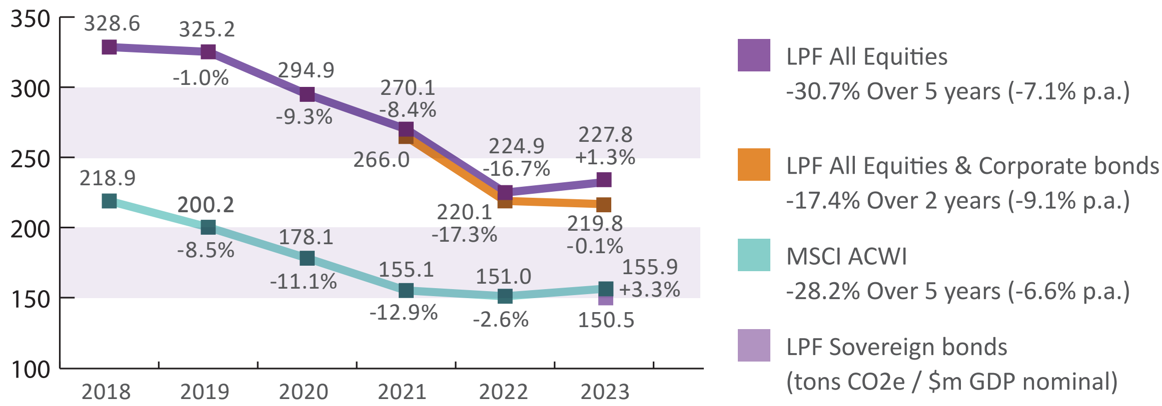
PRINCIPLE 4: PROMOTING WELL-FUNCTIONING MARKETS

MEASURING CLIMATE RISK IN OUR PORTFOLIOS

We believe that accurate measurement of emissions is an important element in assessing the climate risk of an investment portfolio. Supported by a research budget specifically allocated to data services targeting ESG and climate-related risks and opportunities, we published our first annual carbon footprint (weighted average carbon intensity - WACI) for listed equities in 2018 and expanded the scope to include our corporate bond investments in 2020/21. In 2022/23 we expanded our analysis further to consider our sovereign bond holdings, so our most recent carbon footprint covered 67.3% of our total fund.

WACI (TONS CO_2e / $m SALES)

Source: MSCI



In 2021 the UK Government announced that emissions reporting will be mandatory for occupational pensions schemes by 2025 using specific Department of Work and Pensions (DWP) guidelines based on the TCFD framework. Although this doesn't apply to the Local Government Pension Scheme (LGPS), the UK Government launched a consultation proposing to apply broadly the same requirements to the LGPS.

Legislation is expected to be introduced in 2024 mandating first reporting by the LGPS by December 2025 for the 2024/25 financial year. While there are currently challenges with the cost and availability of emissions data, particularly where we're dependent on the level of information provided by external managers, this is a priority for us, and we support industry-wide efforts to improve the provision and quality of data. During 2022 we proactively wrote to our external managers informing them of our future regulatory reporting requirements and requested information from them on emissions reporting, noting that in-scope investment managers regulated from the Financial Conduct Authority (FCA) are working towards meeting the FCA's TCFD reporting requirements by mid-2024.

PRINCIPLE 5: REVIEW AND ASSURANCE

Signatories review their policies, assure their processes and assess the effectiveness of their activities.

We have a range of internal and external review and assurance processes which support good stewardship. We run our review and assurance in conjunction with other underlying business and compliance processes, such as external manager monitoring programmes, which includes responsible investment governance and stewardship, to assess and ensure responsible investment policies are being implemented (see Principle 8).

REVIEW

We take a formal approach to reviewing our policies and their effectiveness. In relation to responsible investment, examples of such reviews are provided below.

We created our SRIP as a direct result of review and assurance.

During a review of our SIP in 2019, we concluded that it didn't fully describe our approach and commitment to integrating responsible investment in all areas of our investment process. As a result, we decided to provide a supplement to our SIP – our SRIP, described in relation to Principle 1.

ANNUAL REVIEW

Our SRIP is reviewed annually. Potential improvements to our responsible investment approach are suggested by LPF staff, reviewed by our Responsible Investment Group (RIG), and proposed for inclusion in the SRIP. Our JISP advisers appraise any changes and recommend a final version which is then reviewed by the Pensions Committee. The SRIP becomes official policy when it's approved by the Pensions Committee. The training standards described earlier in this report support the ability of our various governing bodies to provide a meaningful review of our policies. In addition, their fiduciary duty requires them to take proper advice to discharge their function. This means they may need to consider using suitably qualified advisers before revising policies and procedures.

PRINCIPLE 5: REVIEW AND ASSURANCE

ASSURANCE

PRI Assessment

As a signatory to the Principles for Responsible Investment (PRI), a United Nations supported network of investors which works to promote sustainable investment through the incorporation of ESG, we agree to allow PRI to undertake a comprehensive annual assessment of our approach to responsible investment. As part of this process, LPF has previously been able to undertake a gap analysis on areas of best practice highlighted by PRI, alongside our evolving responsible investment experience, supported by our internal assurance of our PRI assessment response.

The PRI did not conduct assessments in 2022 due to changes in the PRI reporting tool.

A summary of PRI's latest evaluation of LPF (released September 2022) is shown below. As the scoring methodology was changed, it is incomparable with scores from previous PRI assessments. The modules are scored with a numerical grading system and a star rating. The highest rating is five stars, which is awarded to those signatories who demonstrate leading practices within the responsible investment industry. While this new PRI assessment doesn't provide a peer comparison, we were awarded 3 or 4 stars (out of 5) in most modules which would imply our responsible investment behaviour is judged to be in line with or slightly ahead of the PRI's expectations for asset owner signatories across all categories measured.

We use the detailed assessment (which we publish on our website) alongside a transparency report which details our responses to conduct a gap analysis, to assess progress and highlight areas for further improvement towards industry best practice. Further significant changes to the PRI Reporting Framework are planned for 2023.

PRINCIPLE 5: REVIEW AND ASSURANCE

SUMMARY SCORECARD

Module Score / Star Score	AUM Average	0 25 50 75 100
Investment & Stewardship Policy ★★★★		85
Direct - Listed Equity- Active Quantitative - Incorporation ★★★	>=10 and <=50%	59
Direct - Listed Equity- Active Fundamental - Incorporation ★★★	>=10 and <=50%	62
Direct - Fixed Income- SSA ★ (not measured)	<=10%	0
Direct - Real Estate ★★★★	<=10%	76
Indirect Listed Equity - Active ★★★	<=10%	52
Indirect Fixed Income - Passive ★★★	<=10%	50
Indirect Fixed Income - Active ★★★	<=10%	48
Indirect - Real Estate ★★★	<=10%	55
Indirect - Infrastructure ★★★	>=10 and <=50%	58

SSA (above) stands for Sovereigns, Supranational and Agencies

UK Stewardship Code (2020)

As part of the process of producing our second Stewardship Code report in 2022, we addressed feedback on our successful first submission from 2021 and internally assessed our stewardship policies, processes and reporting. We continue to develop better practice, such as the re-introduction of disclosure of our voting records (see Continuous Improvement section below).

Retaining our status as a signatory to the UK Stewardship Code (2020) in February 2023 with our latest submission (which was submitted in October 2022) itself provides external assurance that we're meeting the standard expected of an institutional investor of our scale.

Case study

GREEN APPLE AWARDS

Context & Objectives

LPF has a direct property portfolio of around £400m, which we actively asset manage. This means we work closely with our consultants, facilities managers and tenants on a wide array of matters including environmental initiatives. During 2022, the Fund submitted two of our direct property assets for Environmental Best Practice assessment by The Green Organisation (https://www.thegreenorganisation.info/), which is an independent, international, non-political, non-profit environment group dedicated to recognising, rewarding and promoting environmental best practice around the world.

The aim of the Green Apple Awards is to improve environmental performance, encourage the efficient use of resources, enhance the competitiveness of organisations, support the wider goals of sustainable development including social benefits through community and staff involvement, and help Green Apple Award winners to benefit from their environmental endeavours.

The Green Apple Environment Award can be awarded to any company, organisation or individual that has helped the environment. There are several categories of awards: Green Champions, Gold, Silver & Bronze. Winners are presented with a Green Apple Award Trophy.

Outcome

LPF were Green Apple Environment Award winners for the following direct property assets:

- Bishops Court Retail Park, Exter – Gold Award
- Neptune Business Park – Bronze Award.

The awards were granted for biodiversity improvements, including installations of bird boxes, insect hotels and planting wildflowers.

Assessment and Future Plans

Independent assessment and award success provides assurance that our environmental endeavours are positively impactful and supports the continuation of these asset management activities across our direct property portfolio.

During 2023, we're looking to put forward submissions for three other property assets.

"Initially we thought it's a challenge to bring anything green to an industrial estate within a stone's throw from the M25 and Dartford Crossing. The fact that it's an industrial and largely concrete area makes Neptune Business Park a worthy winner."

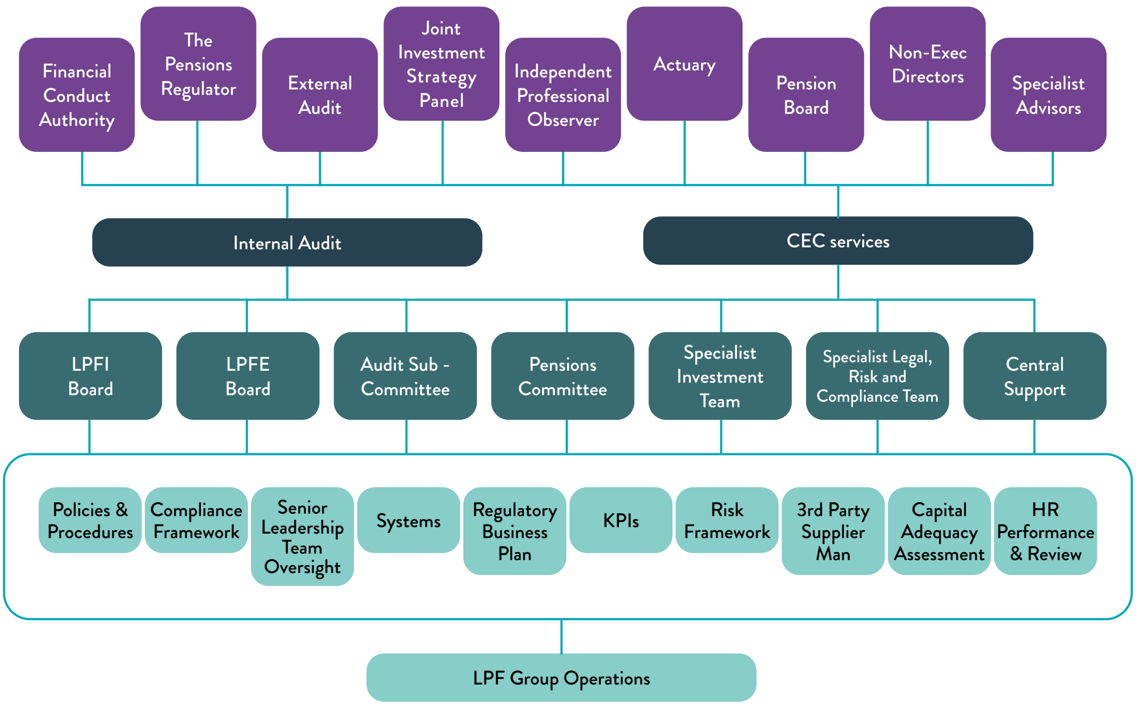
Katie Dickerson, Facilities Manager at JLL

PRINCIPLE 5: REVIEW AND ASSURANCE

OUR ASSURANCE MAPPING PROCESS

We manage assurance as part of an "assurance stack" and we review its effectiveness and efficiency regularly to continuously improve.

LPF GROUP ASSURANCE STRUCTURE

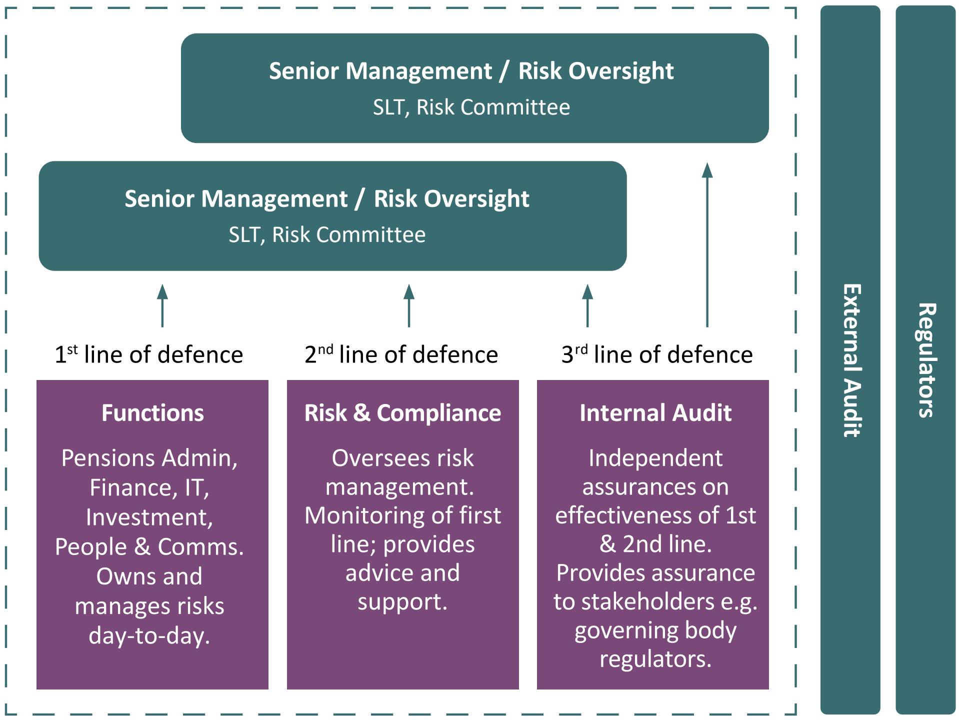


We maintain an assurance overview and mapping document which is designed to ensure that we meet our objectives, are adequately resourced, manage to high professional standards, meet legislative requirements, and deliver high levels of customer satisfaction.

The LPF group's assurance map is categorised in accordance with the 'four lines of defence' model, as illustrated below.

PRINCIPLE 5: REVIEW AND ASSURANCE

GROUP LINES OF DEFENCE OVERVIEW



** Internal Audit is provided in conjunction with external consulting firm PWC*

LPF's Risk and Compliance function is accountable for maintaining an assessment of the assurance framework and, in conjunction with the SLT, ensuring that the framework continues to align with recent developments and LPF's risk appetite. They also ensure awareness and oversight of the assurance map, distillation of its principles throughout LPF's operations and culture and seek to address any perceived gaps or over-extensions.

LPF operates a separate Audit Sub-Committee to review and scrutinise matters, such as internal audit, the financial accounts and regulatory compliance in greater detail, as well as all risks, including information security and cyber risks. The Audit Sub-Committee meets three times a year and reports to the Pensions Committee.

The assurance overview produced by LPF's Risk and Compliance function is considered by the Audit Sub-Committee and the Pensions Committee annually, as part of its Systems and Controls update. It's also tabled once a year to the boards of LPFI and LPFE.

PRINCIPLE 5: REVIEW AND ASSURANCE

TRANSPARENCY AND REPORTING

LPF welcomes external scrutiny of its activities to support its assurance and review processes. In line with the expectations of a public sector organisation, many of our policies and procedures are available on our website. We also publish our PRI assessment results, our PRI transparency report, our Stewardship Report and our voting records on our website.

We recognise the importance of external reporting, which facilitates independent assessment of our practices. Internally, LPF commits senior resources to supporting the quality of such reporting. For example, related to responsible investment:

- Our Responsible Investment Lead has day-to-day ownership of our reporting commitments such as the PRI and the FRC Stewardship Code, with oversight from the Responsible Investment Group
- Our Risk and Compliance and Communications teams ensure accuracy, regulatory compliance, clarity of message and public communication of reporting, as necessary
- Our Senior Leadership Team, specifically our CEO and CIO, are chief sponsors and have responsibility for approving Responsible Investment communications and reporting.

Within our annual report we include information on our approach to climate-related risks and opportunities, following the guidelines produced by the Taskforce for Climate related Disclosures. In addition, we submit an annual UK Stewardship Code Report to the FRC.

As reflected in our governance structure, we have multiple layers of regulation and oversight. We prepare extensive internal reporting across all aspects of the organisation. Together, this reporting brings strong discipline in ensuring we review our policies, assure our processes and assess the effectiveness of our activities.

CONTINUOUS IMPROVEMENT

Having improved the availability of our responsible investment policy and guidance documents in 2020 with the publication of our SRIP, which is reviewed and updated annually, and the creation of our responsible investment E-Zine, Engage, we further improved the governance of our responsible investment activities by creating our Responsible Investment Group in 2021 (as described in Principle 1). We set up our Climate Disclosure and Strategy Project in 2022 to review our climate change strategy and reporting practices, recognising that best practice and regulatory reporting obligations are evolving in this area.

We have reinstated full disclosure of our quarterly voting records on our website, which includes rationale for votes against management, abstentions and shareholder resolutions. While our stakeholders previously signalled that publication of company-level voting data was hard to consume (with details on specific companies lost amongst the scale of disclosure), we recognised growing interest in specific votes, such as "Say on Climate" votes and shareholder resolutions (see Case Study in Principle 12) as well as the development of best practice disclosure guidelines by the Vote Reporting Group, which was established by the FCA in November 2022.

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

TRANSPARENCY AND REPORTING

Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

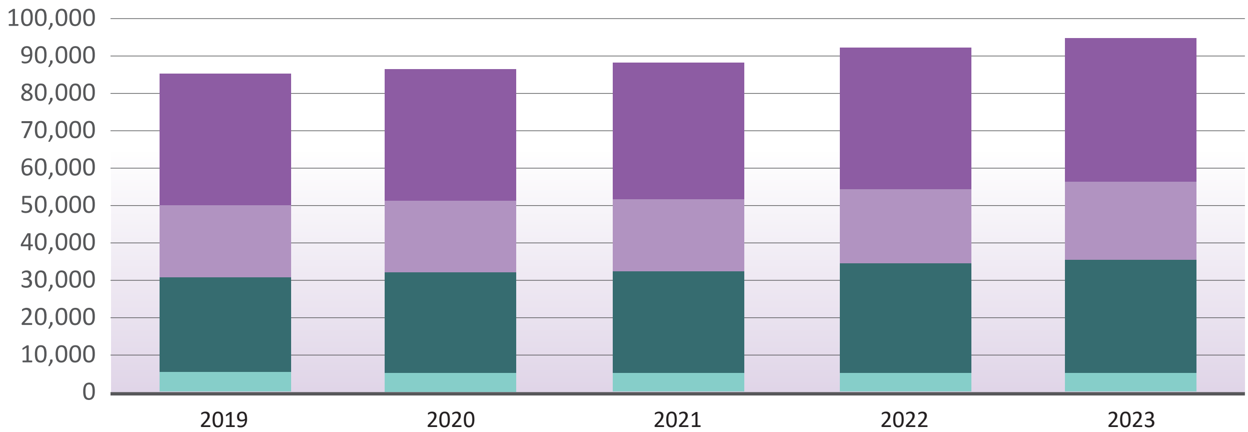
As mentioned earlier in this report, LPF is the second largest Local Government Pension Scheme (LGPS) in Scotland, which is a funded, defined benefit, statutory occupational pension scheme. We refer to our stakeholders, rather than clients and beneficiaries. LPF's stakeholders are the people and entities with an interest in the assets and activities of LPF.

Our stakeholders include the members of the pension scheme (existing and future), their dependants and beneficiaries, as well as the participating employers who contribute to the assets of the fund, and our governing bodies.

OUR MEMBERSHIP

The table and bar chart below shows a breakdown of the membership of our defined benefit scheme. As at 31 March 2023, the number of members in the scheme was 91,996. The average age of our members at the latest actuarial valuation in March 2020 was approximately 53.8 years (active and deferred members average was 51 years old while our pensioners average was 67 years old). As at 31 March 2023, the average age of our members had risen to 54.9 years.

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
Total	83,934	86,292	87,214	90,070	91,996

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

Investment Time Horizon

The Pensions Committee considers the duration of LPF's liabilities when it sets the investment strategy to ensure that there's sufficient cash flow to pay pensions when they fall due. The Fund is open to new members and contributions which means that we'll be paying pension benefits to today's youngest members in several decades time. However, the Fund is a multi-employer fund, so we consider the different needs of those employers and offer different investment strategies to reflect their investment time horizons and cash flow needs, which vary significantly based on the maturity profile of their pension liabilities. These investment time horizons range from a few years to several decades. The different employer strategies are described below:

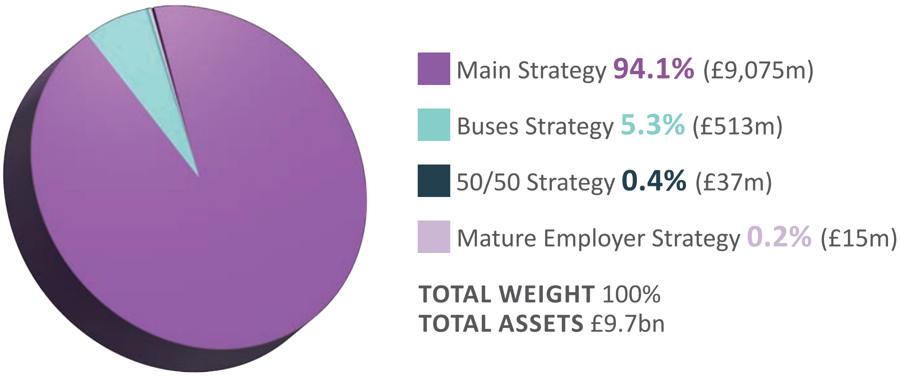
PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

AN OVERVIEW OF OUR INVESTMENT APPROACH

Employer Strategies

LPF 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.

EMPLOYER GROUP STRATEGIES 31 MARCH 2023



Employers fund their liabilities with the strategy that reflects their ability to tolerate risk within an appropriate time horizon, considering the maturity of their liabilities.

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 5.3% of total liabilities.

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

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.

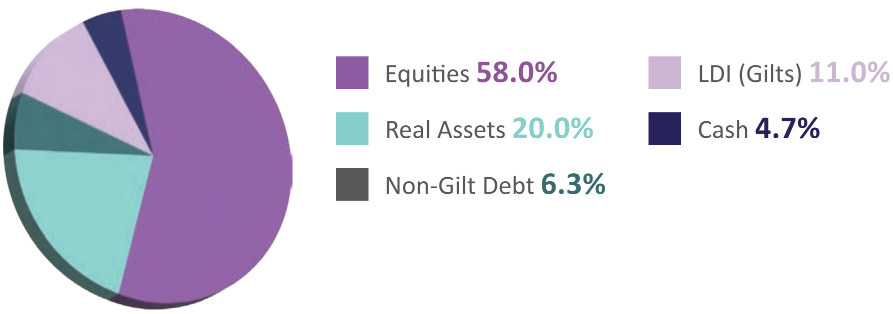
LOTHIAN PENSION FUND 31 March 2023	Main strategy	Mature Employer strategy	50/50 strategy	Buses strategy	Total fund strategy
Equities	60.0%	0.0%	30.0%	33.0%	58.3%
Real Assets	20.0%	0.0%	10.0%	11.0%	19.4%
Non-Gilt Debt	10.0%	0.0%	5.0%	5.5%	9.7%
LDI (Gilts)	10.0%	100.0%	55.0%	50.5%	12.5%
Cash	0.0%	0.0%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

The Pensions Committee delegates implementation of investment strategy to the Fund's officers, who are tasked with investing each policy group within prescribed ranges. These are laid out in our SIP. 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. The Fund's exposures to Equity and Real Assets, which should help protect against inflation, are broadly in-line with target. The Fund has operated comfortably within the prescribed ranges over the year.

ACTUAL ASSET ALLOCATION TOTAL FUND 31 MARCH 2023

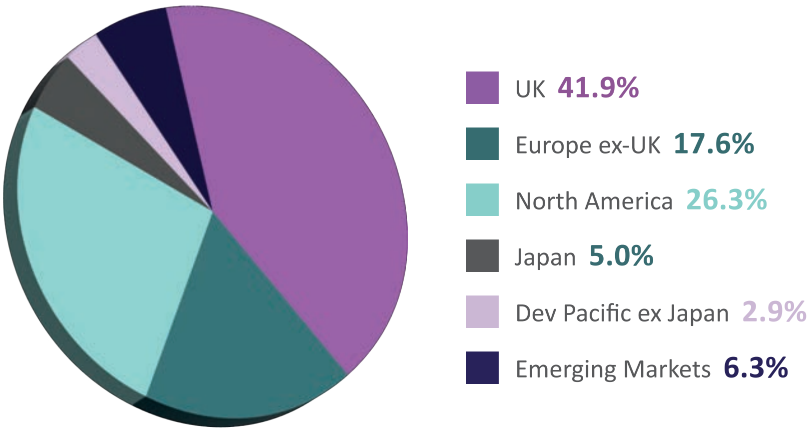


PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

OUR GEOGRAPHICAL EXPOSURE

The pie charts below show an estimated breakdown of the investments of the total fund by geography and asset class at 31 March 2023.

PORTFOLIO ANALYSIS LPF 31 MARCH 2023



PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

Stakeholder Views

Due to the complexity and breadth of responsible investment topics, we don't seek to directly survey our members' views on these topics. However, we benefit from deep integration of member representatives within our Pension Board and Pensions Committee, who provide the important insight that we require about our stakeholders' needs with constructive two-way dialogue.

The Pension Board's role is to provide oversight of the Pensions Committee to ensure that the pension scheme is meeting its legal and administrative requirements and is being operated in the best interest of its stakeholders. Our Pension Board consists of five member representatives and five employer representatives (although we had one employer vacancy at 31 March 2023). The member representatives are union representatives from different unions (who bring insight from their constituent members in different industries but represent all pension members when they sit on the board). We ensure both large and smaller employers are represented on the Pension Board.

We also have an employer representative and a member representative on our Pensions Committee, alongside the five elected members of City of Edinburgh Council (CEC). Pensions Committee members are quasi trustees. Committee papers and minutes are publicly available for all our stakeholders to read, with a link to the relevant CEC website page provided on the LPF website. Contact details for the Pensions Committee are also provided there. The Pensions Committee therefore acts as a conduit for stakeholder views.

Our Senior Leadership Team (SLT) engages with stakeholders (including employers, elected members, Scottish Scheme Advisory Board and The Pension Regulator) in listening exercises to understand their expectations.

Stakeholder Needs

Through this stakeholder engagement, we believe our stakeholders' primary needs to be:

- The provision of a secure pension entitlement for members
- Stable contribution rates for employers
- Recognition of LPF as a Responsible Investor.

Our investment approach and operating plan is driven by what is required to meet these needs. Our strategic goal to "Earn an appropriate risk adjusted investment return as responsible investors" reflects our belief that Responsible Investment and stewardship should reduce the risk associated with the invested assets that the Fund owns to pay pensions when they are due.

LPF has been a signatory to the Principles of Responsible Investment (PRI) since 2008 and demonstrates good stewardship through our Stewardship Report. In accordance with the UK Stewardship Code (2020) our latest Stewardship Report is published on our website, with signatory status confirmed in February 2023.

As explained above, we have four different employer strategies to meet the needs of our different employers, reflecting their maturity profile and hence the needs of the underlying beneficiaries. This ensures investment is aligned with an appropriate investment time horizon.

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

COMMUNICATION

We believe that transparency in terms of investments, communication, access to information and cross-industry collaboration are key components in protecting our stakeholders' interests and ensuring we continuously improve.

At LPF, we support our stakeholders on both a proactive and a reactive basis. Considerable time and effort is spent on proactive engagement designed to support our stakeholders. It means that we can provide clear, carefully constructed responses to frequently asked questions, demonstrating understanding of the issues, and provide insights into the work that we do and the work that's done on our behalf by third parties and collaborative partners.

Specifically on the subject of proactive responsible investment communications, we've created a library of publicly available resources on our website, including:

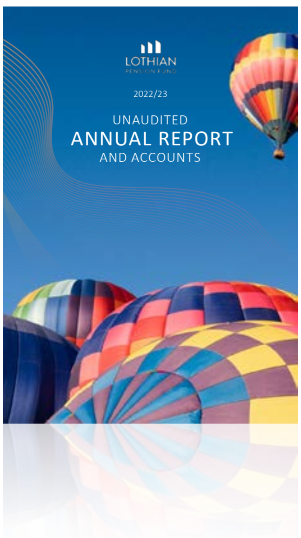
Statutory Reporting:

- The Annual Report and Accounts (which voluntarily includes reporting aligned with Taskforce for Climate-related Financial Disclosures)
- The Statement of Investment Principles (SIP)

Voluntary Reporting:

- The Statement of Responsible investment Principles (SRIP)
- PRI Assessment (and Transparency) report(s)
- Stewardship Report
- Voting data
- Engagement case studies
- Internal equity approach to responsible investment
- The ENGAGE responsible investment newsletter

We encourage members to read, listen and understand these resources to be well informed about the nature of investing and LPF's approach to responsible investing.



PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

LPF is both responsive to, and proactive in its approach to media engagement and external communications. Our Responsible Investment Lead takes an active role in contributing to media articles, through leadership and speaking events.

This included involvement in the following:

- Appearing on a Pensions and Lifetime Savings Association (PLSA) Local Authority conference panel on Renewable Infrastructure's Role in the Energy Transition
- Participating as judges for the GAIN (Girls Are Investors Network) Investment Competition
- Appearing on a PLSA Investment Conference panel on Targeting Net-Zero in Fixed Income
- Participating in a roundtable with the Pensions Minister to discuss how UK pension funds can invest in support of the transition in emerging markets
- Participating in the Engagement Group (steering committee) for the Occupational Pensions Stewardship Council (OPSC).

We also undertake reactive engagement in three broad categories:

- Freedom of information requests
- General and stewardship enquiries
- Indirect general enquiries through Councillors/MSPs/MPs.

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

ENQUIRIES

Both the direct and indirect general enquiries typically follow a similar format. They're enquiries either generated by a website form or downloaded from a website, suggesting that it should be directed to a local political representative. Often these enquiries are from individuals unrelated to the pension fund.

In these instances, we support busy councillors by providing standardised responses. This ensures consistent responses, speed, and greater efficiency and time savings for councillors, committee members and officers alike, as well as upholding the levels of service our stakeholders expect.

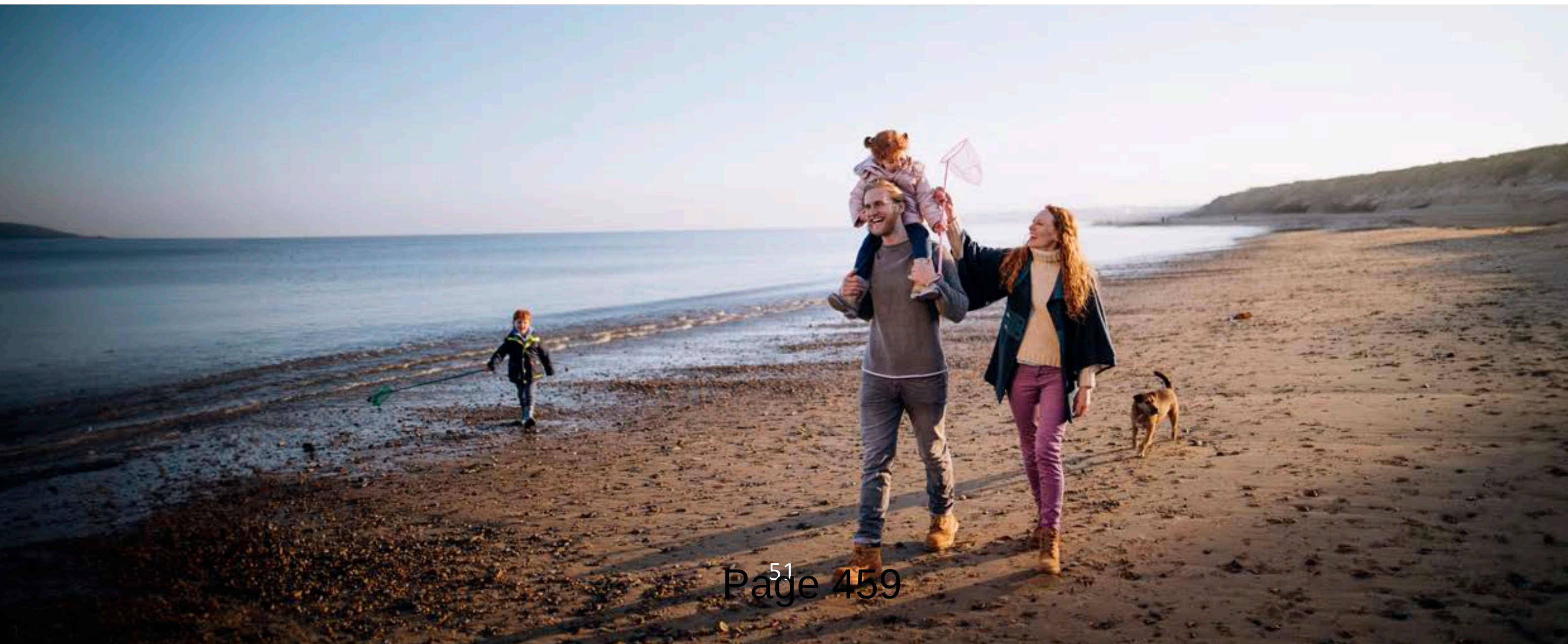
We make a pledge to our members that, when they contact us, we'll:

- Deal with the query promptly, efficiently, fairly and in an easy-to-understand way
- Communicate our service standards
- Reply as quickly as possible with information if we can't answer the query on the spot
- Treat all queries with respect
- Treat our members as individuals.

Evaluation Of Effectiveness

Our proactive and responsive communication strategy combined with the make-up and role of the Pension Board and Pensions Committee in our assurance structure ensures stakeholder engagement with representatives from all our key constituencies. This supports our understanding of stakeholders' needs.

Based on the enquiries from Councillors and the Pensions Committee about LPF, we also believe that our public communication channels are working effectively. While we recognise that some of these enquiries may be from individuals who are not members of LPF, we note that this engagement can be useful in reflecting broader views on emerging issues.



PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

Taking Account of Stakeholder Views

LPF follows a two-year strategic planning cycle, and our planning process begins and ends with a focus on our members through an ongoing feedback loop of listening to our members when we engage with them on administration matters, and in asking for feedback through our complaints and compliments process. The process to develop our 2022-2023 Business Plan included consulting with the Pensions Committee prior to its formal consideration and approval by our Pensions Committee in March 2022 on behalf of our members and employers.

The plan centres around four broadly defined strategic goals, each with more detailed objectives and accompanying targets and measures to allow us to monitor our progress.

STRATEGIC GOALS 2022-2023

How we achieve the sustainability that our multi-generational obligations require

OPERATING PLAN GOALS

Develop and deliver a member and employer proposition for service excellence

- Continue to target external validation including the Pensions Administration Standards Association (PASA) accreditation, the Customer Service Excellence (CSE) award and CEM Benchmarking
- Delivery of our digital strategy to further improve our service proposition for both members and employers
- Preparation for the launch of the Pensions Dashboard and responding to the requirements of the McCloud judgement

Earn an appropriate risk adjusted investment return as responsible investors

- Deliver sufficient investment returns over the long term to meet funding targets
- Seek to have a positive impact on the economy and society by continuing to integrate ESG into our investment processes
- Demonstrate good stewardship of our assets

Extend collaboration and services to existing partners and deepen where possible

- Continue to collaborate through successful investment partnerships
- Offer reliable and impartial advice to policy makers including the Scheme Advisory Board

Achieve greatness in our people, teams and culture

- Empower a broad range of talents to meet organisation priorities
- Cultivate leadership competencies and develop succession plans across the team
- Give our people capacity and encouragement to contribute to our communities

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

Through engagement with stakeholders, we recognised the need for LPF to be recognised as a responsible investor and to demonstrate good stewardship meeting the requirements of the UK Stewardship Code (2020). We published our first Stewardship Report in Q4 2021. This document is our third Stewardship Report.

We have also recognised the views of our stakeholders by taking on board their need for information on climate risk. This led to the creation of Responsible Investment Group (RIG) in 2021 and the initiation of the Climate Disclosure and Strategy project, which progressed through 2022 and continues in 2023. This encompasses a review of evolving best practice and regulation as well as implementation challenges. One of the outcomes of reviewing evolving best practice was the reinstatement of full disclosure of our voting records on our website.

Implementation

Implementation of our investment strategy is achieved using both internal and external managers. We assess all our investments with a view to meeting a required level of financial return in the context of achieving an appropriate level of risk diversification. ESG issues are an integral part of that assessment. The benefit of having an experienced portfolio manager as our in-house Responsible Investment Lead is that we're able to integrate our stewardship and our investment decisions across the fund, according to asset type (see Principle 7).

Debt Denial

We recognise that our ambition (as described in our SRIP) to avoid providing new financing to companies or projects that are incompatible with the aims of the Paris Agreement is a leadership position for asset owner climate policy. Substantial research is taking place across the investment industry on how to determine whether certain companies or specific projects are aligned (or aligning) with the aims of the Paris Agreement. Some frameworks and tools exist (such as the Transition Pathway Initiative and Science Based Targets), but their coverage is incomplete.

For externally managed assets, such as corporate bonds, we're dependent on our external managers to implement this policy on our behalf. We initiated a programme to proactively write to all our managers in 2022 outlining our responsible investment policies and commitments, requesting an update on their policies and commitments (particularly regarding net zero alignment), enhanced reporting on new (primary) financing investments, and their timelines for including product level emissions data in standard reporting. In addition, we also sent our managers the Asset Owner Diversity Project diversity and inclusion questionnaire in accordance with our commitments to this initiative. Monitoring our external managers' responses and provision of enhanced reporting is being progressed through 2023.

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

The purpose of our pension fund is to pay pensions to members as they fall due over a multi-decade timeframe. As an early signatory to the PRI, we've incorporated environmental, social and governance issues into our investment decision-making since 2008. We see stewardship as an essential and integral part of our investment process.

- Our stewardship activities inform us about how companies are performing on specific ESG issues, about how proactively these issues are being managed, and about companies' wider approach to strategy and risk management
- Our stewardship activities often encourage better disclosures to support our investment research and decision-making on ESG issues
- Our investment process identifies risks and opportunities both at a stock and sector level, providing us with a prioritised list of issues to focus on in our engagement
- Our dialogue with companies often generates wider insights about trends, drivers, best practices, and relative company performance, informing ESG analysis.

"There is no such thing as a risk-free investment. ESG issues are central drivers of investment risk and return. Our job is to be aware of the relevant risks, to ensure that we're being paid for the risks we're taking, and to manage and mitigate these risks."

Gillian de Candole
Portfolio Manager and Responsible Investment Lead

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

As discussed in Principle 2, our stewardship efforts are purposely managed and led by our investment team, so that they're embedded in the investment process systematically. We don't treat this as a separate activity. We encourage company management teams to improve their practices and give them time to do so. This support is not open-ended or unquestioning; if we feel progress is too slow, and the prospect of financial risk to us is increasing, we'll withdraw our support and reduce or exit an investment.

We integrate stewardship and ESG issues into our investment analysis and decision-making process.

ESG and Stewardship Integration

Implementation of our investment strategy is achieved using both internal and external managers. We assess all our investments with a view to meeting a required level of financial return in the context of achieving an appropriate level of risk diversification. ESG issues are an integral part of that assessment. The benefit of having a portfolio manager as our in-house responsible investment lead is that we're able to integrate our stewardship and our investment decisions across the fund, according to asset type. How ESG issues are incorporated into investment analysis and decision-making processes varies according to the asset category (but not geography) and whether the mandate is internally or externally managed. The following table explains our approach by asset category and mandate type:

Internal Equity Investment	Our portfolio managers analyse ESG data as part of the stock selection process and, on an ongoing basis, monitor ESG developments at underlying investee companies. Data and rating changes from independent providers trigger stock reviews. We aim to provide new financing only to companies or projects that are compatible with the aims of the Paris Agreement. We engage with existing portfolio companies to ensure climate risk is accounted for and to encourage the development of realistic transition plans. Our internal managers invest directly in listed markets and private market funds, and they monitor public and private markets with the benefit of having integrated ESG analysis into investment decision-making for many years. Our internal managers are ideally looking for investments where ESG- related improvements are in evidence with long term benefits likely to accrue to shareholders. For example, our internal managers assess and monitor the capital spending on green energy noting that much of it is undertaken by the incumbent energy providers (the diversification of carbon-extractive companies and carbon burning utilities). Through our engagement activity, we encourage positive outcomes for asset owners through good capital allocation decisions.
Internal Sovereign Bond investment	Our portfolio managers analyse ESG reports and respond to government and market consultations, either directly or with our collaborative partners.

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

External Managers	During the appointment process, we assess the approach of managers to incorporate ESG issues into their investment analysis and decision-making processes. We monitor the managers’ implementation of the approach on a quarterly basis alongside all other investment matters, with ESG a standing agenda item. We engage regularly and review the PRI transparency reports of external managers, where available. Managers are encouraged to join PRI as signatories where they’re not already members and also to become signatories to the UK Stewardship Code, where appropriate.
External Equity	We assess how our managers incorporate ESG into their investment process and stewardship activities. Our ambition is to appoint managers who won’t provide new financing to companies or projects that are incompatible with the aims of the Paris Agreement because of the investment risks we believe it presents. We engage regularly to discuss and review holdings.
External Corporate Debt	We assess how our managers incorporate ESG into their investment process and stewardship activities. Our ambition is to appoint managers who won’t provide new financing to companies or projects that are incompatible with the aims of the Paris Agreement because of the investment risks we believe it presents. We engage regularly to discuss and review holdings.
Internal Direct Property Investment	During the selection and monitoring process, we assess the environmental efficiency and sustainability credentials of properties, including physical climate risks and transition risks (investment needed to meet tightening energy performance standards). In conjunction with an appointed property manager, we ensure that ESG initiatives to mitigate risk and maximise opportunities are implemented at every stage of the ownership cycle. ESG improvement targets and performance will be incorporated into strategy through asset management plans for owned assets and all new investment acquisition appraisals. As part of our monitoring and review of direct property assets, we engage directly with tenants and build long-term relationships with them.
Real Asset (Infrastructure, Property and Timber) Investment	During the appointment process, we assess the approach of managers to incorporating ESG issues into their investment analysis and decision-making processes. We monitor the managers' implementation of the approach on a quarterly basis alongside all other investment matters, and review PRI transparency and GRESB reports of external managers, where available. Where appropriate, we seek improvement to both the management and implementation of that approach. Managers are encouraged to join PRI as signatories where they're not already members.

Case study

ESG INTEGRATION IN DIRECT PROPERTY

Background

One example of the financial materiality of ESG issues is provided by a series of legislation affecting the UK property sector, including the Minimum Energy Efficiency Standards (MEES) for UK commercial property and the requirement for an Energy Performance Certificate (EPC).

The MEES restricts commercial landlords from letting (and hence generating an income or financial return from) energy inefficient buildings. The EPC rating is a measure of the notional energy capability of a building, based on its CO^2 emissions. These legislative initiatives support the drive to net zero as commercial buildings are estimated to contribute 20% of the UK's carbon footprint.

Initially introduced in 2015 in England and Wales, the MEES has the following implications for commercial property:

- 1 April 2018 – Unlawful to grant new leases of commercial property with an EPC rating of below E (the minimum standard)
- 1 April 2023 – Unlawful to "continue to let" commercial property with an EPC rating of below E (the minimum standard)
- 1 April 2025 – Requirement to register a valid EPC for let, commercial property (proposed regulation)
- 1 April 2027 – The minimum standard raised to EPC rating C (proposed regulation)
- 1 April 2028 – Further requirement to register a valid EPC for let, commercial property (proposed regulation)
- 1 April 2030 – The minimum standard raised to EPC rating B (proposed regulation)

Actions taken

Ahead of these regulations coming into force, we reviewed the EPC status of all direct property assets and prepared a plan to meet the 2023 regulations.

A key initiative in 2022 was the refurbishment of an office building in Winchester, where the EPC was an E rating. With the ability to gain vacant possession following a lease expiry, we budgeted material capital expenditure to refurbish the building, including improvements to the heating, ventilation and air conditioning systems (replacing an old inefficient water-based system with a new, highly efficient hybrid system) and installing energy-efficient light emitting diodes (LEDs) throughout the property. The EPC was improved to an A rating and the building was certified as "BREEAM Very Good". BREEAM stands for 'Building Research Establishment Environmental Assessment Methodology' and is the world standard for environmental assessment and rating of buildings. On completion of the refurbishment two thirds of the building was let, demonstrating tenant demand for energy efficient buildings.

Case study

ESG INTEGRATION IN DIRECT PROPERTY (CONTINUED)

Outcome

The fund was fully compliant with the MEES regulations ahead of the 1 April 2023 deadline, with the improvements made since December 2021 shown in the table below:

	Dec 2021	Dec 2022
EPC Risk Rating Red	24	0
EPC Risk Rating Amber	76	93
EPC Risk Rating Green	19	26

Assessment and Outlook:

Our proactive approach enabled us to meet the 2023 standards ahead of the deadline. However, we continue to improve the EPC ratings of the assets within our direct property portfolio to ensure compliance with proposed regulations anticipated to come into force in future. As at May 2022, a total of 82% of our baseline (Dec 2021) EPC ratings have been improved, both through refurbishment and through engagement with tenants to improve how efficiently the buildings are used.

We are also conducting interviews and receiving proposals from EV charging operators to provide up to 84 EV charge spaces across 7 of our direct property assets. These will not only provide income generation but also provide a service to both tenants and their customers, demonstrating the value of integrating ESG considerations into investment decision-making.

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

PRIORITY ESG ISSUES

We've identified 12 financially material ESG issues or themes that represent our engagement priorities for 2023-25. These guide our voting and engagement activity both internally and through our external engagement provider, EOS (for more information, see Principle 9). We believe they're important issues that will impact shareholder value and so deserve focus in any investment analysis.

- Climate change action
- Circular economy and zero pollution
- Natural resource stewardship
- Human and labour rights
- Human capital
- Wider societal impacts

- Board effectiveness
- Executive remuneration
- Investor protection and rights
- Business purpose, strategy and policies
- Risk management
- Corporate reporting

OUR TOP PRIORITY: CLIMATE CHANGE

Governments and regulators are grappling with a hugely complex, global systemic risk.

We address climate change risks in two ways – through our investment selection process and through our engagement and voting activities. As part of the stock selection process for the fundamentally managed portfolios, any material climate-related risks and opportunities (such as carbon pricing and the low carbon transition) are individually assessed by the managers before acquisition and monitored once they're portfolio holdings. Both the fundamental and quantitatively managed equity funds utilise engagement with investee companies to improve practices.

In our meetings with company management, we routinely discuss how they'll align their businesses with the aims of the Paris Agreement. We encourage our external managers to do likewise and to report on their engagement activity. We believe that accurate measurement and disclosure of corporate emissions and clarity of strategic direction are key to accurately assessing the climate risk and return potential of company shares. Encouraging better disclosure remains a standard part of our dialogue with companies. Data quality remains variable depending on geography and publicly listed companies are generally more transparent than private companies.

We align our stewardship activities to achieve shared outcomes

Carbon intensity numbers are currently treated as outputs of our investment process rather than targeted inputs into the investment process. This is because these numbers are fundamentally easy to "game". For investors, reported portfolio carbon intensity metrics could easily be lowered simply by selling the most carbon intensive stocks and replacing those investments with lower emission stocks. This may be optically attractive, but companies will continue to emit carbon in the same manner whether our, or any other, fund sells or retains the shares.

Strengthening corporate reporting on climate change has therefore been a key focus of our engagement efforts. We work with Climate Action 100+ to encourage better, more meaningful corporate carbon reporting from companies.

Through EOS we've had a formal climate change voting policy in place since 2019 targeting climate change laggards. This policy was strengthened in 2021 with the emergence of formal shareholder votes on companies' responses to the climate crisis and in 2022, further specificity was introduced as to how The Transition Pathway Initiative (TPI) assessments are used to identify climate laggards. We support proposals that demonstrate robust target-setting, and that are aligned with external frameworks and accreditations such as the Science-Based Targets initiative. We also want to see a clear and credible strategy in place to achieve the stated targets.

LOTHIAN PENSION FUND

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

We need good data to build a clear roadmap of risks, opportunities and implications of climate change, so we can make informed decisions in the long-term interests of our stakeholders.

While we assess and manage climate-related risks and opportunities for all our assets, our approach differs by asset class. Above, we describe how we use available data and tools to assess climate change risks and engage, often in collaboration with like-minded investors, to address this systemic risk. Below we provide a spotlight on how we integrate ESG considerations, including climate risk, in infrastructure investment.

We recognise the contribution that some specific sectors and industrial activities make to climate change. While there's a tendency to label companies in carbon-intensive industries as 'bad' and those in low-carbon and alternative energy businesses as 'good', investment is more nuanced than this.

We have a policy of engagement rather than exclusion and divestment. This allows us to exert influence on companies to improve their business practices, align with the Paris goals, and disclose internal management of climate-related risk and opportunity with TCFD compliant reporting.

Finance theory indicates that exclusions may result in lower risk-adjusted returns while the body of empirical research reaches different conclusions depending on the time period chosen. Our inference is that divestment is a sub-optimal strategy as it provides no incentives for management to change. On climate change specifically, divestment may be having the unintended effect of shifting ownership as well as finance to "pollution havens". LPF's approach is to consider investments on their merits, taking into consideration risk and returns available from owning shares in entities capable of directing capital into renewables or back to shareholders, as well as to fossil fuels. We have also invested in a number of pure play renewable energy projects within our infrastructure portfolio, which can be an easier and/or cheaper route to access renewables exposure than listed companies.

Our approach to engagement with companies involved in the extraction of fossil fuels is explained in more detail in Principle 9.

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

SPOTLIGHT ON RESPONSIBLE INVESTMENT IN INFRASTRUCTURE

Our infrastructure investments have the potential to generate attractive risk-adjusted returns, with cash flows often linked to infation.

Infrastructure investments represented 13.8% 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 investment of £1,324m (31 Mar 2022: £961 million), the majority is invested in the UK.

Integrating ESG in infrastructure investment

In addition to being a PRI signatory, we also subscribe to GRESB (an investor-led, sustainability benchmarking provider for real assets, covering real estate and infrastructure assets) to further enhance our analysis of ESG issues. We use the PRI and GRESB annual surveys of managers' ESG policies and activities to support our engagement with our managers, which drives improvements and implementation of best practice.

At 31 March 2023, 88% of the infrastructure portfolio value was invested in assets/funds which were also signatories of the PRI and 20% of funds participated in the 2022 GRESB Infrastructure Assessment. Most of our infrastructure funds also publish an internal ESG policy, outlining the consideration given to ESG issues within the decision-making and ongoing investment monitoring process, and this has become a standard consideration for manager selection.

Within the GRESB Infrastructure Assessments, participating funds and assets report annually to GRESB on their internal controls and policies. GRESB validates the submitted data and assesses the fund or asset with reference to a series of performance indicators, including the sustainability of its investment strategy, stakeholder relations and level of gender/diversity reporting. We use the GRESB scores to benchmark performance of these funds and assets against their peer groups.

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

We've taken a position on environmental and social factors

We recognise the role infrastructure investment can make to address part of the current environmental challenges related to climate change. Approximately 23% of the infrastructure portfolio is invested in renewable energy. During the year, the fund allocated c.£349 million to investments in social infrastructure, transport, renewables, utilities, environmental services and data infrastructure. New opportunities continue to be appraised.

PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

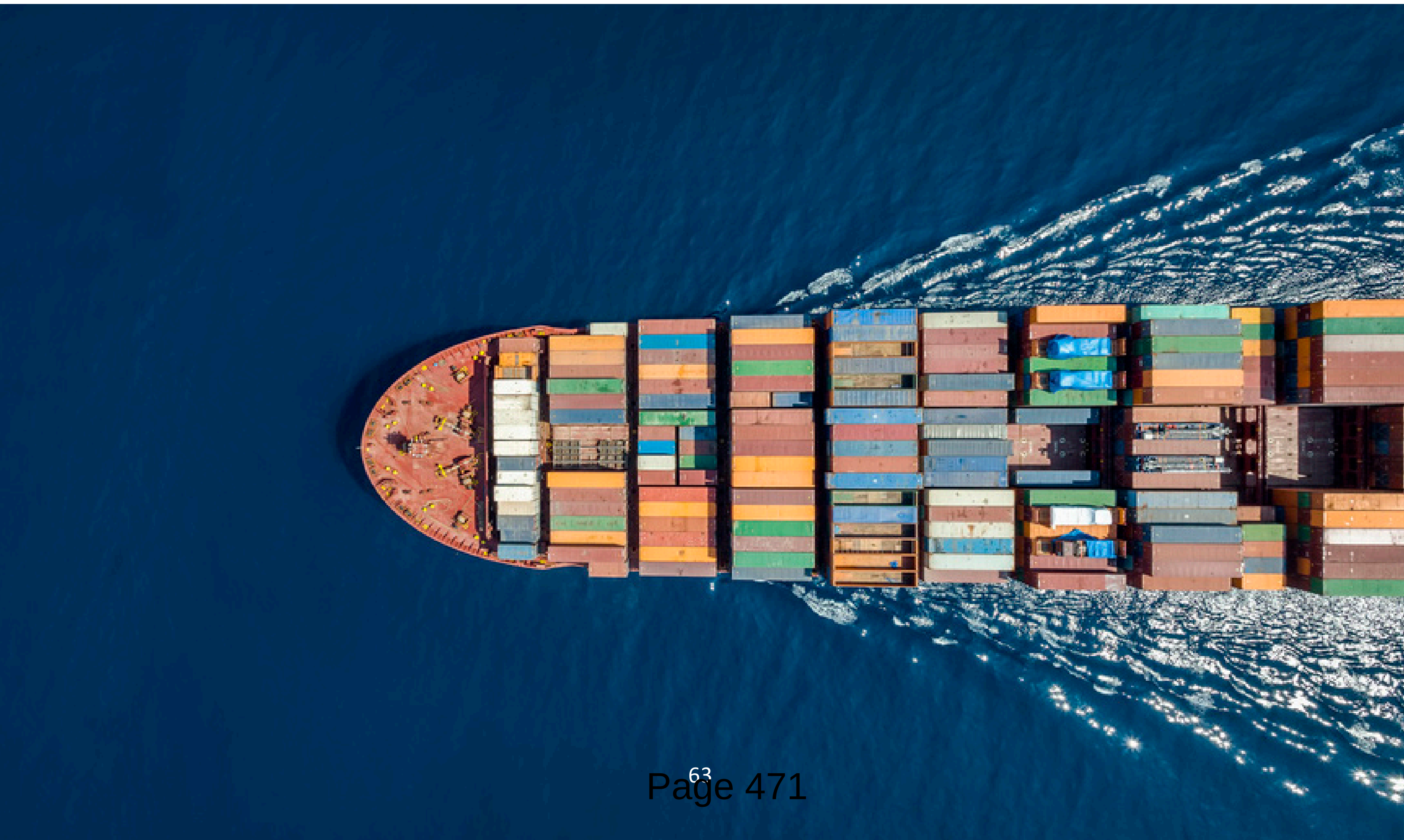
Signatories monitor and hold to account managers and/or service providers.

LPF's Supplier Management Framework sets out our consistent approach to the management and oversight of third-party suppliers in a manner which is proportionate to the contract value and importance of the service.

Prior to engaging a supplier, contractual protections which allow LPF to exercise effective oversight are incorporated into the legal terms. For example, LPF secures:

- Clear performance and quality standards applicable to specified services, and measurement of these using `key performance indicators' where appropriate
- Regular review meetings/calls
- Documented escalation procedures applicable where standards aren't met, with specified supplier personnel dedicated to our client relationship
- Continuous improvement initiatives to improve the efficiency and effectiveness of the service.

Key suppliers relevant to our stewardship of assets include our JISP, our global custodian, the provider of our order management system software, our engagement and voting service providers, and the providers of data and research services, including ESG information.



PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

MONITORING OUR ENGAGEMENT AND VOTING SERVICE PROVIDERS

We use EOS for the provision of engagement work and as our proxy voting advisor across the bulk of our listed investments. We frequently discuss voting-related issues with EOS, especially during voting season when there's a concentration of activity. We also review global developments in governance standards with them each year so we can be sure our engagement and voting policies are updated and aligned as appropriate.

EOS provides regular updates on its voting recommendations and progress on engagement activity with companies, regulators and public policy makers:

- Confidential alerts and reports provide timely updates for use by our internal portfolio managers
- Quarterly reports and an Annual Review of our voting and engagement activities are provided which we publish to our website to enable us to keep our stakeholders informed
- We participate in EOS' biannual client advisory meetings, which are an effective means of reviewing current practices, monitoring performance and providing meaningful input into engagement priorities
- We undertake regular update meetings with our client team at EOS to ensure services have been delivered to meet our needs and strive for further improvements. Key Performance Indicators include:
    - On demand access to EOSi portal
    - Timely and proactive provision of voting alerts, thematic ESG alerts, engagement progress updates and individual company case study reports
    - Execution of voting rights in line with our policy to vote 100%* of our shares
    - Scale of engagement programme coverage - details enable us to prioritise our direct and other collaborative engagements (e.g. through CA100+) on holdings not covered by EOS
- In 2022 EOS engaged with 227 companies in our portfolio on 1,137 environmental, social, governance, strategy, risk and communication issues and objectives – see Principle 9
- In 2022 EOS provided LPF with voting recommendations for 552 company meetings (8,002 resolutions) – see Principle 11.

*99% of LPF's ballots were voted in 2022. The variation was due to two unvoted meetings: one required an administrative declaration and the failure to make this declaration caused the whole ballot to fail. EOS subsequently amended their instructions and procedures for votes that require an administrative declaration. The other related to a company with Russian connections, where our policy was not to vote.

Following a review and streamlining of our internal processes, we didn’t miss any votes due to share-blocking in 2022: in certain markets investors can’t trade shares in the period between registering a vote and the shareholder meeting taking place. This can create liquidity issues for investors if the voting process becomes protracted.

In addition, we have regular discussions with our external managers in this regard. A proportion of our equity investments are managed by Baillie Gifford, who carry out their own voting and engagement. As well as providing information in a quarterly questionnaire, Baillie Gifford include voting, governance and engagement information within their quarterly reporting. We meet with Baillie Gifford on a quarterly basis where we discuss in more detail various elements of their voting and engagement – in particular, areas where at first glance they appear to be deviating from their stated policy. Notes of these meetings are written up for the investment team to view and any areas of interest are discussed at a formal quarterly meeting and followed up if required.

PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

INTERNAL MANAGER MONITORING

Portfolios managed by the in-house investment team are monitored at different levels and at different intervals. Daily reconciliations of assets between custodial and front office systems confirm that portfolios are being managed within the relevant constraints. Systems are coded to prevent managers from breaching those parameters and to alert the Compliance function of potential or actual breaches, which could occur. The Chief Investment Officer attends monthly meetings of investment groups, which are arranged by policy group, providing oversight and scrutiny of portfolio construction and transactions. The Chief Executive Officer and the Chief Investment Officer review all mandates and reports on a quarterly basis.

All quarterly reports include detail on portfolio risk and return, portfolio construction, transactional activity, ESG analysis and engagements. The external independent advisers on the JISP review all reports every quarter and meet with each of the portfolio managers annually to provide assurance that the mandates are being managed in-line with expectations. At the annual review meeting the external independent advisers on the JISP expressed satisfaction with the internal management over 2022, including ESG integration.

The benefit of managing a substantial proportion of assets internally is that we have full transparency and that our internal managers are fully cognisant and aligned with our policies.

EXTERNAL MANAGER MONITORING

We monitor all our external managers to ensure they continuously maintain their own responsible investment and stewardship commitments.

Equities And Debt

- During the appointment process, we assess the approach of managers to incorporating ESG issues into their investment analysis and decision-making processes and in their active ownership
- We monitor the managers' implementation of the approach, in addition to their performance against the mandate and related investment matters (with any subsequent amendments) on a quarterly basis. MiFID 2 was intended to enhance investor protections and it specifies some of the content which our managers must include in their quarterly reports, but we agree the extent of additional content we require to be included in such reports upon appointment. In addition to the quarterly reports that managers provide, we issue a quarterly questionnaire to address other material points, including ESG issues
- Members of our internal investment team also meet with external managers quarterly to understand any changes that might affect the management of the mandates. Both the Chief Executive Officer and the Chief Investment Officer review all external mandates with the internal investment team after these meetings.

PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

Private Markets Fund Managers

- To monitor our diversified portfolio of private market funds, the largest portion being infrastructure assets, we review each manager's quarterly updates of activity, performance and portfolio construction to demonstrate adherence to the fund's agreed strategy. Monitoring includes performance, risk, ESG issues and portfolio construction relative to diversification constraints
- Our portfolio managers are in regular contact with our fund managers, attending annual investor meetings and reviewing the periodic reporting and updates received. In some cases, an LPF representative sits on the advisory board of the fund to review matters such as management of conflicts of interest which require investors' consent. This can provide greater transparency and a forum for challenge.

General

- Where available, we review the PRI transparency or GRESB reports
- Internal reports on our external managers are submitted for senior oversight, with any issues and escalation actions discussed at the quarterly JISP meetings.

We don't always expect external fund managers to be the "finished article". In some instances, we'll consider selecting fund managers with less-developed approaches to responsible investment if we can be assured that there's a present and demonstrable road map towards improvement and development. One example where this may be the case is in relation to infrastructure and real estate investments, where ESG and responsible investment reporting may not be as established as in other asset classes. We believe we can add value in working with managers at this level if we're confident in the investment case and their overall philosophy.

PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

HOLDING MANAGERS AND SERVICE PROVIDERS TO ACCOUNT

In the past year, all of our contracts with our managers and service providers were fulfilled to our expectations, but we continue to engage with our providers on how their service provision can further improve. For example, in April 2022 we raised an issue with one of our providers regarding the formatting of their reports: in line with regulations governing the accessibility of documents for public sector websites, we asked for more accessible formatting to improve their functionality for our stakeholders. This turned out to be a complex issue, requiring significant manual intervention. However, we have asked our provider to work with their design company to incorporate accessible formatting for future documents. Some progress has been made on this over the last year, reducing the requirement for manual reformatting. We'll continue to advocate for accessible formatting for all the documents we publish to our website a part of our commitment to diversity and inclusion.

Evolving expectations on climate reporting

Following the announcement of our ambition to avoid funding companies whose business models aren't aligned with the goals of the Paris agreement, we began engaging with our managers on steps that they could take to align their practices with our aims and objectives. This is a complex area and work is currently ongoing with all our external managers.

Our monitoring (and selection) processes for external managers incorporate ESG assessments, which continue to be refined as the industry evolves. Our policies and expectations change over time, and this is no more evident than in the climate-related commitments that we have made in our SRIP. Our approach is to work with managers, requesting change where required, and we've found a willingness to evolve alongside us, through reporting on ESG analysis and engagements, followed by discussions to gain a better understanding to ensure we are aligned.

In early 2022 we reviewed our manager monitoring process and devised additional questions for our quarterly manager questionnaire to support alignment/assessment of alignment with our ambition. This was implemented through 2022.

Extract from our updated quarterly manager questionnaire:

"Please list all stocks or bonds purchased during the quarter that raised new equity or new debt for the company (eg. rights issues, IPOs, new bond issuance or bond conversions)."

"Please state whether your organisation or this product has made a net-zero commitment."

Where we are not aligned, we would ultimately terminate the mandate. We haven't had to do that over the last year. We monitor private market funds in a similar way, engaging to promote higher standards of reporting and identifying managers with whom we won't invest in the future due to concerns over their approach to managing climate risk.

PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

Monitoring our managers' diversity performance

Another area we seek to address relates to the severe lack of diversity within the fund management industry. This is an ESG issue that we as asset owners and responsible investors feel strongly about both in terms of our values and our role as a manager of managers. It also links to our commitment to promoting well-functioning markets, with a better investment industry. This is why we worked with other asset owners to establish the Asset Owners Diversity Charter (see Principle 4). As a signatory to this initiative, we've recognised that diversity for asset managers is at a critical tipping point and that asset owners have a crucial role in holding them to account. We've committed to:

- Incorporate diversity questions into manager selection
- Incorporate diversity into ongoing manager monitoring
- Lead and collaborate with others in the investment industry to identify diversity and inclusion best practice.

Charter signatories will increase the pressure on fund management firms to share information about diversity, so that industry progress can be benchmarked.

"Diversity, Equity and Inclusion is increasingly being considered a business imperative in the investment and savings industry to better reflect society at large, create better financial outcomes through diversity of thought; and build a pipeline of diverse talent for the future."

Gillian de Candole
Portfolio Manager and Responsible Investment Lead

PRINCIPLE 9: ENGAGEMENT

Signatories engage with issuers to maintain or enhance the value of assets.

As discussed in Principle 7, we believe that a proactive combination of collaboration, engagement and voting supports our mission to pay pensions over the long term. We believe that successful engagement adds value to the investment process by promoting best practice governance and by highlighting and promoting best practice in dealing with environmental, climate change and social issues.

Also discussed in Principle 7 are the 12 key ESG issues or themes which we focus on in our engagement and in our investment research. We've chosen these because of their actual or potential financial significance to our portfolios.

Where material risks remain following engagement activity, we retain the ability to reduce our position size or sell to mitigate our exposure to these risks. We discuss divestment in more detail below.

LOTHIAN
PENSION FUND

Our view on divestment from companies involved in the extraction of fossil fuels

LPF is often challenged about its approach to responsible investment, including requests to promote a policy of divesting from companies involved in the extraction of fossil fuels. We don’t reduce our position size or sell existing holdings for purely non-financial reasons. Nor do we exclude companies from our investment universe for purely non-financial reasons. We do, however, believe that environmental, social and governance issues can affect the financial performance of the companies in which we invest. We take these issues seriously and integrate them into our decision-making processes.

We have a policy of engagement with companies and policymakers rather than a policy of exclusion or divestment. By engaging with the companies in which we own shares, we strive to improve the sustainability of corporate strategy to the benefit of shareholders, and to the benefit of wider society. We believe that a policy of divestment potentially passes shares to less responsible or less active share owners, who are less likely to hold the company's managers to account on planning for and managing significant transitions in their businesses over the next decades. In our view, this achieves nothing in terms of real-world sustainability.

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 some 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. We therefore strive to influence and support positive changes by corporate leaders to achieve sustainability for their firms and for society.

Our policy of engagement allows us to exert influence on companies to improve their business practices, align with the Paris goals, and disclose their climate-related risks and transition plans as well as their investments in solutions, with TCFD compliant reporting.

PRINCIPLE 9: ENGAGEMENT

OUR APPROACH TO ENGAGEMENT

We commit significant resources to engagement activity, which we divide into four distinct elements as shown in the table, below.

We use a variety of engagement approaches, including written correspondence, face-face meetings, voting and public communications. Our preference is for direct engagement as it allows us to set out our expectations and to fully explain our interests and motivations. Irrespective of the engagement approach, the goal is always to achieve good financial outcomes for our stakeholders and to encourage positive corporate behaviour.

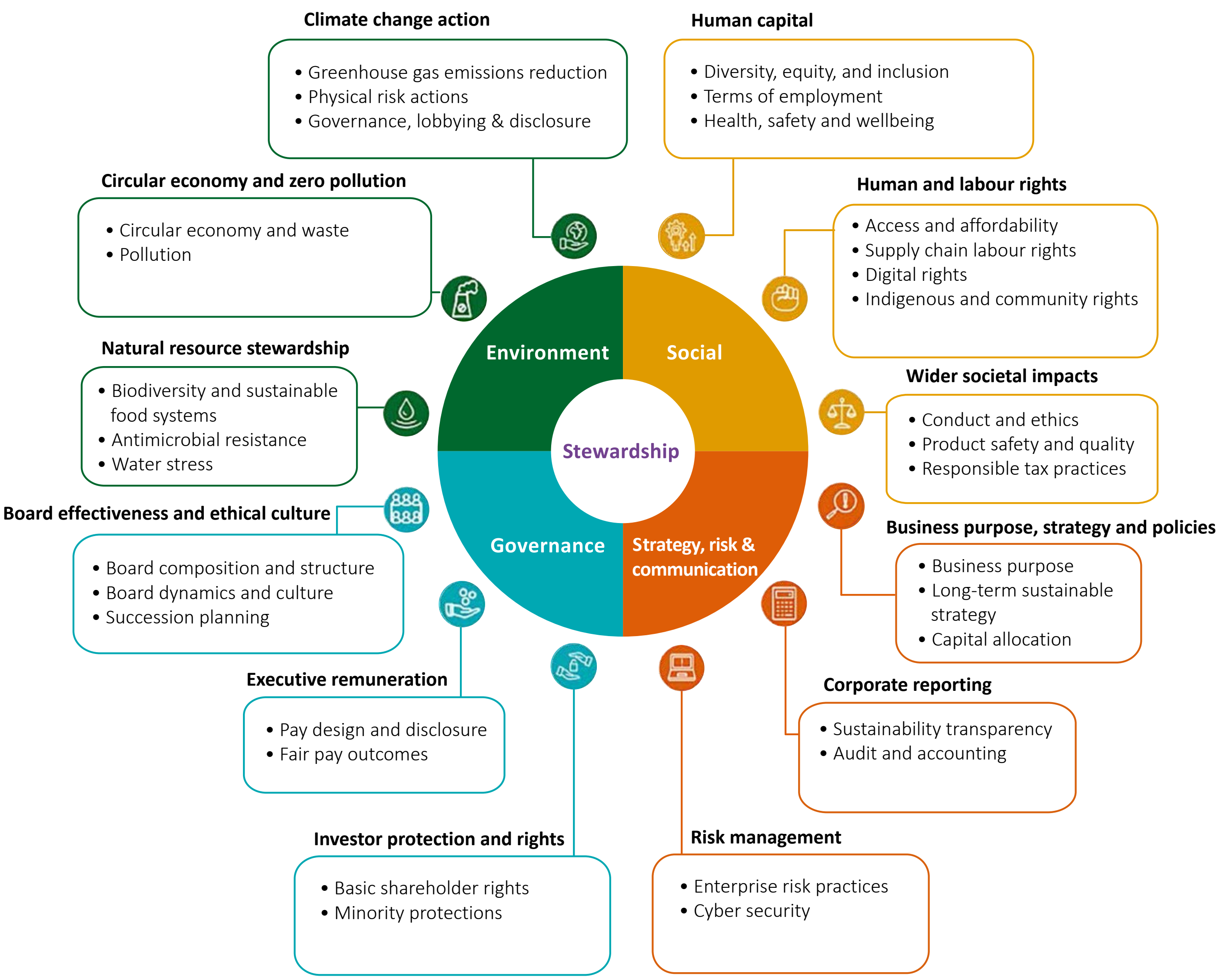
Direct engagement with companies and issuers	In situations where we have significant holdings or where companies have financially significant ESG issues, we'll look to engage directly with these companies to understand their approach. In Principle 12 we discuss how we vote our shareholdings, including how we engage with companies on proposals relevant to ESG issues that have been the subject of either direct or collaborative engagement.
Indirect engagement with companies and issuers through our investment managers	We encourage our external investment managers to engage with the companies and other entities in which they invest. As we discuss in Principle 7, we assess external managers' approaches to engagement and stewardship as part of the manager selection process. We then review each manager's approach on a quarterly basis alongside all other investment matters, and we also review the PRI transparency reports and Stewardship Reports of these external managers, where available. We regularly challenge our managers on their approach, to understand the goals and effectiveness of their engagement activities. We routinely ask our managers to sign up to the same efforts that we sign up to. This includes PRI (as required in PRI Principle 4), and Climate Action 100+.
Collaborative engagement with other investors	We recognise that there are limits to the influence that we can achieve as a single investor and the resources that we can reasonably commit. We therefore collaborate with other investors to raise awareness of and to encourage systemic change on a range of ESG issues. We provide more detail in Principle 10.
Indirect engagement with companies through an engagement service provider	We recognise that engagement can bring important benefits to our investment portfolio and the wider market. We also recognise that we, our investment managers, and the collaborations that we support, cannot cover every ESG issue at every company, with the detail and care that's needed to ensure that engagement is effective in driving improvements in company practice and performance. Working with EOS provides us with a breadth and depth of coverage that we couldn't achieve alone. In 2022, EOS engaged with 227 of the companies in which we are invested on 1,137 environmental, social, governance, strategy, risk and communication issues and objectives. We present some data and examples of the EOS engagement below, including the outcomes that have resulted from this engagement.

PRINCIPLE 9: ENGAGEMENT

WE HAVE AN AGREED ENGAGEMENT PLAN WITH EOS

Each year, we consult with EOS to develop an engagement plan that aligns our priority issues and supports the wider goal of driving higher standards of corporate behaviour. In 2022, we agreed that EOS would focus its 2023-2025 engagement on the 12 main priority themes set out in Principle 7 and illustrated below, with 37 related sub-themes. We agreed that we would support EOS's public policy engagement (explained later in this section), as we recognise that many ESG and sustainability issues require policy interventions.

ENGAGEMENT THEMES



Case study

EOS ENGAGEMENT REPORT
COLGATE-PALMOLIVE

Colgate-Palmolive is an American multinational consumer products company that specialises in the production, distribution and provision of household, health care, personal care and veterinary products. Due to its global presence, the company has tremendous opportunities and important sustainability challenges.

Objective

In 2019, as the lead engager for the CA100+ collaborative, we had a call to introduce the initiative to the vice president of global sustainability and the senior vice president of investor relations. We shared the initiative's goals, including strong climate change governance, action to limit global warming to well below 2°C and disclosure in line with the TCFD. Later in 2019, we encouraged the company to consider linking its 2025 sustainability targets to executive compensation to drive greater accountability.

> **"Colgate's climate strategy is externally aligned with the Science Based Targets initiative"**

Discussion

We continued to engage with the company through 2019-2022. This included sending a letter to the CEO and lead independent director calling on the company to take urgent action and disclose a net zero strategy. We followed up on this letter in a meeting with investor relations and the chief sustainability officer, encouraging them to report in-line with the recommendations of the TCFD. We submitted a statement at the company's 2021 annual meeting urging the board and senior management to engage in a proactive dialogue with EOS and CA100+.

In December 2021, during a group call, we again encouraged a TCFD-aligned reporting, and we were pleased to learn that the company was working towards publishing its first TCFD report in the first half of 2022 and was committed to formalising the link between its climate strategy and executive compensation.

Outcome

In April 2022, Colgate-Palmolive published its first TCFD aligned report which outlined the company's strategy for managing climate-related risks and opportunities. The report included climate-related scenario analysis to understand how climate change may impact the company's business and what actions can be taken to avoid climate risks (both physical and due to the transition) or to capture opportunities.

Colgate's climate strategy is externally aligned with the Science Based Targets initiative and addresses five key areas: supply chain engagement, Net Zero carbon operations, sustainable products and consumers, business resilience and society & nature. The board added performance measures to the 2022 annual incentive programme tied to Colgate's sustainability and diversity, equity and inclusion progress. We continue to engage on the company's strategy for reducing its supply chain emissions.

Emily DeMasi, EOS North American engagement lead

LOTHIAN PENSION FUND

Case study

BAILLIE GIFFORD ENGAGEMENT REPORT
CRH

CRH is an Irish domiciled building materials business with a large and growing exposure to North America. It is one of the largest contributors to the carbon footprint of our equity portfolio.

Objective

We aimed to encourage more detailed disclosure regarding the consideration of climate-related issues by the board and the company auditors. Specifically, we sought more detail on assumptions, including future costs and plausible policy interventions, accounting judgements, and scenario analyses for possible pathways.

Discussion

We took part in collaborative engagement coordinated through Climate Action 100+, an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take action on climate change. We spoke with the board chair, Richie Boucher, and the chair of the audit committee, Shaun Kelly. CRH has strengthened its decarbonisation targets, demonstrating leadership within the construction materials industry that we believe is potentially advantageous but has cost implications. The company commits to being net zero by 2050 and recently outlined new goals, which target an absolute reduction in scope 1 and 2 emissions* of 30 per cent by 2030 versus 2021 levels. These new targets have been validated by the Science Based Targets initiative to be in line with a 1.5-degree pathway.

The focus of our discussion was to encourage more specificity in the financial accounts and to discuss the potential impacts on CRH's business of meeting these long-term objectives. We also asked how the board examines climate risks and how it determines materiality in terms of the company's accounts. We explained that given the carbon-intensive nature of CRH's business, alongside its potential exposure to physical change, it would be helpful for investors to have insight into how the company was thinking about the value of the business and assets under various climate change scenarios. We stressed that more comprehensive disclosure in its annual accounts and auditors' report are important for shareholders to make informed investment decisions.

Outcome

The CRH 2022 annual report, published at the start of March 2023, demonstrates a significant improvement in the disclosure of how, when and by whom climate-related issues are considered in strategy discussions and against existing financial assessments. CRH has also now quantified the incremental spend required to meet its 2030 decarbonisation goals. We consider CRH a leader in terms of its engagement with decarbonisation and the recycling of building materials. We look forward to further discussions on quantitative transparency in 2023 – particularly concerning scenarios for different plausible climate outcomes.

** Scope 1 emissions: Measurement of direct GHG emissions from operations that are owned or controlled by a company. Scope 2 emissions: Measurement of indirect emissions of a company associated with the generation of purchased electricity, steam, heat and cooling.*

LOTHIAN PENSION FUND

Case study

LPF ENGAGEMENT REPORT RIGHTMOVE

Rightmove is a UK-based company which runs rightmove.co.uk, the UK's largest online real estate property portal. In May 2022, Peter Brooks-Johnson, its chief executive officer (CEO), announced his intention to leave the company in 2023. During his leadership, Rightmove cemented its dominant position in its market, and delivered strong returns to shareholders.

Rightmove has a history of internal promotions: Peter Brooks-Johnson joined Rightmove in 2006 and became its chief operating officer in 2013 before he was promoted to top role in 2017. Therefore, the announcement in October 2022 that his successor would be an external appointment drove us to initiate engagement.

Objective

As a long-term investor in Rightmove, we were keen to articulate our concerns around this being the first external appointment to the CEO role at Rightmove. We aimed to gain a better understanding of Rightmove's succession planning, executive recruitment processes and the remit given to the new CEO by the Board. Importantly, we were keen to ensure that at a senior level, the company was fully aware of our thoughts, concerns, and expectations in relation to this matter. Furthermore, we sought reassurance on the cultural fit of the incoming CEO, Johan Svanstrom.

Discussion

In Q4 2022, we met with the out-going CEO, Peter Brooks-Johnson. While the discussion was wide-ranging, the main focus was on his succession. We have been holders of Rightmove shares since late 2009, during which time there have been three CEOs – each of which has been an internal appointment. We articulated our nervousness around this being the first external appointment, elevated by the fact that the incoming CEO, Johan Svanstrom, was previously a partner at EQT (a private equity / venture capital firm). We discussed our preference for internal succession, as an internal successor, particularly one with longevity with the company, will typically have a far better understanding of the business model and feel for the culture of the organisation.

We continue to like the Rightmove business model and we think it works very effectively. Our concern is that when there's an externally appointed CEO, they often feel like they need to 'put their stamp' on the business and change things unnecessarily. The potential for a cultural mis-match due to Johan's private equity background gave us additional cause for concern. Following our discussion and given the importance of the situation, Peter facilitated a one-to-one call with the Chairman, Andrew Fisher, to discuss further.

"Rightmove greatly appreciates the dialogue with Stewart Piotrowicz and the LPF Team regarding our CEO succession. LPF have always been a proactive shareholder seeking to understand the rationale for any governance matters and consistently evidencing the highest levels of stewardship."

Andrew Fisher, Chairman, Rightmove

Outcome

Our call with Andrew Fisher was very helpful and gave us the opportunity to make our views very clear. Andrew discussed the background to the recruitment and the process itself. He provided his thoughts on Johan, with whom he has previously worked, which gave us some comfort on the cultural fit. Johan had only been with EQT for a few years and wanted to be more "operational", having previously worked at U.S.-based online travel shopping company Expedia Group. Andrew completely understood our perspective, and was very much in agreement with our sentiment. We concluded the meeting feeling that the Chairman's views were aligned with our own which is reassuring and gives us confidence in Rightmove's ability to deliver on the long growth runway ahead of them.

Johan Svanstrom joined Rightmove as an executive director on 20 February 2023, before assuming the CEO role in March when Peter Brooks-Johnson stepped down as planned. We continue to monitor closely as the situation develops.

Stewart Piotrowicz, LPF Portfolio Manager

PRINCIPLE 9: ENGAGEMENT

LPF ENGAGEMENT WITH MANAGERS

As mentioned in Principle 8, in 2022 we began engaging with our managers on steps that they could take to align their practices with our Responsible investment aims and objectives, in particular, our ambition to avoid funding companies whose business models aren’t aligned with the goals of the Paris agreement. This is a complex area and work is currently ongoing with all our external managers.

LOTHIAN PENSION FUND

PRINCIPLE 9: ENGAGEMENT

2022: AN OVERVIEW

An overview of the engagement EOS conducted on our behalf in 2022 is presented in Figure 1, with Figure 2 showing the geographic coverage of this engagement.

Figure 1.

In 2022, we engaged with 227 companies on 1,137 environmental, social, governance, strategy, risk and communication issues and objectives. Our holistic approach to engagement means that we typically engage with companies on more than one topic simultaneously.

We engaged with 227 companies over the last year.

- Environmental **31.0%**
- Social and Ethical **27.1%**
- Governance **30.5%**
- Strategy, Risk and Communication **11.4%**

Figure 2.

We engaged with 22 companies over the last year.

- Environmental **34.0%**
- Social and Ethical **17.0%**
- Governance **35.9%**
- Strategy, Risk & Comms **13.2%**

We engaged with 6 companies over the last year.

- Environmental **18.4%**
- Social and Ethical **34.2%**
- Governance **26.3%**
- Strategy, Risk & Comms **21.1%**

We engaged with 54 companies over the last year.

- Environmental **34.8%**
- Social and Ethical **24.5%**
- Governance **31.2%**
- Strategy, Risk & Comms **9.5 %**

We engaged with 101 companies over the last year.

- Environmental **30.1%**
- Social and Ethical **30.1%**
- Governance **27.8%**
- Strategy, Risk & Comms **11.9%**

We engaged with 42 companies over the last year.

- Environmental **28.9%**
- Social and Ethical **26.0%**
- Governance **35.3%**
- Strategy, Risk & Comms **9.8%**

We engaged with 2 companies over the last year.

- Environmental **33.3%**
- Governance **66.7%**

PRINCIPLE 9: ENGAGEMENT

EOS also provide data on the progress (or success) of the engagement conducted on our behalf. Its data, shown in the figure below, suggests that significant progress was made in 2022, with over 200 examples of companies moving forward by at least one milestone, where the milestones are defined as follows:

MILESTONE 1: Concern raised with the company at the appropriate level

MILESTONE 2: The company acknowledges the issue as a serious investor concern

MILESTONE 3: Development of a credible strategy/stretching targets set to address the concern

MILESTONE 4: Implementation of a strategy or measures to address the concern.

Milestone status of engagement

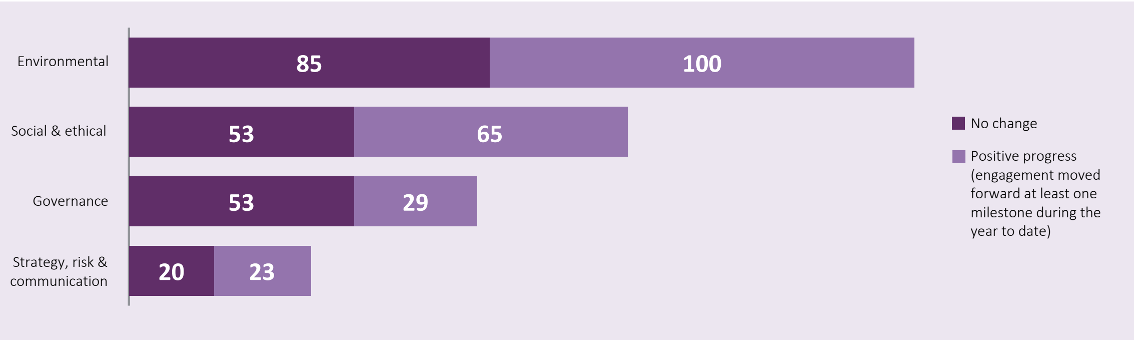
The table below shows the milestone status of our engagement objectives by theme.

Theme	Total Engagement Objectives*	Engagement objective stage (last milestone completed)			Closed engagement objectives	
		Milestone 1	Milestone 2	Milestone 3	Completed	Discontinued
Environment	185	36	69	40	31	9
Social and ethical	118	27	44	23	14	10
Governance	82	16	17	16	18	15
Strategy, risk and communication	43	5	11	11	11	5
Total engagements	**428**	**84**	**141**	**90**	**74**	**39**

includes objectives which were live in the period. Objectives are live when Milestone 1 has been completed.

The rationale for a discontinued engagement includes "company unresponsive", "company disagreed", "no longer relevant/material" and "restarted as new objective/issue.

At least one milestone was moved forward for about 51% of our objectives during the year. The following chart describes how much progress has been made in achieving the milestones set for each engagement.



LOTHIAN
PENSION FUND

PRINCIPLE 9: ENGAGEMENT

ENGAGEMENT WITH POLICYMAKERS

EOS engages with policymakers for a more sustainable financial system. This is achieved through engagements and meetings with government officials, financial regulators, stock exchanges, industry associations, and other key parties. It also participates in public consultations. In 2022 EOS undertook several public policy engagements, including multiple engagements focused on Methane Emissions and Biodiversity. As mentioned previously, LPF supports EOS's public policy engagement, as we recognise that many ESG and sustainability issues require policy interventions.

EOS participates in sign-on letters on ESG policy topics which it supports, typically as one of a few collaborative industry bodies and initiatives around the world, in which it is an active participant.

LPF also participated directly in advocating for a number of changes to public policy and market best practice by asking governments to commit to more ambitious climate targets and policies through signing the Investor Letter to Governments ahead of COP27 (see case study on Climate Change: Our Role In Real World Change in Principle 1) and through responding to consultations, such as the November 2022 Department of Levelling Up, Housing and Communities (DLUHC) consultation on Local Government Pension Scheme (England & Wales): Governance and Reporting of Climate Change Risks.

PRINCIPLE 10: COLLABORATION

Signatories, where necessary, participate in collaborative engagement to influence issuers.

LPF is committed to working collaboratively to increase the reach, efficiency and effectiveness of our Responsible Investment activities. We work with a host of like-minded partner funds, service providers and related organisations striving to attain best practice in the industry and to improve industry standards. A list of our collaborative partners and their roles is publicly available on our website.

We work with others towards common goals

There are limits to the influence that we can achieve as a single investor and the resources we can reasonably commit. We recognise that progress can be best achieved on ESG issues through collaboration with other investors and organisations and we take a very active role in several of the Responsible Investment initiatives below.

LOTHIAN
PENSION FUND

Collaboration in furtherance of the Principles for Responsible Investment (PRI)

PRI Principles for Responsible Investment

We've been a signatory of the UN-backed PRI since 2008 and align our practices and processes to their six principles and definition of Responsible Investment. Our SRIP formally acknowledges the role and integration of the PRI's six principles within our investment process. PRI's Principle 5 is relevant: “We will work together to enhance our effectiveness in implementing the Principles.” The collaborative activities below evidence our continuing commitment.

Climate Action 100+

CA100+ is an international collaborative initiative by institutional investors representing over $55 trillion in assets. Signatories to Climate Action 100+ engage with the boards and senior management of companies to take necessary action on climate change [See case study below for more details].

IIGCC is a network of over 400 European investors representing over $65 trillion in assets. We joined IIGCC in 2020 to further the work we do alongside other like-minded asset owners. The workstreams at IIGCC include: the Policy Programme; the Corporate Programme; the Investor Strategies Programme. We're assessing the organisation's investor guide on the 'Net-zero Investor Framework' and its suitability for implementation.

TPI is a global initiative led by asset owners and supported by asset managers. It assesses companies' preparation for the transition to a low-carbon economy, supporting efforts to address climate change. In our SRIP, we've committed to benchmarking holdings against TPI's assessment as a measure of financial risk.

GRESB is an investor-led, sustainability benchmarking provider for real assets, covering real estate and infrastructure assets. It's a key driver of transparency regarding energy consumption data, particularly for standing real estate. We support this collaborative initiative as an investor member.

We've been clients of EOS since 2008 and they manage most of our voting and engagement activity. Our Internal Equities team work closely with EOS in our collective approach to engagement, reflecting the areas of stakeholder interest and concern. Through working collaboratively with EOS, and alongside EOS's international client base, we're able to have a stronger voice when engaging with our investee companies. We provide more detail in our text on Principle 9.

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

We also work closely with other asset owners in several semi-formal working groups including:

UK Pension Fund RI Roundtable

The UK Pension Fund RI Roundtable is a longstanding collaborative endeavour, first convened by the Environment Agency Pension Fund, which brings together UK Asset Owners from the public and private sector, alongside charitable bodies and endowments, to work together to establish best practice in RI. LPF is an active participant.

Occupational Pensions Stewardship Council

The Occupational Pensions Stewardship Council was launched in July 2021. It's coordinated by DWP and ShareAction, and supported by the FRC and Department for Levelling Up, Housing and Communities (DLUHC). It aims to be a forum to share learning, identify areas of joint interest, signpost to relevant activities elsewhere, and, where no pre-existing activity has been identified, facilitate collaborative engagement. LPF is an active participant and a member of the engagement group, which acts as a steering committee.

asset owner diversity charter

DIVERSITY PROJECT

The Asset Owner Diversity Charter was formed with an objective to formalise a set of actions that asset owners can commit to in order to improve diversity, in all forms, across the investment industry. Signatories collaborate to build an investment industry which embodies a more balanced representation of diverse societies. It's now part 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.

And with charities:

FUTURE ASSET

Working with high school girls throughout Scotland to promote careers in investment management, Future Asset strives to open up the industry to poorly represented pools of talent. The investment industry has a well-known gender diversity problem, and LPF's investment professionals support Future Asset events acting as presenters and mentors for the girls, as well as providing work experience as a Future Asset partner.

GAIN Girls Are INvestors

Girls Are INvestors (GAIN) is, a charity set up by investment professionals to improve gender diversity in investment management by building a talent pipeline of entry-level female and non-binary candidates. In 2022 LPF joined their internship programme to offer a summer 2023 internship.

"Thank you for welcoming high school students to LPF for work experience. It is exactly the sort of opportunity that Future Asset is encouraging firms to offer and LPF have led the way in providing practical experiences and inspiring young women to believe they can work in investment management ."

Helen Bradley, Programme Manager, Future Asset

Case study

COLLABORATIVE ENGAGEMENT: CLIMATE ACTION 100+

Climate Action 100+ has notched up five years of collaborative engagements with the world's biggest greenhouse gas emitters and is now entering its second phase. Since December 2017 the collaborative engagement initiative has been striving to bring the world's biggest corporate emitters into line with international ambitions for a 1.5-degree world.

Signatories to CA100+ request the boards and senior management of companies to:

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

LPF committed internal engagement resource to CA100+ by becoming a participant member of CA100+ in 2020 and co-leading engagements with a focus company. In addition to direct engagement as part of CA100+, we encourage our external managers to support the initiative.

Our engagement provider, EOS is also a significant supporter of CA100+, leading or co-leading engagement at 24 of the CA100+ focus companies across Europe, North America, and Asia.

Progress of environmental objectives for selected CA100+ companies engaged by EOS, 2022

Company Name	EOS Sector	Participation
Mercedes-Benz Group	Automobiles	Lead
Volkswagen	Automobiles	Co-lead
Dow	Chemicals	Co-lead
Hon Hai Precision Industry	Industrials	Co-lead
POSCO Holdings	Mining & Metals	Co-lead
BP	Oil & Gas	Co-lead
Chevron	Oil & Gas	Co-lead
Kinder Morgan	Oil & Gas	Co-lead
PetroChina	Oil & Gas	Co-lead
Petroleos Mexicanos	Oil & Gas	Co-lead
TotalEnergies	Oil & Gas	Co-lead
Enbridge	Oil & Gas	Support
AP Moller – Maersk	Transportation	Co-lead
Stellantis	Transportation	Co-lead
Lockheed Martin	Transportation	Support

Source: EOS data

Case study

COLLABORATIVE ENGAGEMENT: CLIMATE ACTION 100+ (CONTINUED)

For example, EOS met repeatedly with BP management, including the CEO, to challenge the strategy put forward. EOS also made a statement at the AGM with other co-leads, supporting the company's efforts but also identifying areas where further progress is needed. At TotalEnergies, EOS determined that the climate strategy remained materially below CA100+'s sector-specific expectations and escalated by pre-declaring the intention to recommend a vote against the climate change progress report. At Chevron, as co-lead of the CA100+ engagement, EOS requested a report on the company's methane emissions. EOS successfully urged the board to support this resolution, and we supported EOS to file an exempt solicitation with the US Securities and Exchange Commission to publicly encourage investors to vote for the board's recommendation. The resolution ultimately passed with 98% support.

Outcomes
By participating actively in the CA100+ initiative, our officers and service providers have influenced real change, including an accelerated timetable for methane emissions reductions and a change to the corporate lobbying practices of companies with significant carbon emissions.

Assessment
We believe that such collaborative engagement actions have assisted the target companies in becoming better prepared for a net-zero world. Equally, we recognise that CA100+ focus companies still have significant work to do to align their businesses to achieve a net-zero world. It seems clear that government policies rather than investors' voting and engagement activities alone are needed to drive change.

In January 2023, CA100+ reflected on its progress to date, driven by engagement from its investor signatories:

- **75%** of focus companies have committed to achieve net zero emissions by 2050 or sooner across all or some of their emissions footprint. In addition, over a third of focus companies have set long-term targets that align with a 1.5°C pathway
- **92%** of focus companies have some level of board oversight of climate change
- **91%** of focus companies have aligned with TCFD recommendations either by supporting the TCFD principles or by employing climate-scenario planning.

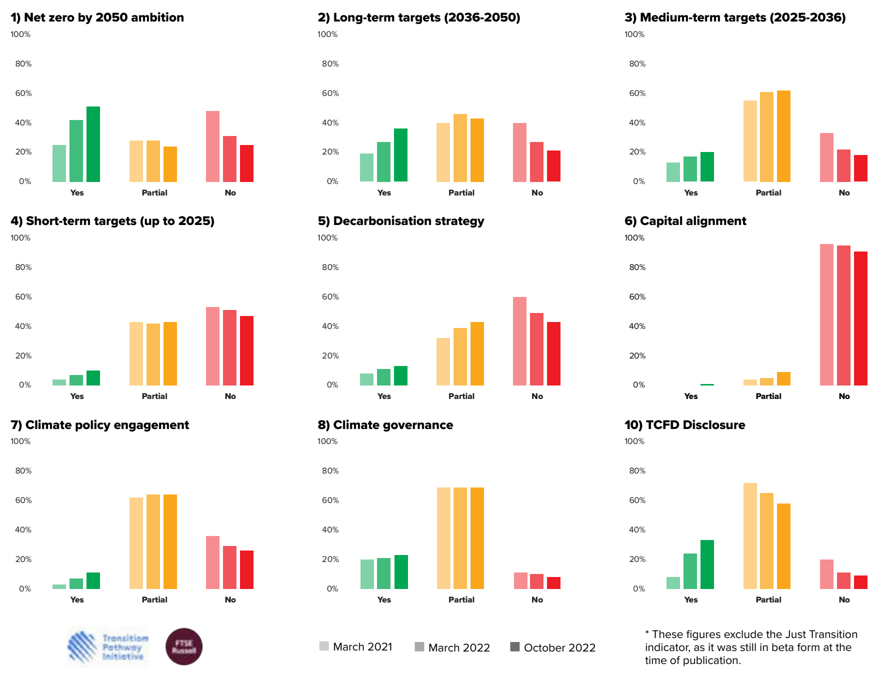
Case study

COLLABORATIVE ENGAGEMENT: CLIMATE ACTION 100+ (CONTINUED)

However, the encouraging uptake of net zero commitments isn't matched by the development and implementation of credible decarbonisation strategies. As a priority, investors need to see corporates outlining the practical actions on how they'll begin to meet their net zero commitments. Specifically, the assessments reveal:

- An absence of short and medium-term emissions reduction targets aligned with limiting warming to 1.5°C. Whilst 82% of focus companies have set medium-term targets, only 20% have established ambitious medium-term targets and only 10% have set short-term targets (up to 2025) that are aligned with a 1.5°C scenario and cover all material emissions
- Net zero targets are often not supported by strategies to deliver them
- Scope 3 emissions remain absent - Only half (51%) of focus companies have comprehensive commitments for net zero by 2050 or sooner that cover all material GHG emissions
- Alignment of capex strategies with net zero transition goals largely remain missing - Only 10% of companies have committed to fully align their capex plans with their emissions targets or the Paris Agreement.

Disclosure Framework results at a glance



Reference: https://www.climateaction100.org/progress/progress-update/

Case study

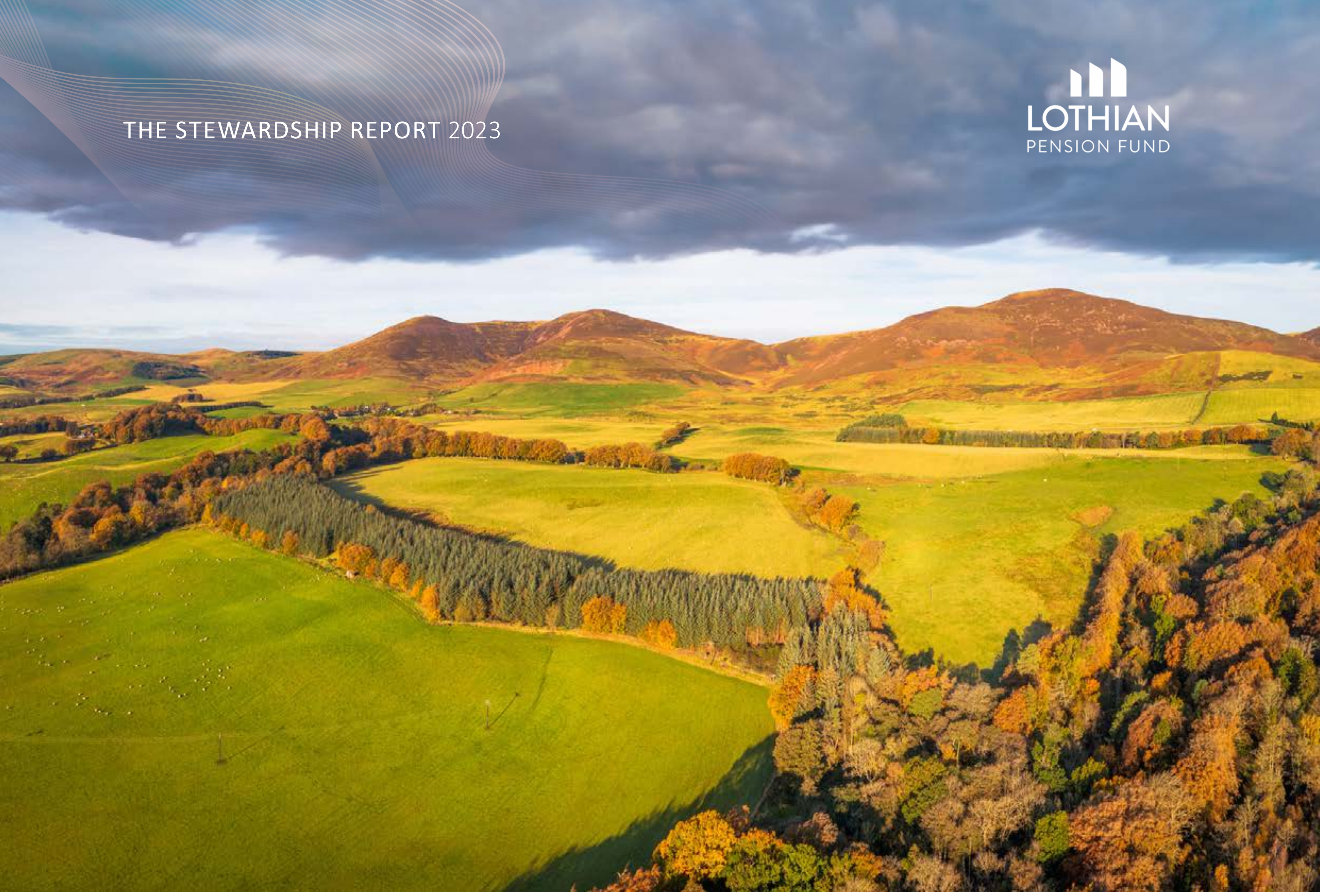
COLLABORATIVE ENGAGEMENT: CLIMATE ACTION 100+ (CONTINUED)

Looking ahead

CA100+ aims to move beyond disclosure during its second phase from 2023-30. It will be pushing for focus company action to develop and implement Paris-aligned transition plans backed by credible, sufficient investment.

It's introducing a significant upgrade to the benchmark to assess progress, with a greater focus on emissions reductions, alignment with 1.5°C pathways and net-zero transition planning, which will include a deeper assessment of capital allocation and asset-level changes.

The second phase will also introduce new measures to enhance collaborative participation from investors and encourage more transparent planning and escalation strategies across the co-leads for focus companies.



PRINCIPLE 11: ESCALATION

Signatories, where necessary, escalate stewardship activities to influence issuers.

We aim to engage proactively and constructively in public and private markets, with companies directly or via external managers. As we illustrate in this report, our stewardship activities include:

- Direct engagement with investee companies and issuers
- Collaborative engagement with companies, including with CA100+
- Abstaining or voting against management (including against specific directors and against the annual report and accounts)
- Using the media and other forums to challenge companies
- Using the insights from engagement to inform our investment research and decision-making.

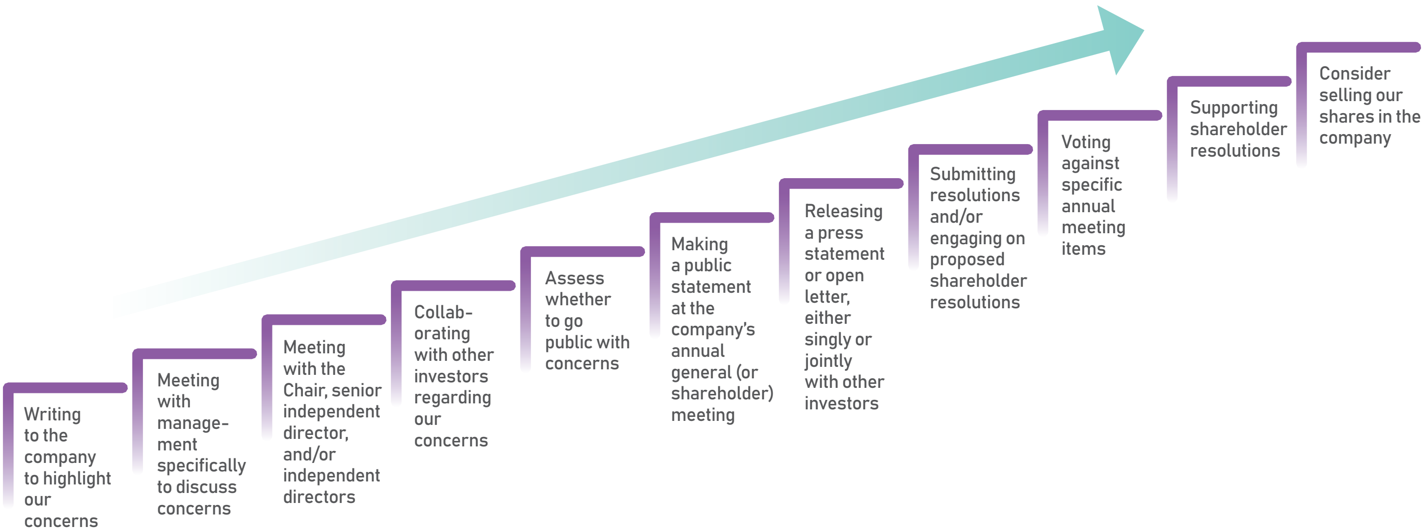
Given the range of assets in which we invest, we don't have a universal escalation policy. Instead, we tailor our approach to the investment type and the scale of the issues identified. We prefer to engage through dialogue for improvement, but we'll escalate our concerns if necessary improvements aren't forthcoming.

PRINCIPLE 11: ESCALATION

Escalating concerns with companies in which we invest

We expect companies to advise us when there are material changes and issues which impact long term shareholders. Our initial position is to support the board and management to improve their corporate strategy to the benefit of shareholders.

When appropriate and where we have concerns, we'll begin a dialogue (either directly or through EOS, our engagement and voting service provider, or other collaborative initiatives) and put forward proposals for the board's consideration. If our concerns aren't adequately addressed, we may consider a range of escalation options as part of an escalation process illustrated below:



As no two engagement escalations are the same, different steps may be taken at a different order for different cases. However, selling our shares isn't among the first steps. It's often the last step on the long escalation ladder, as engaging and addressing an issue in an undervalued firm, can create financial returns for long-term investors.

PRINCIPLE 11: ESCALATION

Escalating ESG concerns with external managers

We also set clear expectations of stewardship in our mandates with external investment managers. We challenge them if we feel that they're not delivering on the stewardship commitments they've made to us. If we're concerned about an investment manager's performance (which we'll capture in our monitoring reports), and if the investment manager has not improved following feedback from us, we've a range of escalation options available to us, as outlined in below.

Typical escalation options:

- Notifying the external manager about their placement on a watch list
- Engaging the external manager's board or investment committee
- Reducing our exposure to the external manager until any non-conformances have been rectified
- Terminating the contract with the external manager (or not reappointing them) if failings persist over a period of time.

Escalating concerns through our engagement and voting provider

As we discuss in Principles 9 and 12, EOS provides us with an engagement and voting service which involves engaging with the publicly listed companies in our portfolios and providing us with voting recommendations for these holdings. Generally, EOS' preference is to engage with companies. This is generally only escalated into voting against management in situations where engagement is proving to be ineffective. However, in 2021 EOS introduced a more proactive approach to use voting to target laggards on climate change and in 2022, EOS introduced another policy to consider voting against relevant directors where there are significant concerns about a company's actions relating to human rights. We strongly support this approach. We generally support EOS' voting recommendations, but we scrutinise all recommendations and do, infrequently, vote in a different way (e.g. if we think it's premature to escalate or if we think that it's time to escalate and EOS hasn't recommended it). In 2022 there were no occasions where we voted differently from EOS' recommendations (see Principle 12).

Escalating concerns in private markets

While the options available to us in terms of escalation of stewardship activities to influence issuers in closed ended investment funds (private equity, private debt, infrastructure and indirect property asset classes) are more limited, we do make it clear that concerns or a lack of transparency will feed into the assessment of subsequent investment opportunities presented by that manager.

Case study

ESCALATION WITH NATIONAL GRID

Background

National Grid plc is a multinational electricity and gas utility company with operations in the UK and the US. Its principal activities are operating electricity and natural gas networks as well as production and supply of electricity and gas. We consider National Grid to have a critical role in decarbonising UK electricity, while also recognising the risk that grid capacity issues and new connection delays could slow the deployment of clean energy.

Engagement

As part of our collaborative engagement efforts through CA100+, we co-lead engagement with Finnish utility Fortum and participated in the utilities working group, alongside like-minded investors who are the lead or co-lead engagers for other European utilities. These engagements aim to encourage and support corporate managers to identify and unlock potential barriers to their decarbonisation strategies.

Escalation

In Q4 2022, we supported an escalation of engagement with National Grid by co-signing a letter to the Chair, Paula Reynolds, calling on the company to enhance its commitment and collaborative efforts to accelerate the transition to a cleaner and more secure energy future. The letter appealed for urgent, ambitious and proactive action to be taken in regard to decarbonisation and requested specific responses to a number of climate policy questions.

In Q1 2023, the CA100+ co-lead engagers repeated requests for greater transparency from National Grid on its climate lobbying. Our voting and engagement service provider, EOS, also met with National Grid's head of sustainability and head of strategy to amplify the request for improved disclosure in this area. Companies need to have strong governance of their climate-related lobbying and to identify and act on any misalignment between their own goals and trade association lobbying to avoid this creating a barrier to legislative reform for an orderly low-carbon transition.

On 19 June 2023, ahead of National Grid's Annual General Meeting, one of the co-lead engagers publicly pre-declared its intention to vote against the re-election of both the Chair and the CEO due to the company's lack of climate lobbying disclosure, noting that National Grid was one of only two European utilities engaged by CA100+ to have failed to provide investors with this disclosure. CA100+ flagged this as part of its policy to flag shareholder proposals and other votes aligned with the goals of the initiative.

Outcome

On 30 June 2023, National Grid released an updated responsible lobbying policy and publicly committed to review its membership of all trade associations and their alignment with the company's climate change strategy, and to take action to resolve misalignment where necessary. This was welcomed by investors and those that had predeclared intentions to vote against the CEO and Chair due to this issue, reversed plans in recognition of this response.

Assessment and Next Steps

While our role in this escalation was fairly minor, by co-signing the letter we signaled our support for real-world action on decarbonisation. National Grid has committed to publishing the findings of its lobbying review by the end of its 23/24 financial year. We look forward to reading this and will continue to engage, either directly or indirectly (through EOS or through CA100+) to support the goal of transitioning the real economy to net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius by 2100.

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

Signatories actively exercise their rights and responsibilities

We believe that responsible investment involves exercising our rights and responsibilities as an active owner. We consider voting to be an integral part of our engagement with companies.

We aim to vote on all resolutions tabled at the General Meetings of our investee companies (listed equity) and also on all LPF consent matters within the funds we've invested in (across private market asset classes). We also hold our managers to account on how they exercise rights and responsibilities on our behalf, for example, how our debt managers exercise their responsibilities to integrate ESG in credit investment through the negotiation of ESG-linked ratchets into loan documentation.

In Principle 8 we explain how the practice of share-blocking in certain geographies (e.g. Norway) can impact our ability to fully exercise our rights and responsibilities in these markets due to potential liquidity constraints. However, following a review and streamlining of our internal process for approving votes in share-blocking markets, we did not miss any votes due to share-blocking in 2022.

In Principle 4 we provide examples of exercising our rights and responsibilities by engaging with policymakers and responding to industry consultations. In Principle 7 we provide a case study on ESG integration in direct property which includes exercising of our rights and responsibilities to meet increasingly stringent minimum energy efficiency standards as a commercial landlord.

Our Voting Policy for Listed Equity Investments

Voting, in combination with engagement, can reinforce the message we send to company management about how they’re running their businesses. While much focus tends to be on controversial votes and votes against management, we think it's equally important to signal our support for management in situations where management is doing a good job of navigating risks, challenges and complexities. As can be seen from our voting data below, we recognise that, in most cases, boards are managing these issues effectively and we continue to support them in their endeavours.

We subscribe to a specialist third party service (EOS) to provide engagement (see Principle 9) and to provide proxy voting recommendations to us which covers approximately 96% of our listed equity investments (the remainder of our equity assets are in funds where our external managers undertake voting in accordance with their voting policies, which we monitor quarterly). Through EOS we monitor what shares and voting rights we have and apply an ESG lens informed by active engagement over the top of proxy voting recommendations provided by Institutional Shareholder Services Inc. (ISS), a proxy voting service provider whose primary research and proxy voting infrastructure is utilised by EOS.

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

EOS' Global Voting Guidelines act as a policy to inform EOS' voting recommendations. EOS applies local market conventions in 20 markets around the world as a final overlay in the voting decision-making process, where EOS has developed region-specific principles due to different governance conventions across global market. These set out the fundamental expectations of companies, including on business strategy, communications, financial structure, governance and the management of social and environmental risks in each region. Generally, we follow EOS's voting policy and voting recommendations which are informed by their engagement with companies.

However, we reserve the right to override EOS voting recommendations. In recognition of the value of active engagement, EOS works with our internal and external fund managers to co-ordinate and execute voting instructions. We require EOS to provide our portfolio managers with notice of voting instructions and allow them to override any EOS recommendation.

Whenever there's a controversial vote (e.g. a recommendation to vote against management) or when there's an issue that we're concerned about (e.g. a governance risk identified through our own investment research and direct engagement activities), we'll communicate with EOS about the resolution, to understand the context and their reasons for the recommendation being made. In practice the number of voting recommendations that we override each year is minimal. In 2022 we didn't override any, but significant consideration is given to each issue (as explained in the case study in Principle 3). EOS voting alerts are reviewed by the equity team and escalated to our Responsible Investment Group (RIG) where necessary.

Case study

"SAY ON CLIMATE" VOTES

Background

The Say-on-Climate initiative works with companies to establish robust net zero transition plans with shareholder feedback in an annual advisory vote. Launched by hedge fund activist investor Chris Hohn through the Children's Investment Fund Foundation, major companies have agreed to put their climate plans to a vote.

2022 was the second year for formal shareholder votes on companies' responses to climate change, with an increase in the number of management-proposed Say-on-Climate proposals.

There were also several climate-related shareholder resolutions, including some filed by Follow This (a Dutch non-governmental organisation of activist shareholders), requesting that companies set comprehensive greenhouse gas emissions targets that are consistent with the goals of the Paris Agreement.

When exercising our equity voting rights, we're guided by EOS's proxy vote recommendations which consider both global best practice and regional governance requirements. EOS applies a rigorous case-by-case approach to assessment of transition plans and progress reports, only recommending support of plans that demonstrate robust targets and a clear and credible strategy to achieve the stated targets.

Voting activity and outcome

Examples of how we voted on climate plans or emission reduction targets are presented in the table with an explanation and assessment below.

	Management proposed "Say on Climate " vote	LPF Vote	Vote Result	Follow This Vote	LPF Vote	Vote Result
Mining companies						
Rio Tinto	Climate change report	For	84% support	n/a		
Glencore	Climate change progress	Against	76% support	n/a		
Energy companies						
TotalEnergies	Sustainability and climate change transition plan	Against	89% support	n/a		
BP	Climate change report	For	88% support	Yes	Against	15% support
Shell	Energy transition progress report	Against	80% support	Yes	For	20% support
Equinor	Energy transition plan	Against	98% support	Yes	For	4% support
Chevron	n/a			Yes	For	33% support
ConocoPhillips	n/a			Yes	For	39% support
Exxon Mobil	n/a			Yes	For	28% support

Case study

"SAY ON CLIMATE" VOTES *(CONTINUED)*

Assessment

Strong support from shareholders for management-proposed "Say-on-Climate" votes coupled with waning support (compared to 2021) for resolutions filed by climate activist groups such as Follow This, indicated a general pattern of investors being willing to support companies for incremental progress on climate plans in the context of increased concerns about energy security and affordability in 2022. Our voting record shows we continued to exercise our voting rights in alignment with our identification of climate change as a key systemic risk, while being willing to recognise leadership:

- We voted in favour of BP's climate change report due to the comprehensive nature of its targets and overall leadership in the sector: BP was the only oil major to have a long-term net-zero goal as well as short and medium-term targets across its own operating emissions and its Scope 3 emissions (produced when the energy products it sells are used). Furthermore, BP was projecting that by 2030, 50% of its capital expenditure will be in `transition growth' businesses, indicating a major shift in its business. We didn't support the Follow This shareholder resolution, as we assessed it as lacking additionality given the progress made at BP following a similar resolution which was passed in 2019.

- We voted in favour of Rio Tinto's climate change report in recognition of its significantly increased ambition and updated 2030 targets, including a commitment to reduce absolute Scope 1 and 2 emissions by 50%. The company has also developed targets relating to customer engagement to control its Scope 3 emissions (mainly related to emissions generated by its industrial customers of its iron ore and bauxite products to produce steel and aluminium). In contrast, we opposed Glencore's climate progress report, assessing its progress as insufficient given the company's ongoing exposure to coal, although also recognising that 80% of its capital expenditure is now focused on producing metals such as copper, cobalt, zinc and nickel which are needed for clean energy technologies.

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

We report on our voting activities, including the number of votes cast, the votes for and against management and controversial votes. We report this information alongside information on our engagement activities because we believe that the two activities work together, not as discrete, stand-alone activities.

Stock Lending

Our stock lending programme uses our existing asset base to generate an additional source of income. The programme is managed in accordance with our responsible investment policies. During 2020 we updated our policy for securities lending. We now automatically recall all securities on loan for voting purposes. This enables us to vote 100% of our holdings for our entire holding at 100% of the relevant meetings, which adds significant weight to the influence we exercise as shareholders.

Co-filing Activity

We're prepared to file or co-file shareholder resolutions on important issues at our investee companies. However, we weren't involved in filing any resolutions in 2022.

DATA AND STATISTICS: EOS ADVISED FUNDS

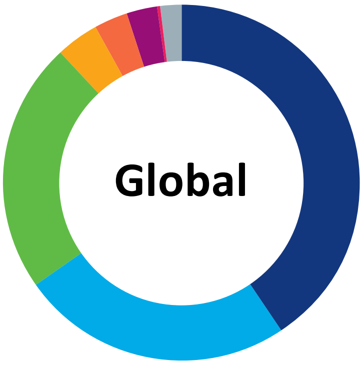
We publish information on our voting activities and its relationship to engagement on our website: www.lpf.org.uk.

We have reinstated full disclosure of our quarterly voting records on our website, which includes rationale for votes against management, abstentions and shareholder resolutions. While our stakeholders previously signalled that publication of company-level voting data was hard to consume (with details on specific companies lost amongst the scale of disclosure), we recognised growing interest in specific votes (such as "Say on Climate" votes) as well as the development of best practice voting disclosure guidelines in the UK.

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

99% of LPF's ballots were voted in 2022. This meant we voted on 8,002 resolutions at 522 meetings. The variation from our target of 100% was due to two unvoted meetings [as explained in Principle 8]: one required an administrative declaration and the failure to make this declaration caused the whole ballot to fail; the other related to a company with Russian connections, where our policy was not to vote. At 322 of those meetings, we opposed one or more resolutions. We abstained from voting on eleven resolutions due to concerns related to inappropriate membership of committees or potential conflicts of interests.

The issues on which we voted against management (in-line with EOS recommendations) are presented below.



We recommended voting against or abstaining on 890 resolutions over the last year.

- Board structure **40.8%**
- Remuneration **24.6%**
- Shareholder resolution **23.0%**
- Capital structure and dividends **3.9%**
- Amend articles **2.9%**
- Audit and accounts **2.7%**
- Poison pill/Anti-takeover device **0.3%**
- Other **1.9%**

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

Reflections on the 2022 voting season

Shareholder resolutions on social issues were in the spotlight during the 2022 voting season, as soaring inflation eroded the purchasing power of take-home pay globally, while paid sick leave and reproductive rights were important issues in the US. It was also the second year for formal shareholder votes on companies' responses to climate change, with a steep rise in management say-on-climate proposals. We also maintained our voting attention on two more traditional areas: board diversity, and executive remuneration. We offer some reflections on these topics below.

Board Diversity

We tightened our diversity and inclusion voting policies in 2022, encouraging greater representation of women and ethnic minorities on boards and in leadership teams. In the US we expect women and ethnic minorities to make up at least 40% of the board at the largest companies, with a minimum of 30% gender diversity. For example, we opposed proposals for insufficient gender and ethnic diversity at US electricity utility, NextEra.

We enforced our guidelines for ethnic diversity on UK boards and were pleased to see great progress by FTSE 100 companies in meeting minimum standards of representation. We continued to oppose chairs where this wasn't the case, for example at Glencore.

Executive Remuneration

We saw a resurgence in some executive pay packages in 2022. In Europe, we pushed for greater shareholdings for executives (to improve alignment of interests), and improved disclosure particularly where pay awards were substantial. For example, at pharmaceuticals giant, GSK, we were amongst the significant minority (38.2%) of shareholders who didn't support their executive remuneration policy which proposed increased bonuses of up to 3x annual salary (a substantial increase from the previous policy which capped bonuses at 2x).

In North America, we opposed the majority of say-on-pay proposals on the basis that practices across the region remained materially misaligned. For example, we opposed pay proposals at Caterpillar, Chevron, ExxonMobil, Meta, Mondelez International, Netflix, Visa and Walmart. This was mainly for excessive quantum, without adequate disclosure of the additional value created for long-term shareholders when paying the CEO significantly above the labour-market median. At Netflix, 73% of shareholders rejected the pay proposal, so we expect a robust response from the compensation committee in the coming year.

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

SHAREHOLDER ACTION

We describe our approach to shareholder action in relation to Principle 4: Promoting a well-functioning financial system. We consider participating in class actions to be another way that we exercise our responsibilities as asset owners. Taking action to recover assets lost through investments in companies as the result of corporate mismanagement or wrongdoing is an aspect of our duty to stakeholders.

Exercising Rights and Responsibilities in Private Markets

For our private market investments across private equity, private debt, infrastructure, forestry and property funds, we scrutinise corporate actions which require investor approval (such as fund term extensions) and vote in accordance with our fiduciary duty. We'll engage with our external managers to understand their rationale for such requests. Where we are able to obtain a position on the investors' advisory committee for a fund (e.g. through the size of our investment) we will secure additional rights and responsibilities (such as being consulted on proposed changes to the fund's investment guidelines, approving certain matters such as changes to key executives, scrutinising potential or actual conflicts of interest and the related mitigating actions). We aim to use our rights and responsibilities to improve the value of the assets in our portfolio, in line with our fiduciary duty

Exercising Rights and Responsibilities in Direct Property

For our direct property portfolio, we aim to improve the value of the assets in our portfolio in line with our fiduciary duty. This includes consideration of health and safety issues and other regulations to ensure we are a good landlord. As detailed in the case study in Principle 4, we took a proactive approach to meeting the 2023 Minimum Energy Efficiency Standards and we continue to improve the energy performance of our assets to ensure future compliance with proposed regulations.

GLOSSARY

CEC	City of Edinburgh Council - administering authority for LPF
COP	Climate Change Conference of Parties - 'the parties' refers to the 197 nations that agreed to a new environmental pact, the United Nations Framework Convention on Climate Change, at a meeting in 1992
DWP	Department of Work and Pensions
EOS	Federated Hermes EOS - engagement and voting provider for LPF
ESG	Environmental, Social and Governance
FRC	Financial Reporting Council - an independent regulator responsible for setting the UK's Corporate Governance and Stewardship Codes
GRESB	An investor-led, sustainability benchmarking provider for real assets, covering real estate and infrastructure assets
IIGCC	Institutional Investors Group on Climate Change - a leading global investor membership body and the largest one focusing specifically on climate change
ISS	Institutional Shareholder Services - a proxy voting service provider
JISP	Joint Investment Strategy Panel (of advisers to the Fund)
KPI	Key Performance Indicators
LGPS	Local Government Pension Scheme
LPF	Lothian Pension Fund
OPSC	Occupational Pension Stewardship Council - UK initiative to promote and facilitate high standards of stewardship of pension assets
PLSA	Pensions and Lifetime Savings Association
PRI	Principles for Responsible Investment - an international network of investors, supported by the United Nations, working to promote sustainable investment through the incorporation of ESG
SIP	Statement of Investment Principles
SRIP	Statement of Responsible Investment Principles

LOTHIAN
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Pensions Committee

2.00pm, Wednesday, 27 September 2023

Business Plan and Budget Update

Item number 6.8

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note progress of the Fund against the 2023-2024 Business Plan, together with specific updates on:

- performance indicators
- membership and cashflow monitoring; and.
- Capital injection into LPFI

Alan Sievewright
Chief Finance Officer, Lothian Pension Fund

Contact: Jason Koumides, Financial Controller, Lothian Pension Fund

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

Business Plan and Budget Update

2. Purpose

2.1 The purpose of this report is to provide an update on progress against the 2023-2024 Strategy and Business Plan, performance indicators and the actions to enable the Fund to meet its key objectives.

3. Executive Summary

3.1 The 2023-2024 Strategy and Business Plan centres around four broadly defined strategic goals, each with more detailed objectives and accompanying targets and measures to allow us to monitor our progress and identify where interventions may be required.

3.2 They are:

- 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.

3.3 The plan set out the work plans, budget and targets for 2023-24 and formed the base line against which performance would be and has been judged.

3.4 Matters to highlight in the main body of the report are:

3.4.1 All KPI's are on target at 30th June, with the exception of a number of administration categories that are being actively managed ***(discussed in 4.2).***

3.4.2 Annual benefit statements were delivered 1 month earlier than statutory deadline and prior year ***(4.21-4.23)***

3.4.3 Progress continues on process enhancements and provision of data for Actuarial Valuation and accreditations.

3.4.4 The quarter to June continued the trend in increasing the asset allocation to Real Assets from Cash ***(4.24-4.31)***

3.4.5 The Risk Management Framework continues to evolve and the LPFI ICARA was approved by the board on 4th September ***(4.34-4.39)***

3.4.6 The lease for the new office has been signed with an expected move date in Spring 2024 ***(4.43)***

3.4.7 Forecasted financial outturn to 31 March 2024 ***(section 5)*** shows a projected £2,125k saving against original budget. The two main contributors are savings from in-housing the investment management form Harris and the reduction in costs from the pausing of Project Forth.

3.4.8 Capital injection into LPFI made by the Fund to ensure on-going compliance with FCA capital requirements ***(5.9)***

4. Main Report

4.1 Progress of particular note made against LPF's Strategic and Functional plans year to date are detailed below.

Operations

Pension Administration performance indicators

4.2 Overall, Pension Administration are marginally below target year to date. A number of factors have contributed to this including -

- Workforce includes a large number of trainees. Trainees require daily support, time out to study towards exams and also require work to be checked by a senior administrator which can result in delays to workflows. Changes have been made to address these issues including the appointment of 2 new coaching roles (from existing headcount) to assist trainees with day to day queries, increasing capacity for checking and creating a dedicated training resource to upskill less experienced staff.
- Due to secondments and permanent leavers the Fund has lost some experienced colleagues from the operations teams. Active recruitment processes are underway to backfill these gaps. To adapt to these challenges improved workflows have been introduced with a case ownership model introduced, resulting in a single point of contact for customers and a more efficient use of our resources. Daily check ins by each team manager are helping to address any issues and to ensure work priorities are being met.

Accreditation

4.3 The Fund has held the Customer Service Excellence (CSE) standard for a number of years. To achieve CSE accreditation an independent assessment takes place against 5 sets of criteria and 57 separate elements. These are then assigned a rating – non-compliant, partial compliant, compliant or compliant plus.

4.4 LPF's on-site assessment took place in March 2023. The assessor evaluated evidence with regards to processes and service delivery, observing the interaction the Fund has with its members and employers. Not only did the Fund retain its fully compliant status but an additional 2 compliance plus levels were awarded bringing its total to 9 at the highest recognition level.

4.5 LPF has held the Pensions Administration Standards Association (PASA) accreditation since 2017. To achieve the award, an independent assessment against 10 sets of criteria and standards takes place. This year's assessment begins with the provision of supporting evidence in October followed by a site visit in November to validate this evidence. A final review with recommendations is expected by the end of the calendar year.

Customer Experience Team

4.6 Through a combination of group events and Customer Journey Mapping the Fund has been reviewing some of its key procedures, with particular focus on death and retirement processes.

4.7 As a result of reviewing the experience of bereaved members, improvements and efficiencies have been found within the death procedure, including the option to upload documents securely on our website which links directly to the pension system and the associated member's record.

Digital Enhancements

4.8 After a successful trial with Crown Agents Bank (CAB), a new digital process for overseas pensioners to complete their annual existence check was rolled out between October 2022 and March 2023. The new process allows members to complete the exercise from home using their laptop or mobile device by taking a live photo of themselves and their photo ID. **91%** of members completed the exercise with **88%** doing so using the digital process.

4.9 The Fund is now investigating the possibility of switching its overseas payment services to CAB. This could provide considerable benefit to our members including more favourable exchange rates on payments and greater self-service functionality through the CAB portal.

Actuarial Valuation

4.10 Work continues to progress on the triennial valuations for both Scottish Homes Pension Fund and Lothian Pension Fund, with positive feedback from the Actuary on the timeliness and quality of data received. Initial results have been received which indicate the overall funding position for both Funds has improved since the 2020 valuations.

4.11 The Fund will now review the results for individual employers and consider the impact of these on employer contribution rates for the next three years, the results of which will be shared with Committee in due course.

Review of Funding Strategy Statement and Employer Performance

4.12 Pensions Committee approved a revised Funding Strategy Statement (FSS) in June 2023. As required under the scheme regulations, a consultation exercise was carried out with Fund employers. No responses were received.

4.13 The revised FSS amended the salary strain recharging mechanism to provide that a review of each employer's funding position would be carried out in tandem with the annual salary strain exercise. The results of this review will then determine the level of salary strain recharged to the employer.

4.14 As this change has retrospective effect (from December 2022), fund officers have engaged the actuary to carry out a review at that date. When the results have been received, officers will review charges levied to employers for the 2022 exercise.

4.15 The Fund's employer services team continues to support employers by providing training and guidance on their roles and responsibilities under the regulations. Training has been delivered to five employers, with further training planned and positive feedback has been gained from employers on efforts introduced to simplify processes.

4.16 An example of this is the introduction of a simplified process for submitting information for members leaving the fund before retirement, previously advised to Committee in June 2023. This process reduces work for employers and as a result employer performance for submitting early leaver information has improved significantly.

McCloud

4.17 McCloud rectification comes into effect from 1 October 2024. We believe we are well placed to implement the requirements.

4.18 Employer data collection and cleansing continues to take place using the Altair Insights dashboard tool. Through data testing, records in the pensions system have been identified for corrections before revised McCloud calculations take place. The outputs of these quotations will allow the Fund to check records to ensure the underpin calculation is correct and get a better idea of the level of assistance required to correct errors and check underpins.

Pensions Dashboard

4.19 The UK Government's vision is that the Pensions Dashboard will enable individuals to assess their pensions information online, securely, and in one place to support better planning for retirement and growing financial well-being. Lothian Pension Fund, as a data provider will be compelled to supply data to the ecosystem once live.

4.20 The timeline for this has now been delayed and the government announced this date has been extended until 31 October 2026, a further year later than initially indicated. The parliamentary under-secretary of state for pensions stated "more time is needed to deliver this complex build and for the pensions industry to help facilitate the successful connection of a wide range of different IT systems to the dashboards digital architecture. We await further guidance and detail and continue to improve the quality of the data we hold for all our members.

Annual Benefit Statements

4.21 The Fund notified and published 100% of benefit statements to its active and deferred members by 31 July 2023. This was achieved a month earlier than the statutory deadline of 31 August and represents a significant time saving on last year's completion (24 August 2022).

4.22 Significant changes were made to how this exercise was distributed to members, making greater use of the pension systems functionality to send bulk emails instead of using an external product. This also had the added benefit of extra security as emails were generated within the system and not extracted and transferred.

4.23 Ahead of benefit statement production, an exercise took place to contact members who up until now had a requested a paper copy of their statement and gauge interest in moving to e-communications. This exercise was extremely successful with the number of paper statements dropping from 1,354 in 2022 to 502 in 2023. Newsletter printing was also kept in house using Royal Mail's Print and Post functionality creating a saving on print costs of over £2.5k.

Investments

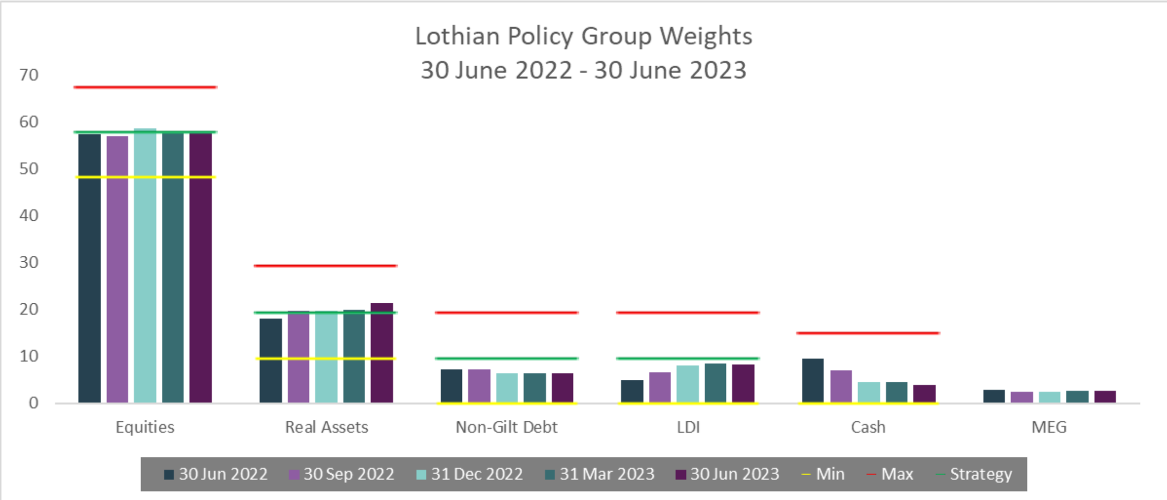
Asset Allocation

4.24 The assets under management by the Fund at 30 June 2023 are as follows –

31 March 2023 £'000	Lothian Pension Fund – Policy Groups	30 June 2023 £'000
5,595,028	Equities	5,476,284
1,922,199	Real Assets	2,037,823
605,179	Non Gilt Debt	599,634
807,288	LDI (Gilts)	793,926
262,748	MEG (Mature Employer Gilts)	243,236
448,097	Cash	364,898
9,640,539	**Total**	**9,515,801**

4.25 The LPF total fund return was -1.4% in Q2, broadly in line with the Fund benchmark of -1.5%. The slightly negative return was characterised by a largely flat return from both Equities and Real Assets, brought down by a double-digit negative return from Liability-driven investments (LDI) and a smaller negative return from Non-Gilt Debt assets. During the quarter, the Fund invested more into Real Assets (infrastructure) and LDI, sourced from reductions in Equities and Cash. Relative to the strategic asset allocation, the Fund (as at 30.6.23) was underweight Equities, Non-Gilt Debt and LDI, and overweight Real Assets and Cash.

4.26 The green lines in the bar chart below represents the strategic target for each policy group and the yellow and red lines show the ranges within which officers are permitted to operate. The bars show the trends in weightings to the five policy groups and MEG over the last few quarters to end June 2023. ***All policy groups remain comfortably within the agreed ranges***. (The allocation to MEG is held to fund more mature employer liabilities.) In the event that the policy group weights move outwith those ranges, officers are required to report this to the Pensions Committee and agree what action to take.



Activity

4.27 The main changes to asset allocation over the last several quarters have been the increase in the weight to Real Assets and LDI (index-linked gilts) and the reduction in Cash. Further commitments to Real Assets, all of which have been infrastructure investments, and LDI have been made post the end of the quarter.

4.28 Index-linked gilt prices have weakened, and real yields once again approached or breached the levels of autumn last year. Bond price weakness has not been a purely UK phenomenon as the chart below highlights. It displays the US 30-year bond yield (black line) rising from 1.2% to 4.2% over the last 3 years as the US inflation rate (yellow line) spiked to levels not experienced since the early 1980s.

Source: Bloomberg

4.29 The inverse of yields rising is prices falling and the following chart shows the price of the 2055 index-linked gilt. It was issued in 2005 and traded in a band of 102 to 140 for the next 5 years. As quantitative easing (QE) became established and yields fell, the price peaked at over 300. It now trades near 100, and the Fund has increased its weight and reduced its long-standing underweight position.

Source: Bloomberg

4.30 The consequence of rising interest rates is pressure on financial asset valuations in general as future cash flows are discounted at a higher rate. With central banks still in monetary tightening mode to tame inflation, there is a headwind to asset prices.

4.31 This has created opportunities in infrastructure, and the Fund has added investments during 2023, mainly in the social, renewables and transport sectors. The source of funds for these investments has been a reduction in the weight in Cash and in Equities. The exuberance around artificial intelligence (AI) seems to ignore the impact that rising interest rates should have on high growth equity valuations.

Investment Strategy Review

4.32 Investment strategy is inextricably entwined with the actuarial assessment of the Fund, so in this actuarial valuation year, the officers and advisers have started work to review the existing strategy.

4.33 The Fund's investment consultant will share the results of its initial investment modelling exercise with the Pensions Committee in September. This provides a framework for setting investment strategy and will incorporate the experience of the last 3 years, and future expectations for asset and liability values, including consideration of major risks, such as climate change risks. The Committee should be in a position to reaffirm or alter the existing strategy and benchmarks (which were discussed earlier in the year) in late 2023 / early 2024.

Governance, Legal, Risk & Compliance

Risk Management Framework

4.34 The plan to improve and embed the risk management framework is progressing well with some key components developed to help operationalise the framework across the business. This includes the development of standard risk language, simplification of risk evaluation methodology, a comprehensive review and refresh of the risk register, introduction of operational functional risk profiles, and improved reporting.

LPFI Internal Capital and Risk Assessment (ICARA)

4.35 The ICARA process is being enhanced with increased collaboration between the Risk & Compliance and Finance teams and improved integration with the risk management framework. In addition, business stakeholders have been more actively engaged in the process to ensure more thorough evaluation of plausible scenarios and informed variables has been reflected in the internal assessment of capital. As colleagues continue to evolve the process, further enhancements are expected.

Data Protection, Information Governance and Procurement

4.36 The Information Governance framework is being improved with the development and embedding of refreshed policies and procedures. The Risk Management Group's terms of reference have been refreshed, and now include a standing item on Information Governance metrics. This will allow effective oversight of compliance with key obligations such as: data breaches, subject access requests, data protection assessments, and freedom of information requests.

4.37 The Information Governance framework is being improved with the development and embedding of refreshed policies and procedures. The Risk Management Group's terms of reference have been refreshed, and now include a standing item on Information Governance metrics. This will allow effective oversight of compliance with key obligations such as: data breaches, subject access requests, data protection assessments, and freedom of information requests.

4.38 The roll out of a new board portal for Pensions Committee, Pensions Board and LPFE/I board meetings has been completed. This will enable meeting papers to be efficiently and securely distributed and meeting attendees to easily access and annotate them before and during meetings.

4.39 Incident reporting processes have been improved, with LPF-wide training sessions carried out, to ensure that all colleagues remain aware of the importance of protecting our members data, where data risks may arise, and can identify and manage potential issues.

Finance

Finance General Ledger System

4.40 Good progress is being made in the financial systems project. The project will lead to a new single financial system and enable enhanced functionality and processes. Currently Oracle (provided by CEC) is used to record LPF's financial transaction and Xero is used for LPFE/I. As a result of a competitive tender process the Fund awarded a contract to Xledger (subject to an independent assurance review) to provide a finance system for LPF and its 2 companies LPFE and LPFI.

4.41 A 2-stage process for implementation was agreed, with the onboarding of LPFE/I took place in September and LPF to be onboarded at a later date, to be agreed with CEC (expected to be H1 2024). Substantial training and testing has already taken place on the system and the lower volumes of transaction in LPFE/I will allow staff to get used to the system, while LPF and CEC agree timescales and resources for the transition of LPF data.

Projects

Project Forth

4.42 An update on Project Forth is covered in a separate paper. For 2023/24 financial projection it has been assumed that Forth will remain on hold and associated costs/income have been removed.

Office Relocation

4.43 The lease has been signed for the new premises, landlord fit-out work is on-going as is expected to be completed in October, with an expected move date in Spring 2024. Final costings/timing associated with the move are being collated and will be communicated to the Committee in due course.

5. Financial impact

5.1 A summary of the projected and year-to-date financial outturn compared to the approved budget for 2023/24 is shown in the table below:

Category	Budget	Projected Outturn	Projected Variance	Budget to date	Actual to date	Variance to date
	£'000	£'000	£'000	£'000	£'000	£'000
Employees	8,344	8,170	(174)	2,086	1,751	(335)
Transport & Premises	577	577	-	144	97	(47)
Supplies & Services	2,768	2,478	(290)	692	567	(125)
Investment Managers Fees -Invoiced	3,850	2,800	(1,050)	962	819	(143)
Other Third-Party Payments	2,583	1,351	(1,232)	646	215	(431)
Central Support Costs	732	732	-	183	228	45
Depreciation	227	227	-	56	46	(10)
Gross Expenditure	**19,081**	**16,335**	**(2,746)**	**4,769**	**3,723**	**(1,046)**
Income	(2,621)	(2,210)	621	(655)	(537)	118
Total Cost to the Funds	**16,460**	**14,335**	**(2,125)**	**4,114**	**3,186**	**(928)**

5.2 The financial outturn includes year to date budget, actual expenditure and variance as at the end of June 2023. Year to date actual expenditure includes provision for services incurred but for which no invoice has yet been received.

5.3 The projection shows an underspend of approximately £2,125k. The key variances against budget are:

- Investment Managers Fees - Invoiced - £1,050k underspend. In July the Fund terminated the externally managed mandate of Harris bringing the resulting funds into inhouse management. The CIO will review the impact of this on internal resources/staffing headcount which will be quantified in forecasting when known.

- Other Third-Party Payments - £1,232k underspend. Due to the pausing of Project Forth all related costs have been removed from the forecasted outturn for the year. This accounts for a majority of the underspend.
- Income – £621k below budget. As with Other Third-Party Payments below budgeted income is expected due to the pause on Project Forth. Additional costs associated with the project were expected to be shared and recharged back to Falkirk. This income has been removed from projections.
- Supplies & Services – £290k underspend. Miscellaneous underspends expected for system, legal, and other costs.
- Employees – £174k underspend. Expected to be broadly in line with budget. At 30 June ongoing recruitment process underway for members in Operations team, as well as for a Senior Investment Risk and Compliance Officer (joined August 2023) and replacement Chief Investment Officer (expected start date November 2023).

5.4 Variance to date shows an underspend of £928k. A majority of this relates to Project Forth as per Other Third Party Payment commentary above. The year-to-date underspend on Employee costs is due to ongoing recruitment exercises and variable pay arrangements payable in March.

5.5 As noted in 4.43, the Fund is in the process of finalising the costings for the new premise. The current projections costs are in line with the budgeted assumptions. When finalised these, assumptions will be revised accordingly.

Membership and Cashflow monitoring

5.6 A high level summary of the cashflows from dealing with members as at the end of July 2023 and projections for the rest of year are shown below. These have been prepared on a cashflow basis (compared to the accruals basis of the year-end financial statements and budget projections) with prior year figures for comparison.

2022/23 Actual £'000		2023/24 YTD £'000	2023/24 Projected £'000
265,122	Contributions Received	88,014	280,000
(282,713)	Benefits Paid	(101,099)	(312,000)
(17,591)	**Net Additions/(Deductions) From Dealings with Members**	**(13,085)**	**(32,000)**

5.7 2023/24 projected cashflow is broadly inline with expectations. With Lothian Pension Funds' maturing membership profile, pensioner payments are expected to increase over the period as pensioner numbers grow. This coupled with the pensions increase award in April of 10.1% an increase in expenditure compared to the prior year was expected.

5.8 While for the foreseeable future Lothian Pension Fund expects to have a negative cash flow position, whereby pension payments exceed total contributions received, current levels of investment income provide multiple cover for negative net pensions cash flow. Therefore, no asset sales will be required for the foreseeable future to fund on going pensioner payments.

LPFI capitalisation

5.9 The LPFI Internal Capital Adequacy and Risk Assessment (ICARA) concluded that, compared to previous years, LPFI needs to hold more capital as a result of the increased AuM and to allow for an appropriate buffer to ensure on-going compliance with the FCA prudential capital requirements. The LPFI board approved the allotment of 1m shares at the board meeting in September. LPF will be required to finance the additional £1m of share capital for LPFI taking the total share capital to £1,690k.

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.

7. Background reading/external references

7.1 LPF Strategy and Business Plan 2023/24

7.2 LPF Investment Strategy

8. Appendices

Appendix 1 – Business Plan Performance Indicators

Appendix 1

LOTHIAN PENSION FUND

Business Plan Performance Indicators

Pensions Committee

27 September 2023

Key Performance Metrics – Targets & Actual Performance 2023/24

	Q1 April to June	Q2 July to Sept	Q3 Oct to Dec	Target	Status
Customer Satisfaction, as measured by employers and members through survey results > 90% (12 month rolling)	93.9% (Year to date 93.9%)			90%	
>92% of critical pensions administration work completed within standards	87.92% (Year to date 87.92%)			92%	
Data Quality, as defined by the Pensions Regulator achieve “common” and “conditional” data scores in excess of 95% and 95% respectively. The data is assessed as at 31 August 2022 (members’ Annual Benefit Statements)				Pass	
The Fund operates within the approved budget	Within (Year to date Within			Within	
The audit of the Annual Report is unqualified				Unqualified	
Rolling 10-year fund return is >+5% pa unless the benchmark is <+5%pa, in which case, the relative return is positive	Pass (Year to date Pass)			Pass	
Publish ENGAGE, Revised SIP and SRIP	Pass (Year to date Pass)			Pass	
Mandatory LMS training completion rate >90%	100% (Year to date 100%)			90%	
The Employee Engagement index KPI of 70% or above	79% (Year to date 79%)			70%	
Less than 10% unplanned employee turnover	9.18% (Year to date 9.18%)			10%	

Service Performance Indicators – Targets & Actual Performance 2023/24

	Q1 April to June	Q2 July to Sept	Q3 Oct to Dec	Target	Status
Monthly Pension Payroll paid on time (Service1)	100% (Year to date 100%)			100%	✅
Acknowledge the death of a member to next of kin within 5 working days. (Service2)	98.01% (Year to date 97.1%)			96%	✅
Percentage of employer contributions paid within 19 days of month end (Service3)	99.9% (Year to date 99.9%)			99%	✅
Estimate requested by employer of retirement benefits within 10 working days. (Service4)	100% (Year to date 100%)			91%	✅
Notification of dependant benefits within 5 working days of receiving all necessary paperwork. (Service5)	95.6% (Year to date 96.6%)			96%	✅
Notify early leavers entitled to deferred benefits of their rights and options within 10 days of being informed of end of pensionable service. (Service6)	97.7% (Year to date 97.1%)			91%	✅
Notify members holding more than 3 months, but less than 2 year service, of their options at leaving. Target is within 10 days of the end of the one month and a day lying period or after the employer providing full leaving information if later.(Service7)	97.4% (Year to date 96.3%)			85%	✅
Pay a refund of contributions within 7 working days of receiving the completed declaration and bank detail form. (Service8)	97.0% (Year to date 98.3%)			91%	✅
Pay any lump sum death grant within 7 working days of receipt of the appropriate documentation. (Service9)	100% (Year to date 100%)			96%	✅
Pay lump sum retirement grant within 7 working days of receiving all the information we need from the member. (Service10)	98.2% (Year to date 98.4%)			96%	✅
Payment of CETV within 20 working days of receiving all completed transfer out forms. (Service11)	94.4% (Year to date 97.2%)			96%	✅
Pension Admin Workflow - Non Key Procedures Performance. (Service12)	75.4% (Year to date 77.0%)			75%	✅

	Q1 April to June	Q2 July to Sept	Q3 Oct to Dec	Target	Status
Proportion Of Members Receiving A Benefit Statement By 31st August (Service13)		100%		100%	✓
Provide a maximum of one guaranteed Cash Equivalent Transfer Value (CETV) within 10 working days of receiving a request. (Service14)	99.6% (Year to date 99.8%)			91%	✓
Provide new members with scheme information within 20 working days of getting details from employer (Service15)	99.7% (Year to date 97.6%)			96%	✓
Provide transfer-in quote within 10 working days of receiving the Cash Equivalent Transfer Value (CETV) from member's previous pension provider. (Service16)	100% (Year to date 97.4%)			96%	✓
Respond In Writing Within 20 Working Days To Formal Complaints That Have Escalated From Frontline Resolution, Or Recorded Directly As An Investigation (Service17)	100% (Year to date 100%)			100%	✓
Level of sickness absence (Service18)	2.1% (Year to date 2.6%)			4%	✓
A minimum of twenty hours training for all staff for the year (Service19)	80% (Year to date 72%)			100%	△

Pensions Committee

2.00pm, Wednesday, 27 September 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 Update;

1.2 note a review of the existing group risk register has been undertaken and a revised risk register created;

1.3 note the ongoing strategy and development around the group's risk management framework; and

1.4 note the increase in capital request to LPFI board to meet FCA regulatory capital requirements

Kerry Thirkell
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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 continuing to progress. A comprehensive review of the LPF group risk register has been undertaken, which has resulted in a clearer articulation and evaluation of current risks which the group is exposed to and how these are being managed. This re-alignment has been managed in a methodical and transparent way to ensure a proper audit trail of the changes is recorded. A summary of LPF key risks is noted in appendix 1, whilst the updated risk register summary is available in appendix 2 to this report. The register will continue to be reviewed and overseen by the LPF Risk Management Group (RMG), and is now also complimented by awareness and consideration of emerging risks.

3.2 Introduction of the revised risk assessment methodology as well as a full review and validation of the risks and controls themselves has led to some changes in risk ratings which are noted in appendix 1 and 2.

3.3 Following the review and simplification of LPF risk evaluation methodology, and development of common risk language, operational risk profiles have been developed for the Risk & Compliance (R&C), Legal and Governance teams. The programme to complete these for other business areas is expected to run until at least the end of 2023.

3.4 The purpose of the RMG has been reviewed and a revised terms of reference and membership has been implemented. The objectives of the RMG are more clearly and comprehensively articulated and the membership has been refined to support risk ownership and improve operational efficiencies with the meeting. In addition, review and oversight of several frameworks has been formally brought within scope of the RMG to ensure proper governance around these frameworks and arrangements.

Key Risks

3.5 As noted above, both the risk register and the RMG have been reviewed and updated. The RMG operating under its updated terms of reference met on 1 August 2023 and considered the revised LPF group risk register and the key risks to which the LPF group are exposed.

3.6 The full review of the LPF risk register using the revised methodology has determined some changes in risk ratings shown in appendix 1 and 2. There are currently 2 high rated risks: Regulatory breach; and Supplier performance and oversight. Both risks are considered to be high at present due to observations made through the course of assurance work - the Investment Services Review and the Internal Audit on Third Party Supplier Management. LPF management are satisfied that the action plans established to address the noted weaknesses in both reviews will mitigate these risks, and which are expected to reduce shortly as actions are completed. At the time of writing, significant progress has been made on the Investment Governance Improvement Plan workstream on JISP and Governance, and individual actions have been completed in relation to the Internal Audit review.

3.7 Emerging risks are now also formally captured and the RMG will also actively review these, and consider the actions the LPF group need to implement or plan for depending on the timeline and certainty currently known regarding the risk.

3.8 Emerging risks:

3.8.1 Risk: Some employers may choose to crystalise their surplus to release capital for other projects and spending commitments and exit or cease contributions to the fund.
Action: A working group has been set up to consider the implications and issues on the fund and remaining employers should an employer or employers choose this strategy in the current economic environment.

3.8.2 Risk: Structural review of the LGPS in Scotland might have implications on pension provision. This could include potential consolidation of multi-fund LGPS employers where there is a case for rationalisation.
Action: LPF's membership of the Scheme Advisory Board ('SAB') helps ensure we can actively contribute to the role of this group in relation to advising on scheme design, other policy issues or regulation, and effective and efficient scheme administration and management. LPF also continues to follow the progress with LGPS pooling arrangements in England and Wales and the current consultation to introduce further changes and expand and accelerate pooling.

3.8.3 Risk: Creation of National Care Service may include a dedicated pension fund and consequently reduce member and employer numbers and efficiencies

gained from multi employer membership.
Action: After months of uncertainty, in July the Scottish Government ruled out transferring local authority care staff into new care boards and has agreed those employees will continue to be employed by councils. For LPF the status quo remains with no action currently required.

4. Monitoring & Assurance Summary

Compliance Monitoring Programmes (CMPs)

All testing for Q2 2023 has been completed.

4.1 Non-FCA Compliance Monitoring Programme – Findings & Recommendations

4.1.1 Although no new issues were raised, poor or incomplete record keeping regarding pension errors was again noted in relation to one test. This finding has been linked to an already identified issue.

4.1.2 The Information Governance internal audit recommended introducing further compliance monitoring on key information governance policies and procedures. This will be considered as part of the Q4 LPF CMP, and additional tests may be introduced.

BDO LPFI Compliance Monitoring Programme - Findings & Recommendations

4.1.3 Two new issues were recorded following completion of testing by BDO, and both have since been actioned and closed:

- Communication and availability of Business Continuity Plans (BCP) to employees
- Client due diligence record keeping

Spot Check

4.2 Following several data and Freedom of Information (FOI) incidents reported by the media, the R&C team undertook a spot check on the processes and controls during Q2. This check concluded that:

- controls relating to data handling are adequate and protect data by design. Notwithstanding, the risk of human error is the most likely cause of an incident occurring and regular training and awareness activities should continue to support this.

- the process around handling FOIs is inconsistent and controls should be enhanced regarding clear documentation of the process to follow and a consistent central approval process introduced. The current incident reported in the media regarding the Police Service of Northern Ireland highlights some very severe consequences of inadequate processes and controls in this area.

- a by-product of the spot check also highlighted the need to review LPF's cyber security insurance coverage to ascertain in what scenarios our current insurance would cover. This is currently being followed up.

Internal Audit

4.3 The CEC Internal Audit programme of reviews to be undertaken in 2023/24 commenced in July with the audit on People processes. This review has now completed with a green *substantial assurance* rating. The remaining audits in the plan are expected to begin during August and September.

Training

4.4 A R&C bulletin was issued to all staff in June covering incident management, data and conflicts of interest, as well as a follow up on the general risk management training delivered to all the teams during May. More detailed incident management training was delivered by the R&C team to all staff in July. Engagement from colleagues across the business was very encouraging and the R&C induction programme for new starts has been enhanced to cover this in more detail.

Issues & Incidents

4.5 Improvements continue to be made to the processes, governance and reporting regarding LPF Issues and incidents. In Q2, two further enhancements have been introduced: setting a limit of three times an issue can have a due date extended; and rating each issue as low, medium, or high, defined as follows:

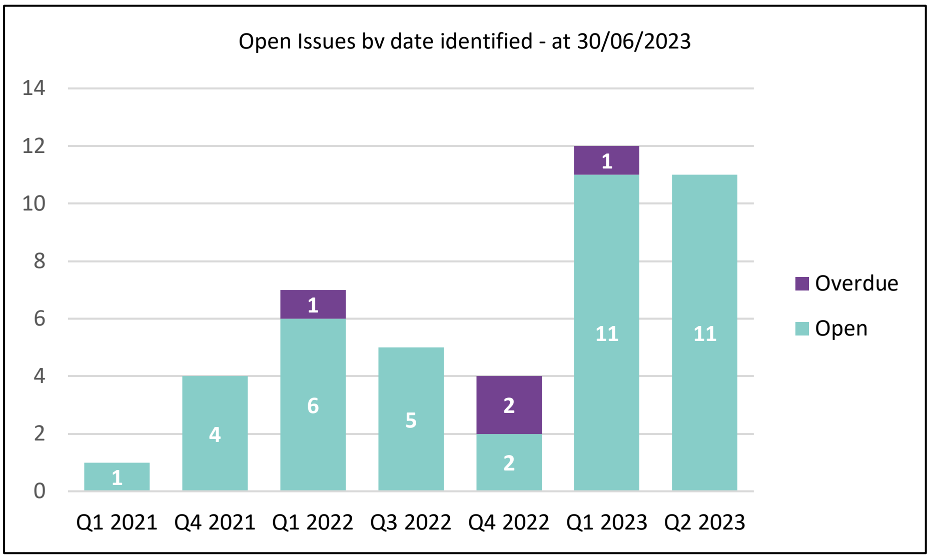
4.5.1 Low: Low Priority, actions will improve efficiency or effectiveness of existing controls.

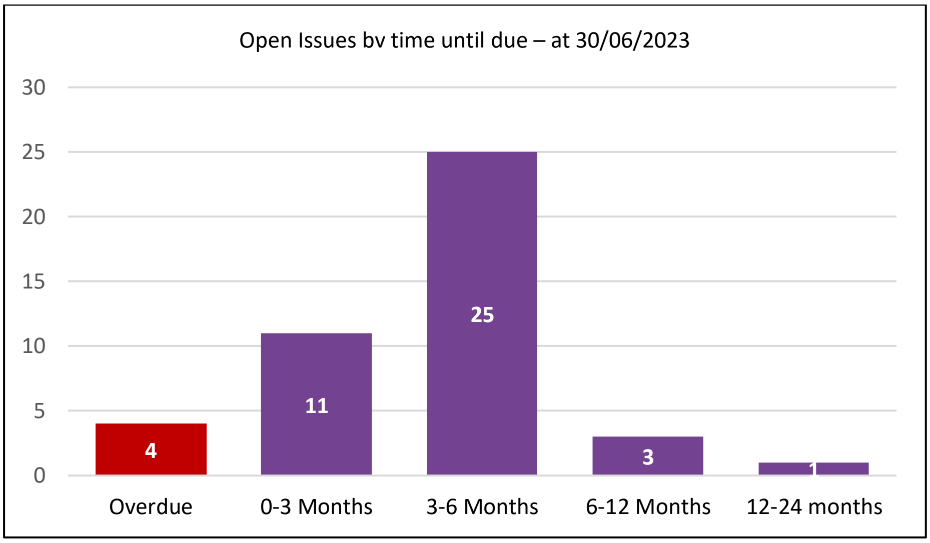
4.5.2 Medium: Medium priority, weakness may lead to moderate impact on LPF. Timely action required to mitigate.

4.5.3 High: High priority, material weakness or failure in processes. LPF exposed to significant risk without action.

Issues

4.6





4.6.1 During Q2, 20 issues were closed and 15 new issues were raised. These issues comprise findings predominantly from the internal audit on Information Governance, the Financial Crime themed review and the Investment Services review.

4.6.2 Since end Q2, 2 further issues have been added, identified by the spot check review of data and FOI processes. At the time of writing, there are currently 41 open issues, 1 of which is overdue and a further 11 have a due date by the end of September.

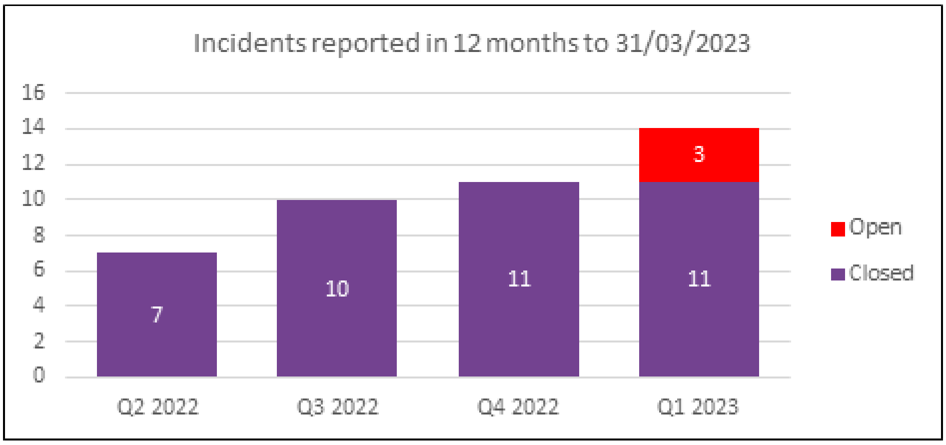
4.6.3 The Risk & Compliance team continue to actively engage with issue stakeholders to ensure agreed actions are being taken by the due date. This table shows current open issues by rating and due date:

Issue rating	Overdue	Sep 2023	Q4 2023	Q1 2024	Total
High	1	1	6	1	9

Medium		6	5	1	12
Low		4	15	1	20
Total	**1**	**11**	**26**	**3**	**41**

Incidents

4.7 Eighteen incidents were raised during Q2 2023, five of which were classified as non-reportable data breaches and 1 was classified as a non-reportable FCA regulatory breach. Required actions to remediate thirteen of these incidents were completed during Q2, and the incidents subsequently closed.



4.8 Following the end of Q2, 14 further incidents have been raised within LPF group.

4.9 The quality of information being recorded continues to be enhanced making analysis of any themes or trends more effective. A total of 7 incidents and near misses arising in Q2 related to pre- or post- trading activities. Identified causes included configuration or set-up of the Charles River system, set-up within Northern Trust system, and unclear processes or human error within LPF. Each of these areas is expected to improve from work within the IGIP project to clearly document investment processes, the new R&C hire, and a planned upgrade to the Charles River system.

4.10 Further information on issues and incidents is available on request.

FCA Regulatory Compliance – ICARA

4.11 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. These systems and controls must include a process to assess and allocate additional capital where a residual, material risk remains.

4.12 As part of the UK's financial services regulatory framework and as set out in the relevant prudential standards (MIFIDPRU), LPFI is required to establish and maintain an Internal Capital Adequacy and Risk Assessment (ICARA), which should be updated on an annual basis, or upon a material change.

4.13 The requirement for the ICARA arises from the FCA's IFPR, the purpose of which is to ensure investment firms remain viable on an on-going basis and are able to wind-down in an orderly manner. In practice, this means holding a minimum level of financial resources (capital and liquidity), and regularly assessing how much of each should be held.

4.14 The LPFI ICARA as at 31 March 2023 has been reviewed and updated, and will be / has been considered and approved by the LPFI board.

4.15 Approval was sought from the LPFI board to increase LPFI capital by £1,000k. The increase is due to consideration and evaluation of plausible scenarios through the harm-led risk assessment and significant increase in LPFI AuM since March 2022, the date of the previous ICARA.

4.16 As previously reported, due to the increase in AuM, with effect from 1 July 2023, LPFI ceased to meet threshold criteria for being a SNI firm (small non-interconnected firm) and will be required to update the ICARA as at 30 September 2023 as a Non-SNI firm to take account of additional regulatory reporting and methodology due to the change in category.

4.17 The R&C and Finance team have collaborated to review and update the ICARA as at 31 March and are developing a plan to complete the more extensive review and update required as at 30 September, which will be presented to the LPFI board at the December meeting.

5. Financial impact

5.1 To ensure that LPFI remains adequately capitalised the LPFI board was recommended to review and approve the injection of £1,000k from Lothian Pension Fund. This change in capital should be noted by the Pension Committee.

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.

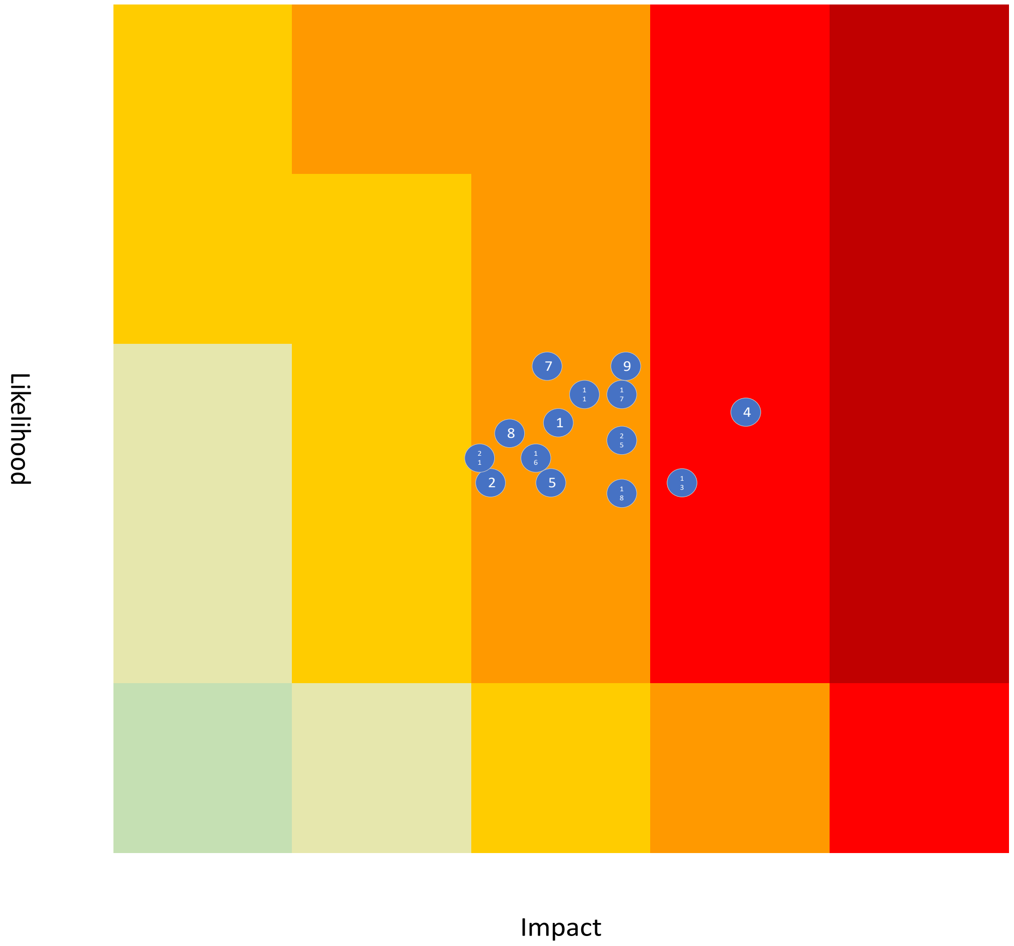
8. Appendices

Appendix 1 – LPF Key Risks

Appendix 2 – Risk Register Summary

Appendix 1

LPF Key Risks



Ref	Type	Name	Rating
4	Governance Legal & Compliance	Regulatory breach	
13	Business Operations	Supplier performance and oversight	
1	Investment Management	Investment Performance	
2	Information Security IT & Data	Data Management	
5	Scheme	Employer contributions payment failure	
7	Governance Legal & Compliance	Discharge of responsibilities and accountabilities	
8	Business Operations	Investment services delivery	
9	Business Operations	Business Interruption	
11	Information Security IT & Data	Cybersecurity	
16	People & Culture	Recruitment & retention	
17	People & Culture	Resources	
18	Strategy	Climate change & Responsible Investing	
21	Strategy	Strategic Goals	
25	Governance Legal & Compliance	Best practice governance	

	Very High
	High
	Medium
	Low
	Insignificant

Risk Register Summary

Appendix 2

Risk Ref	Level 1 Risk	Level 2 Risk	Risk name	Risk Description	Entity	Current Risk
4	Governance Legal & Compliance	Regulatory Compliance	Regulatory breach	LPF do not meet regulatory obligations leading to enforcement action or fines and reputational damage	All	
13	Business Operations	Third Party	Supplier performance and oversight	Sub-optimal service performance/delivery, management and oversight of third party suppliers could lead to lack of resiliency and/or material errors and breaches	All	
1	Investment Management	Investment Management	Investment Performance	Investment returns are less than expected due to fall in fair price of securities including equities, bonds, real assets could impact value of the fund and consequently funding levels and liabilities	All	
2	Information Security IT & Data	Data	Data Management	Mis-management or poor maintenance and protection of data could lead to operational errors, regulatory breaches/fines or reputational damage	All	
5	Scheme	Employer Contributions	Employer contributions payment failure	Failure of an employer to pay contributions leads to a fall in funding or balance to be met by higher contributions from remaining employers	LPF	
7	Governance Legal & Compliance	Governance	Discharge of responsibilities and accountabilities	Pension Committee or Board don't effectively discharge their responsibilities and accountabilities to the fund and decisions are taken against sound advice, beyond delegated authorities, on political grounds or due to lack of knowledge or attendance	LPF	
8	Business Operations	Processing & Execution	Investment services delivery	Delivery of LPFI's investment services do not meet client expectations or requirements or regulatory obligations	LPFI	
9	Business Operations	Business Continuity	Business Interruption	Significant and/or extended business interruption (including third party suppliers) leading to a failure or inability to complete key LPF processes	All	
11	Information Security IT & Data	Information Security & Cyber	Cybersecurity	Inadequate cyber and data security arrangements to protect LPF from information security threats and cyber-attacks could prevent key operational processes from being undertaken and lead to financial losses and reputational damage	All	
16	People & Culture	People & Culture	Recruitment & retention	Ability to attract, recruit, engage and retain talent leading to workforce capability gaps could affect LPF's ability to meet strategic objectives and legal and regulatory requirements and expectations	All	
17	People & Culture	People & Culture	Resources	Key person dependencies (particularly in significant roles or small teams) and resourcing could affect LPF's ability to meet strategic objectives and legal and regulatory requirements and expectations	All	
18	Strategy	Climate	Climate change & Responsible Investing	LPF don't adequately address Environmental, Social and Corporate Governance factors within the company, with service providers, and through underlying investments, due to lack of climate or sustainability strategy. This could lead to missed opportunities, regulatory scrutiny, financial loss and reputational or stakeholder damage	All	
25	Governance Legal & Compliance	Governance	Best practice governance	Failure to operate within corporate governance best practice and principles could impact strategic decision making and may lead to project failure, increased costs, poor morale and/or regulatory censure	All	
21	Strategy	Strategic	Strategic Goals	Strategic goals are unclearly defined and/or inconsistently implemented	All	
6	Business Operations	Processing & Execution	Operational errors	Material or systemic operational errors, in relation to members, employees or clients (such as trading errors or pension payment errors) could result in operational losses, regulatory breaches or reputational damage	All	
10	Information Security IT & Data	Technology	IT systems	LPF's IT does not meet operational requirements due to inadequate IT hardware or software leading to material or extended service delivery issues	All	
12	Business Operations	Business Change	Project and change activities	Ability to deliver internal or regulatory change in line with strategic or legal/regulatory expectations could overwhelm business areas through pressure on BAU processes, causing delivery delays or failures, and/or change fatigue and impacting organisational culture	All	
14	Business Operations	Internal Fraud	Fraud by LPF staff or relating to members	Challenges due to general cost of living increases could drive both employees and members to attempt to acquire assets or monies not belonging or due to them	All	
23	Scheme	Funding	Unexpecetd drop in funding	Unexpected drop in funding levels may require higher employer contributions	LPF	
24	Information Security IT & Data	Data	Data integrity and quality	Data used to fulfil member, employer, client, regulatory or reporting requirements, and trigger actions or inform decision making, comes from multiple sources and systems and may contain errors	All	
15	Business Operations	Communication & Digitalisation	Member engagement, servicing and reporting	Member engagement, servicing and reporting does not meet LPF's expected standards and corporate values contributing to operating inefficiencies, member di-satisfaction or complaints and reputational damage	LPF	
19	Investment Management	Investment Management	Investment Strategy	Investment strategy does not deliver investment objectives due to incorrect implementation, investments falling outside agreed risk parameters or inadequate JISP governance. This could lead to a fall in funding levels andinability to meet liabilities.	LPF and LPFI	
20	Business Operations	Communication & Digitalisation	Communications	Unclear, misleading or out of date member or client communications compromises the quality of their decision-making, leading to member or client complaints and reputational damage as well as regulatory censure	All	
22	Scheme	Funding	Meeting liabilities or capital requirements	Insufficient funds and liquid assets to meet liabilities or capital requirements	All	
26	Scheme	Funding	Increase in future liabilities	Increase in future liabilities due to rising inflation and other external factors	All	
3	Conduct	Conduct	Unauthorised activity or poor conduct	Unauthorised activity or poor conduct behaviours by employees representing themselves or the firm could fall short of legal and regulatory standards and requirements	All	

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

Agenda Item 9.2

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

Agenda Item 9.3

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