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Notice of Meeting and Agenda

Pensions Audit Sub-Committee

2.00 pm Tuesday, 19th March, 2024

DoubleTree by Hilton Hotel Edinburgh City Centre - 34 Bread Street, Edinburgh, Scotland, EH3 9AF

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

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 Any items under "Private Business" will not be published, although the decisions will be recorded in the minute.

Contacts:

Kimberley Russell, Company Secretary, Lothian Pension Fund

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Andrew Henderson, Committee Officer, City of Edinburgh Council Email: andrew.henderson@edinburgh.gov.uk

1. Quorum Check

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

2. Order of Business

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

3. Declaration of Interests

3.1 Members of the Sub-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 Audit Sub Committee of 04 December 2023 (circulated) – submitted for approval as a correct record.	7 - 16
5.2	Action Tracker (circulated)	17 - 18

6. Reports

6.1	Governance Update – report by the Company Secretary, Lothian Pension Fund (circulated)	19 - 32
6.2	Funding Strategy Statement Update - report by the Chief Finance Officer, Lothian Pension Fund (circulated)	33 - 86
6.3	Actuarial Valuation for Lothian Pension Fund – report by the Chief Finance Officer, Lothian Pension Fund (circulated)	87 - 140
6.4	Actuarial Valuation for Scottish Homes Pension Fund – report by the Chief Finance Officer, Lothian Pension Fund (circulated)	141 - 178
6.5	Lothian Pension Fund - Internal Audit Update – March 2024 – report by Head of Internal Audit, City of Edinburgh Council (circulated)	179 - 198
6.6	Lothian Pension Fund –ProposedInternal Audit planfor 2024/25–report byHead of Internal Audit, City of Edinburgh Council (circulated)	199 - 212
6.7	External Audit Annual Plan 2023/24 by Azets – report by External Auditor, Azets (circulated)	213 - 252

7. Motions

7.1 None.

8. Resolution to Consider in Private

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

9. Private Reports

9.1	Risk & Compliance Update - report by the Chief Risk Officer, Lothian Pension Fund (circulated)	253 - 270

Nick Smith

Service Director, Legal and Assurance

Committee Members

John Anzani (Convener), Councillors Doggart and Ross.

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

Information about the Pensions Audit Sub-Committee

The Pensions Audit Sub-Committee consists of 2 Councillors and 1 external member and is appointed by the City of Edinburgh Council in its separate capacity as administering authority of the Lothian Pension Fund. The Audit Sub-Committee monitors the operation of the Fund's internal controls, governance, risk and compliance arrangements and financial reporting.

This meeting of the Pensions Audit Sub-Committee is being held on a hybrid basis in LPF Board Room - LPF Board Room, Atria One, 144 Morrison Street, Edinburgh and by Microsoft Teams and is open to members of the public.

The meeting will be monitored by Kimberley Russell.

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

Alison Murray

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

Emmanuel Bocquet, 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 Kimberley Russell, Company Secretary, Lothian Pension Fund, Atria One, 144 Morrison Street, Edinburgh EH3 8EX, Tel 0333 996 1587, email rus12k21@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.

Pensions Audit Sub-Committee Minutes

2pm, Monday 4 December 2024

Present:

John Anzani (Convener), Councillor Phil Doggart and Councillor Neil Ross.

Pension Board Member:

Jim Anderson.

Other Attendees:

Susan Handyside (Assistant Company Secretary, Lothian Pension Fund)
Andrew Henderson (Clerk, City of Edinburgh Council)
Andy Marchant (Non Executive Director, LPFI board)
Colin McCurley (Principal Audit Manager, City of Edinburgh Council)
Anne Mitchell, (Head of IT, Lothian Pension Fund)
Alison Murray (Independent Professional Observer)
Alan Sievewright (Chief Finance Officer, Lothian Pension Fund)
Karlynn Sokoluk (Chief Operations Officer, Lothian Pension Fund)
Kerry Thirkell (Chief Risk Officer, Lothian Pension Fund)
David Vallery (Chief Executive Officer, Lothian Pension Fund)

1. Quorum

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

2. Order of Business

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

3. Declaration of Interests

John Anzani made a transparency statement that no part of his income was affected by the City of Edinburgh Council being a managing partner of Lothian Pension Fund.

4. Minutes

Decision

To approve the minute of the Pensions Audit Sub-Committee of 26 September 2023 as a correct record.

(reference – minute, Pensions Committee 26 September 2023, submitted.)

5. Agenda Planning and Governance Update

Officers presented the agenda planning document and provided the committee with an overview for the proposed agendas for future meetings of the Pensions Committee and the Pensions Audit Sub Committee in addition to the annual cycle. An update on the Committee's key actions from it's meeting in September 2023 was also presented.

In responding to comments regarding item 2 on the action tracker, officers agreed to circulate an explanation of the differential in equities in advance of the next meeting of the Pensions Committee on the 5th of December 2024.

Decision

1) To note the agenda planning document and the action tracker (appendix 2);
2) To note that the Pension Board Members are invited to comment on agenda items during committee meetings;
3) To agree to hold an additional Audit Sub Committee meeting in March 2024 to consider the actuarial calculation and the AVC review paper; and
4) To agree that officers circulate an explanation of the differential in equities in advance of the next meeting of Pensions Committee on the 5 of December 2024.

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

6. Lothian Pension Fund - Internal Audit Update – November 2023

Details on the progress of Internal Audits Insurance activity on behalf of LPF as over seen by the City of Edinburgh Council's Internal Audit Function across the period from 26 August 2023 to 1 November 2023 were provided. Good progress being highlighted with the delivery of the 2023/24 Internal Audit annual plan with both the people processes audit and senior managers and certification regime audit being closed and two further audits underway.

The report detailing the outcomes of the Senior Managers and Certification audit was presented to committee for review and scrutiny. It was highlighted that as of the 1st of November 2023 LPF had 24 open management actions with 5 actions passed the original implementation date. 6 actions have been closed since August 2023 and 8 new actions have been raised.

Members asked that officers liaise with PWC regarding the relevance of comments made and the principles of what is included in Audits with reference made to recommendation 1.1 b of the Recommendations and Management Action Plan: Senior Managers and Certification Regime governance arrangements of the Findings and Management Action Plan.

Decision

1) To note the progress of the 2023/24 Lothian Pension Fund internal plan with two audits now being complete and a further two in process;
2) To note progress with Implementation of agreed management actions from previously completed internal audits; and

3) To agree that officers to liaise with PWC regarding the relevance of Comments made and the principles of what is included in Audits.

(Reference – report by the Principal Audit Manager, City of Edinburgh Council, submitted)

7. Employer Performance and Data Quality Update

Details of the ongoing work to enhance the quality of the pension administration membership record data were provided. In accordance with the LPF's Pension Administration Strategy, the fund continues its efforts to improve the flow of data from employers through regular reporting and liaison.

It was highlighted that the fund has focused on cleansing member records for the annual benefit statement production, the triennial valuation and data collection and analysis for the McCloud remedy. LPF has also been preparing for the Pensions Dashboards Programme and has continued to review data quality specified by the Pensions Regulator.

Members asked the Chief Executive of LPF to provide further detail on employer performance and failures to meet the service standard for new starts, leavers, retirements and deaths. Members acknowledged that one employer, the City of Edinburgh Council, had recently implemented a new HR system and it was anticipated that this would improve the timeliness and quality of data provided to LPF.

Members asked the Chief Executive of LPF to remind employers who were not meeting service standards that fines will be levied should there be no clear commitment to improve. Members agreed that an update be provided to the March meeting of the Pensions Audit Sub Committee.

In response to members comments, officers agreed to ensure that the operations team are aware of differences in the McCloud Underpin.

Decision

1) To note the report;

2) To agree that the LPF Chief Executive will discuss the failure to meet standards for new starts, leavers, retirements and deaths with the Executive Director Corporate Services of the City of Edinburgh Council, highlighting that fines will be implemented should no clear commitment to improvement;

3) To note that the LPF Chief Executive will follow up the meeting with the Executive Director Corporate Services (CEC) in writing;

4) To agree that an update would be provided to the next meeting of the Pensions Audit Sub Committee; and

5) To note that officers will ensure that the operations team are aware of differences in the McCloud Underpin.

(References – Report by the Chief Operations Officer, Lothian Pension Fund, submitted)

8. Investment Income Review Cross Border Withholding Tax and EU Tax Recoveries

Details on the EY benchmarking assurance review into the effectiveness of the procedures in place to manage the tax exposure on the investment income of the LPF and the Scottish Homes Pension Fund was provided.

The review highlighted that Northern Trust was generally applying the correct withholding tax rates on investment income and is pursuing reclaims were possible. A summary of identified opportunities and issues was provided and it was acknowledged that no significant claims had been settled during this period.

An update on the progress on Fokus bank reclaims was also provided and it was highlighted that during the period covering the EU Tax and Claims and Other Income Tax Recoveries paper no additional claims had been paid.

Members asked officers to confirm if interest would be owed to LPF on tax authority reclaims with Northern Trust and EY.

Decision

1) To note the report;
2) To note that whilst the review by EY shows that Northern Trust is generally applying the correct withholding tax rates on investment income, several rates applied were queried as suggested by EY;
3) To note progress on French Fokus claims via KPMG and ongoing work on Fokus claims via WTax; and
4) To agree that officers ensure that Northern Trust and EY provide full advice on potential interest on owed to LPF regarding tax authority reclaims.

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

9. Risk and Compliance Update

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.

An overview of the monitoring and assurance undertaken by LPF since the last meeting was provided along with a summary of the work to enhance current risk management arrangements.

Decision

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

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

10. IT Information Security Update

The Sub-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 and 6 of Schedule 7(A) of the Act.

An overview of the actions taken following the LPF's annual penetration test was presented.

Decision

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

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

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by virtue of paragraph(s) 1, 3, 6 of Part 1 of Schedule 7A
of the Local Government(Scotland) Act 1973.

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Pensions Audit Sub Committee

Action Log

Meeting	Formal/Informal	Type	Owner / Lead	Detail	Update	Completion date	Status
04/12/2023	Formal	action	LPF Company Secretary	**Agenda Planning:** 1)To agree to hold an additional Audit Sub Committee meeting in March 2024 to consider the actuarial calculation and the AVC review paper.; 2)To agree that officers circulate an explanation of the differential in equities in advance of the next meeting of Pensions Committee.	1) Meeting of ASC arranged for March. 2)ASC provided update on 5 Dec 2023	19/03/2024	propose to close
04/12/2023	Formal	action	Principal Audit Manager, CEC	**Lothian Pension Fund - Internal Audit Update November 2023** 1)Officers to liaise with PWC regarding the relevance of comments made and the principles of what is included in Audits.	1) The Principal Audit Manager will provide an update during the meeting.	19/03/2024	propose to close
04/12/2023	Formal	action	LPF Chief Executive Officer	**Employer Performance and data Quality Update** 1) To agree that LPF Chief Executive will discuss with the Executive Director Corporate Services (CEC) and highlight that fines will be implemented should improvements in processing times not be made; and 2) That the LPF Chief Executive will follow up his meeting with the Executive Director Corporate Services (CEC) in writing and report back to the March Committee. Note: Officers to ensure that the operations team are aware of difference in the McCloud Underpin.	Report is tabled at the March Pensions Committee (private agenda) providing an update on LPF CEO's meeting and correspondence with CEC Director of Corporate Services.	20/03/2024	propose to close
04/12/2023	Formal	action	LPF Chief Risk Officer	**Risk and Compliance Update** 1)To agree that an update report on overdue actions be submitted to the special meeting in March 2024. Note: Chief Executive LPF to outline why LPF and CEC staff might be conflicted if they undertake any work in relation to the legal review into Project Forth.	1) Risk and Compliance Update and verbal update will include details.	19/03/2024	propose to close
04/12/2023	Formal	action	LPF Chief Finance Officer	**IT Information Security Update** 1)To note that a further update on IT information Security demonstrating the steps taken would be included in the next Business Plan due to be submitted the Pensions Committee meeting in March 2024.	1) IT information security plans have been included in the Buisiness Plan rerport being considered by Pensions Committee in March 2024.	19/03/2024	propose to close

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Pensions Audit Sub Committee

2.00pm, Tuesday, 19 March 2024

Governance Update

Item number 6.1

1. Recommendations

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

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

1.2 note the agenda planning document set out in Appendix 1 to this report;

1.3 note that the Pension Board Chair, Jim Anderson, steps down from the Pension Board at the end of March 2024, having made a significant contribution to Lothian Pension Fund and the Pension Board over the last 9 years;

1.4 note the Pension Board Chair arrangements from 1 April 2024 to 31 March 2025;

1.5 note the appointment process for the non-elected Pension Committee members;

1.6 note the update on members training hours and the development of training; and

1.7 note the expected introduction of the Pensions Regulator new general code with effect from 27 March 2024.

Kimberley Russell
Company Secretary, Lothian Pension Fund

Contact: Susan Handyside, Assistant Company Secretary, Lothian Pension Fund

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

Governance Update

2. Executive Summary

2.1 At its meeting in December 2023, the Pensions Committee requested that officers provide regular updates on governance matters, including compliance with the Nomination and Appointments and Training and Attendance Policies, as well as any other relevant matters arising, in addition to the usual agenda planner. This report seeks to provide that fuller update.

2.2 Work is underway to appoint new members for current and anticipated vacancies in the Pension Board and Pensions Committee.

2.3 All four Committee Members and eight Pension Board Members have met the training requirement. The remaining Committee Members have confirmed their intention to meet the requirement before the period end. Appendix 2 of the report provides detail of Committee and Board training hours undertaken over the year.

2.4 A gap analysis has commenced to assess LPF's compliance against the new The Pensions Regulator (TPR) code with the results and implications being reported to Committee in June.

2.5 Appendix 1 of the report provides the proposed agendas for future meetings of the Pensions Committee and Audit Sub Committee, accordingly.

3. Background

3.1 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.

3.2 To provide an overview of the content of those future meetings, and an awareness of the annual cycle of items, an agenda planning document is submitted each quarter. The content of the agenda planning document arises from several sources: (a) standing items for each meeting, (b) re-occurring items at a specific cadence (quarterly, annually, biennially, for example), and (c) ad hoc or stand-alone items, where those arise. The agenda planning document is maintained by LPF's Company Secretariat and governance team and presented as a standing item at each meeting for noting.

4. Main Report

Future Dates and Agenda Planning

4.1 The Committee meeting dates for 2024/25 are set out below and calendar invites have been issued. These meetings will be held in person with the option, if required, to attend virtually.

Pensions Committee	**Audit Sub Committee**
• Wednesday 26 June 2024 at 2pm	• Monday 24 June 2024 at 2pm
• Wednesday 25 September 2024 at 2pm	• Tuesday 24 September 2024 at 2pm
• Thursday 5 December 2024 at 2pm	• Tuesday 3 December 2024 at 2pm
• Wednesday 26 March 2025 at 2pm	• Tuesday 25 March 2025 at 2pm (provisional)
• Wednesday 25 June 2025 at 2pm	• Monday 23 June 2025 at 2pm

4.2 The proposed agendas for the June and September 2024 meetings are set out in the following tables, based on the usual Committee cycle plus any additional and intra-cycle requests. The current annual agenda planning document is set out in Appendix 1.

4.3 Specifically in respect of the Audit Sub Committee, the agenda for June includes the two papers deferred from the December meeting. These were the AVC Review Update and a report regarding Global Custody Services Performance. While it had been reported that the former would be brought to the Audit Sub Committee in March, this has not been possible. A fuller update regarding the status of the AVC Review is provided in the Business Plan and Budget report, with a provisional hold for the AVC Review scheduled for the Audit Sub-Committee's meeting in June. The Global Custody Services Performance will be available for LPF to report in June.

4.4 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.

June 2024

Pensions Committee	**Audit Sub Committee**
• Referrals / recommendations from Pensions Audit Sub Committee • Annual Report and Accounts of Lothian Pension Fund and Scottish Homes Pension Fund (unaudited) • Internal Audit Annual Report and Opinion • Statement of Investment Principles • Joint Investment Strategy Panel Activity • Annual Investment Update – Lothian Pension Fund • Annual Investment Update - Scottish Homes • Annual LPF Group Governance Update • Approach to Responsible Investment • Risk and Compliance Update	• Annual Report and Accounts of Lothian Pension Fund and Scottish Homes Pension Fund (unaudited) • Internal Audit Annual Report and Opinion • Internal Audit Update • AVC Review (provisional) Private agenda • Global Custody Services Performance • IT Information Security Update • Risk and Compliance Update

September 2024

Pensions Committee	**Audit Sub Committee**
• Audit Sub Committee Convenor's Annual Update, including any referrals / recommendations from Pensions Audit Sub Committee • Employer Covenant Review • Discretions Policy • Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund (including the Annual Audit Report and Opinion by the External Auditor) • Stewardship Report • Operating Plan and Budget Update • Contract Awards Update • Risk and Compliance Update Private agenda • Employers participating in the scheme	• Lothian Pension Fund Annual Report and Accounts (Audited) • Internal Audit Update including any key audit finding reports completed in the reporting period • Fraud Prevention Private agenda • Risk and Compliance Update

Rotation of the Pension Board Chair & Membership of the Pension Board

4.5 The current Pension Board Chair, Jim Anderson, steps down from the Pension Board at the end of March. Jim has been a dedicated member of the Pension Board since its inception in March 2015. This report wishes to formally note and record thanks and gratitude to Jim for his significant contribution to the Pension Board.

4.6 In respect of the position of Pension Board Chair, the Pension Board constitution states that '*the chair of the Pension Board will be rotated on an annual basis*' (with provision for the Chair's tenure to be extended for one further year, subject to approvals). As Jim was drawn from the member representation, the 2024/25 Chair is, accordingly, required to be drawn from the employer membership of the Pension Board.

4.7 The Pension Board are scheduled to meet in advance of the March Pensions Committee. It is, therefore, expected that the Pensions Board shall provide a verbal update to the Committee regarding the Chair appointment for 2024/25.

4.8 More broadly, regarding Pension Board membership, to note that an appointment has been made to the Pensions Board, an employer representative, in accordance with the Nomination and Appointments Policy, a verbal update will be provided at the meeting.

4.9 The Pension Board constitution provides that it will comprise *five employer members and five employee members*. With Jim's departure, the membership of the Pension Board, at the time of writing this report, is four employee representatives and four member representatives. Activity to fill vacancies, being one employer representative and, following Jim's departure, one member representative, drawn from the trade Union Unison membership continues.

Non-Elected Members of the Pensions Committee

4.10 As set out in the LPF Nominations and Appointments Policy, non-elected members of the Pension Committee can serve a maximum of three consecutive years before either standing down or submitting themselves as a candidate for further election. The current non-elected Pension Committee members will come to an end of their tenure the end of June. LPF commenced the recruitment and appointment process in February and details of the process was communicated to both Committee and Pension Board members at that time. A verbal update on progress will be made to the Committee at the meeting.

Training hours 2023/24 for the Pensions Committee and Pension Board

4.11 In accordance with the Fund's Training Policy the expected training hours for members of the Pensions Committee and Pension Board is a minimum of three days

(21 hours), with the annual training cycle being 1 April to 31 March. The Pensions Regulator also requires those involved with the governance of local government pension schemes to develop and build sufficient knowledge to effectively carry out their role.

4.12 Appendix 2 provides a breakdown of training hours of the Pensions Committee and Pension Board notified and recorded by the Company Secretariat team.

4.13 At the time of writing this report all Pension Board members have either met or exceeded the training requirement. Four of the Pension Committee Members have met the requirement. It is expected that all Pensions Committee members will fully achieve the minimum training requirement by the end of March.

4.14 Committee and Pension Board members have recently been given access to LPF's the Learning Management (training) System (LMS) enabling members to view recorded training sessions. It is also expected that members shall have access to update their training hours directly via the system from 1 April 2024.

The TPR General Code

4.15 The Pensions Regulators new general code (**Code**) was laid before Parliament in January this year and expected to come into force on 27 March. Set to replace ten of The Pension Regulators current codes of practice into a series of modules (related to five themes: the governing body; funding and investment; administration; communications and disclosure; and reporting), work has commenced to review the Code to identify any potential gaps in existing policies and practices. The Committee shall be updated in June on the output of that analysis.

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 – Training Log 2023/2024

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Appendix 1

Frequency	Pensions Committee	Audit Sub Committee
Every 3 years	**December or March**	
	Actuarial Valuation: LPF SHPF	N/A
	March	
	Funding Strategy Statement	N/A
Biennial	**September**	
	Pension Administration Strategy	N/A
	Administrating authority Discretions Policy. Next review due September 2024	N/A
Annually	**March**	
	LPF Strategy and Business Plan and Budget	N/A
	Annual Audit Plans (Internal and External)	*Draft internal audit plan will be developed in consultation with the Convenor of the Audit Sub Committee, the CEO (LPF) and, if appropriate, the Independent Professional Observer and circulated to the Audit Sub Committee members for comment.*
	Benchmarking – Investment and Administration Costs	N/A
	June	
	Annual Report and Accounts Lothian Pension Fund and Scottish Homes Pension Fund (Unaudited)	Annual Report and Accounts Lothian Pension Fund and Scottish Homes Pension Fund (Unaudited)
	LPF Internal Audit Annual Report and Opinion	LPF Internal Audit Annual Report and Opinion
	Statement of Investment Principles	N/A
	Joint Investment Forum Activity Update	N/A
	Annual Investment Updates - Lothian Pension Fund and Scottish Homes Pension Fund	N/A
	Annual LPF Group Governance Update	N/A

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

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

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

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LPF INTERNAL DATA

LPF PUBLIC DATA

Committee and Pension Board Members' Training Record
From 1 April 2023 to 31 March 2024

Appendix 2

LOTHIAN PENSION FUND Event:	TPR online training	PLSA Investment Conference 2023	LPF Training	Audit Sub Committee	Pensions Committee	LPF Training	Audit Sub Committee	Pensions Committee	LGC Investment Seminar Scotland 2023	LPF Training - Valuation Session	LPF Training - Virtual Valuation session	LPF Training	Audit Sub Committee	Pensions Committee	Investment Training	PLSA Investment Conference 2024	LPF Training	Audit Sub Committee	Pensions Committee	Additional training/ reading	Total
Date	n/a	6-8 June	12/06/23	19/06/23	21/06/23	15/09/23	26/09/23	27/09/23	19-20 Oct	31/10/23	15/11/23	17/11/23	04/12/23	05/12/23	06/02/24	27-29 Feb	07/03/24	19/03/24	20/03/24	N/A	
Pensions Committee																					
Steve Burgess	0	3	2.5	N/A	1	0	N/A	1	0	3	1.5	3	N/A	1	3	0	3	N/A			**22.00**
Neil Ross	0	0	3	0.5	1	3	0.5	1	2	3	1.5	3	0.5	1	3	0	1				**24.00**
Phil Doggart	0	0	3	0.5	1	3	0.5	1	0	3	1.5	3	0.5	1	3	0	3				**24.00**
Mandy Watt	0	0	3	N/A	1	3	N/A	1	0	3	1.5	3	N/A	1	0	0	3	N/A			**19.50**
Vicky Nicolson	0	0	0	N/A	1	3	N/A	1	0	3	0	3	N/A	1	0	0	2.75	N/A			**14.75**
John Anzani	0	0	0	0.5	1	0	0.5	1	0	3	0	3	0.5	1	3	tbc	3			49.64	**66.14**
Richard Lamont	0	0	0	N/A	1	3	N/A	1	0	3	1.5	3	N/A	1	3	0	3	N/A		7.5	**27.00**
Lothian Pension Funds' Pension Board																					
Employer Representatives																					
Darren May, (Scottish Water)	0.5	0	3	N/A	1	0	N/A	1	7.5	2	0	3	N/A	1	3	0	0			6.25	**28.25**
Sharon Dalli (Police Scotland)	0	0	3	N/A	1	3	N/A	1	0	3	1.5	3	N/A	1	0	0	3			13	**32.50**
Alan Williamson (Edinburgh College)	0	0	3	N/A	1	0	N/A	1	9	0	0	3	N/A	1	3	0	1.25			7.5	**29.75**
Nick Chapman (Lothian Valuation Joint Board) **(Left 22/06/2023)**	0	0	3	0.5	1	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	n/a	N/A	N/A	N/A	N/A	2.5	**7.00**
Vacancy	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	**0.00**
Member Representatives																					
Brian Roberston (UNITE)	0	0	0	N/A	0	3	N/A	0	0	2.5	1.5	0	N/A	0	3	0	3			19	**32.00**
Jim Anderson (UNISON)	1	16.5	3	N/A	1	3	N/A	1	8	0	1.5	3	0.5	1	0	12	3			14.5	**69.00**
Tom Howorth (UNISON)	0	6	3	N/A	1	3	0.5	1	0	3	0	3	N/A	1	3	9	3			9	**45.50**
Thomas Carr Pollock (GMB)	1	0	0	N/A	1	3	N/A	1	6	3	1.5	0	N/A	0	3	5	3			3	**30.50**
Tony Beecher (UNITE)	2	0	3	N/A	1	3	N/A	1	0	0	0	0	N/A	1	0	0	3			13.11	**27.11**
Total	4.5	25.5	32.5	2	15	33	2	14	32.5	34.5	13.5	36	2	13	30	26	38	0	0	145	**499.00**

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Pensions Audit Sub Committee

2.00pm, Tuesday, 19 March 2024

Funding Strategy Statement Update

Item number 6.2

1. Recommendations

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

1.1 note the summary of responses received as part of the consultation process; and

1.2 note the revised Funding Strategy Statement.

Alan Sievewright

Chief Finance Officer, Lothian Pension Fund

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

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

Funding Strategy Statement Update

2. Executive Summary

2.1 As required under the Local Government Pension Scheme (Scotland) Regulations, the Lothian Pension Funds' Funding Strategy Statement (FSS) has been reviewed as part of the actuarial valuation process to ensure that it remains appropriate. In revising the FSS, the Fund has considered:

- Actuarial valuation results;
- Consultation feedback from fund employers;
- Guidance from Hymans Robertson, the Fund's actuary; and
- Regulatory amendments.

3. Background

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

- employer admission to the Fund;
- employers leaving the Fund;
- Setting employer contribution rates; and
- Salary strain mechanism.

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

3.3 The last review of the FSS was carried out in June 2023. At that time amendments were made to the salary strain mechanism following employer feedback.

3.4 A draft revised FSS was presented to Committee in December 2023. The changes proposed took account of indicative results of the 2023 valuation and changes made to funding policy as a result. Following Committee approval of the revised draft FSS, an employer consultation exercise was carried out.

3.5 In February 2024, the Local Government Pension Scheme (Scotland) (Amendment) Regulations 2024 were laid before the Scottish Parliament. These amendments come into force on 28 March 2024, and the FSS has been revised in anticipation of these amendments.

3.6 The revised FSS, which has been reviewed by the Fund actuary (Hymans Robertson), is attached as Appendix 1 to this report.

4. Main Report

Actuarial Valuation of the Pension Funds

4.1 As separately reported to Committee on this agenda, the Fund actuary carried out a valuation of the Funds as at 31 March 2023. These valuations are required under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2018, and the Actuary has prepared the reports in line with required Technical Actuarial Standards.

4.2 The valuation reports contain rates and adjustments certificates setting out employer contribution rates for the 3 years from 1 April 2024. The valuation must be completed before the first anniversary of the valuation date, ie by 31 March 2024. In setting contribution rates, the Actuary must have regard to the FSS and the actuary will certify these rates following Committee approval of the FSS.

Employer Consultation

4.3 A draft revised FSS was presented to Committee for approval in December 2023. As required under the Local Government Pension Scheme (Scotland) Regulations 2018, employers must be consulted on changes being made to the FSS. The draft revised FSS was issued to employers in December 2023. Employers were invited to comment on during the consultation period which ran from 11 December 2023 to 31 January 2024.

4.4 A summary of the comments received from employers, together with responses to these comments is attached at Appendix 2. The summary will be circulated to all employers via the next Employer Bulletin. As set out in Appendix 2, no changes to the FSS are being made as a result of this feedback.

The Local Government Pension Scheme (Scotland) (Amendment) Regulations 2024

4.5 In February 2024, the Local Government Pension Scheme (Scotland) (Amendment) Regulations 2024 were laid before the Scottish Parliament. These amendments include amendments and clarifications relating to employers considering exiting the Fund and the FSS has been revised in anticipation of these amendments.

4.6 The FSS was revised in 2022 to introduce the ability for employers to request an indicative exit valuation which would remain valid for 90 days. Previously, employers looking to exit were at the risk of adverse market movements between the time they received an indicative exit valuation and the date of exit. The 2024 amendments clarify that the 90 days is from the date used in the indicative valuation. In addition, a further condition regarding the provision of exit valuations has been introduced, namely that they will not be provided if the employer has requested an indicative exit valuation within the previous 12 months.

4.7 Section 7.11 of the FSS ('Employers Leaving the Fund') has been amended to highlight this latter change. Further, for completeness wording has been added to confirm that when such valuations are carried out, up-to-date membership data will be used. This approach, as opposed to 'rolling forward' membership data from the last triennial valuation, means that liabilities will be valued more accurately and will therefore reduce risk to the Fund and employer.

Review by Fund actuary, Hymans Robertson

4.8 The draft revised FSS was shared with the Fund actuary who reviewed and provided comments for consideration. In the main, comments related to clarification of certain points for ease of reading, however Committee may wish to note the following key amendments:

- References to the suspension of the Contribution Stability Mechanism have been amended to confirm that it previously covered the period to 31 March 2024 to prevent confusion.
- The table in Section 7.6 (Employer Time Horizons') has been amended to confirm time horizons for specific employers.
- Section 2.3 ('Principles for determining payment') of the Bulk Transfer policy (Appendix B) has been amended to confirm that transfer terms will be negotiated by the relevant actuaries and that if agreement cannot be reached for any reason, an independent third actuary will be consulted.
- In Appendix E ('Calculation of Employer Contributions'), the table setting out how the methodology will be applied to individual employers has been amended to ensure that all employers are included. In addition, the Actuary has also provided another version of the table showing the calibration of the Economic Scenario Service as at 31 March 2023. The revised table shows annualised returns for 10, 20 and 40 years compared to 5,10 and 20 years in the previous version.
- The salary strain mechanism does not apply to employers which are part of the contribution stability mechanism. In addition, the salary strain monitoring only relates to benefits built up in the scheme before 1 April 2015. Such benefits are final salary benefits and therefore salary increases have a direct impact on the member's benefits on retirement.

5. Financial impact

5.1 The funding strategy is intended to ensure that the Fund has sufficient assets in the long term to meet is liabilities.

6. Stakeholder/Regulatory Impact

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

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

7. Background reading/external references

7.1 None.

8. Appendices

Appendix 1: Draft revised Funding Strategy Statement.
Appendix 2: Funding Strategy Statement – response to employer comments

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Appendix 1

LOTHIAN
PENSION FUND

Funding Strategy Statement

CONTENTS

1. INTRODUCTION

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

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

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

This statement was approved by the Pensions Committee on 20 March 2024 and is effective from 21 March 2024. It replaces all previous Funding Strategy Statements and policies on funding.

1.1 Maintenance

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

1.2 Availability

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

LOTHIAN
PENSION FUND

2. PURPOSE OF THE FUNDING STRATEGY STATEMENT

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

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

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

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

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

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

2.1 Regulatory Framework

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

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

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

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

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

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

3. AIMS AND PURPOSE OF THE FUND

3.1 Aims of the Fund

The aims of the Fund are to:

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

3.2 Purpose of the Fund

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

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

4. AIMS AND RESPONSIBILITIES OF THE KEY PARTIES

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

4.1 The Administering Authority should:

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

4.2 The individual Employers should:

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

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

4.3 The Fund Actuary should:

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

5. GENERAL FUNDING AND SOLVENCY ISSUES

5.1 Funding Principles

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

5.2 Solvency

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

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

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

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

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

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

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

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

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

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

5.3 Long term cost efficiency

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

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

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

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

5.4 Financial Assumptions and link to investment strategies

The key financial assumption in calculating the solvency and contribution rates is the rate of return which will be achieved on the Funds' investments. The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns (resulting from the investment strategy). To the extent that investment returns may be lower than expected, then higher contributions may be required from employers, and vice versa. Hence, the funding and investment strategy are inextricably linked.

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

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

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

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

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

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

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

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

5.5 Demographic Assumptions

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

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

5.6 Contributions

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

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

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

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

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

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

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

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

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

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

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

LOTHIAN PENSION FUND

6. FUNDING – SCOTTISH HOMES PENSION FUND

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

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

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

7. FUNDING – LOTHIAN PENSION FUND

7.1 Objectives of the Lothian Pension Fund's Funding Strategy

The objectives of the funding strategy include:

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

7.2 Investment Strategy

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

<u>Primary Strategy</u>
This strategy adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer.

This strategy applies to the following types of employers:

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

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

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

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

Lower Risk Strategy

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

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

This strategy applies to the following types of employers:

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

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

Medium Risk Strategy

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

This strategy applies to the following types of employers:

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

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

Lothian Buses

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

Allocation to strategies

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

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

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

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

LOTHIAN PENSION FUND

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

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

7.3 Employer Asset Tracking

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

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

7.4 Setting employer contribution rates

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

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

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

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

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

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

Changes in employer contributions may be phased over time in order to minimise the degree of short-term change and enhance affordability. The Administering Authority, in consultation with the Fund's Actuary decides how any reductions or increases to contribution rates are introduced, taking into account specific employer circumstances.
Further information on calculating employer contribution rates is set out in Appendix E.

7.5 Contribution Stability

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

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

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

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

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

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

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

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

A contribution stability mechanism operated between 2013 and 31 March 2023. From 1 April 2024, the contribution stability mechanism will be suspended for a period of three years and is expected to be reintroduced following the 2026 actuarial valuation. A review will be carried out in 2025 in order to establish how the stabilisation mechanism will operate following the 2026 valuation.

Commented [DV1]: Probably need to retain some mention 2the CSM operated between 2013 and 2023. It was suspended at the 2023 valuation and is expected to be reintroduced prior to 2026". You have the second part. Think the first is necessary

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

7.6 Employer time horizons

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

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

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

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

<table>
<tr><th></th><th>Employer</th><th>Time Horizon (Years)</th></tr>
<tr><td rowspan="9">Councils/Large Scheduled bodies</td><td>City of Edinburgh Council</td><td rowspan="8">20</td></tr>
<tr><td>Midlothian Council</td></tr>
<tr><td>West Lothian Council</td></tr>
<tr><td>East Lothian Council</td></tr>
<tr><td>Scottish Fire & Rescue Service (Civilians)</td></tr>
<tr><td>Scottish Police Authority</td></tr>
<tr><td>Lothian Valuation Joint Board</td></tr>
<tr><td>Scottish Water</td></tr>
<tr><td>Visit Scotland</td><td>15</td></tr>
<tr><td rowspan="8">Universities / Colleges</td><td>Heriot-Watt University</td><td rowspan="6">15</td></tr>
<tr><td>Newbattle Abbey College</td></tr>
<tr><td>Queen Margaret University College</td></tr>
<tr><td>Napier University</td></tr>
<tr><td>Edinburgh College</td></tr>
<tr><td>West Lothian College</td></tr>
<tr><td>Scottish Rural University College</td><td rowspan="2">FWL [1]</td></tr>
<tr><td>University of Edinburgh</td></tr>
<tr><td></td><td>Edinburgh Leisure</td><td>15</td></tr>
<tr><td></td><td>Enjoy East Lothian
Lothian Buses
LPFE
Scottish Futures Trust
West Lothian Leisure</td><td>20 ~~(TBC)~~</td></tr>
<tr><td>Other ~~T~~transferee Admission Bodies</td><td>Transferee Admission Bodies not named above</td><td>Shorter of FWL [1] or contract period</td></tr>
<tr><td>Employers open to new entrants</td><td>Scheduled bodies and open Community Admission Bodies not named above</td><td>15</td></tr>
<tr><td>Employers closed to new entrants</td><td>Closed Community Admission Bodies not named above</td><td>FWL [1]</td></tr>
</table>

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

7.7 Admission bodies – affordability constraints

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

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

7.8 Post Valuation adjustments

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

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

7.9 Review of Employer Contribution Rates

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

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

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

7.10 Employers joining the Fund

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

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

7.11 Employers leaving the Fund

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

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

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

In order to make an informed decision, an employer considering exiting the fund may request an indicative exit valuation. The fund will arrange for indicative exit valuations to be provided unless the employer has requested an indicative exit valuation within the previous 12 months. Indicative exit valuations will be carried out using up-to-date membership data to ensure that liabilities are valued accurately.

7.12 Bulk Transfers

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

8. KEY RISKS AND CONTROLS

The Administering Authority has an active risk-management programme in place. The risk register is reviewed on an ongoing basis by the Risk Management Group, with a quarterly summary provided to the Pensions and Audit Sub-Committees. The following extract from the risk register, with Impact and Probability for each risk scored on a scale of 1-5, highlights those risks which can be considered of particular relevance to the funding strategy:

Risk Register as at December 2023

Risk Description	Existing controls	Impact	Probability	Current Risk
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	• Investment management oversight model including reviews, policy statements and quantitative analysis. • Formal review of strategy and investment assumptions as part of triennial valuation. • Asset liability studies. • Quarterly performance and funding level assessment by Joint Investment Strategy Panel. • Bespoke investment strategy offered to eligible employers.	3	3	
Failure of an employer with a deficit, or failure to pay required contributions or failure to fulfil a funding agreement on cessation may lead to the balance to be met by higher contributions from remaining employers	• Admissions Policy, including use of guarantees. • Regular contact with employers. • Education to improve understanding, including grant funding implications. • Annual employer covenant review, and quarterly membership monitoring. • Funding Strategy Statement includes alignment of higher-risk employers to Councils as appropriate. • Funding agreements in place for payment of cessation debt and security sought where appropriate. • Affordability confirmation built into Funding Strategy Statement.	3	3	

	• Staff reminded of late reporting procedures regarding late payments to enable prompt action from the fund. • Additional employer covenant analysis and engagement in response to COVID-19 carried out with updates to be provided to all four Councils regarding aligned bodies.			
Unexpected drop in funding levels may require higher employer contributions which may be unaffordable to employers.	• Triennial valuation process. • Contribution stability mechanism and testing. • Funding Strategy Statement. • Investment strategy and monitoring.	2	3	
Insufficient funds and liquid assets to meet liabilities or capital requirements which may arise through contribution payment failure by employers, unexpected employer exits, shortfalls in expected investment income, unexpected investment calls and failure and delays of creditors and receivables.	• Quarterly review of financial performance highlights financial position of fund and subsidiaries by Financial Controller and Chief Financial Officer. This will highlight current cash position of the fund. • Regular review of cash position by Financial Controller also highlights if significant deterioration of operating account. • Action is then taken by Financial Controller to recall funds from Treasury activities.	2	3	
Investment Strategy does not deliver investment objective due to incorrect implementation, investments falling outside agreed risk parameters or inadequate Joint Investment Strategy Governance. This could lead to a fall in funding	• Joint investment panel with other Local Government Pension Scheme funds meets quarterly and provides advice and input on strategy. • Independent advisers in place on joint panel. • Front office systems pre- and post-trade monitoring in place to ensure implementation in line with strategy. Exceptions reported to investment team and monitored by investment committees and Joint Investment Strategy panel. • All trades placed follow approval rules before being placed. • Second line compliance checks are undertaken to review and escalate alerts when investments are outside agreed parameters.	2	2	

level.				
Lothian Pension Fund 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 challenge.	• Statement of Responsible Investment Principles updated annually. • Regular review of Scottish Local Government Pensions Scheme Advisory Board advice on fiduciary duties. • Pension Committee training on Responsible Investing and climate change risks. • Joint Investment Strategy Panel reviews climate-centred risks and opportunities at least annually. • Adherence to the UK Stewardship Code 2020 requirements.	3	3	

APPENDIX A: ADMISSION POLICY

1. Background

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

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

This policy will be reviewed as and when considered necessary.

2.General application of discretion to admit new bodies

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

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

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

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

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

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

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

4.Policy in relation to other admission bodies

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

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

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

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

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

LOTHIAN PENSION FUND

APPENDIX B: BULK TRANSFER POLICY

1. Background

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

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

1.1. Regulatory Framework

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

1.2 Reviews of Policy

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

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

2. Principles

2.1. Over-riding Principles

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

<u>Transfers Out</u>

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

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

<u>Transfers in</u>

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

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

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

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

Transfer terms for both bulk transfers-in and transfers-out will be negotiated by the relevant actuaries, and if agreement cannot be reached for any reason, an independent third actuary will be consulted.

Intra-fund transfers

On transfers from one Fund employer to another existing Fund employer, assets equal to 100% of the transferring liabilities will be transferred, unless otherwise agreed.

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

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

Direction Orders

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

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

When liabilities are transferred into the Fund:

- Before agreement to the transfer can be provided, the employer must provide sufficient assurance to the Fund's satisfaction;
- Where applicable, the employer's guarantor/aligned body must agree to the transfer;
- In situations where the transfer will result in a deterioration of the employer's funding level, the employer must undertake to make such additional contributions to make good the shortfall. The level of contributions required, and the period of time over which these will be

paid will be determined by the Fund in consultation with the Actuary; and

- The ceding fund must provide assurance that membership data meets the Pension Regulator's common and conditional standards. This will ensure that liabilities transferred are correct.

Where liabilities are transferred out of the Fund:

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

2.2 Interaction with funding policy

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

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

2.3 Principles for determining payment

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

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

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

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

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

3. Process

3.1. Responsibilities of ceding/receiving employers

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

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

3.2. Responsibilities of the Administering Authority

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

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

3.3. Responsibilities of the Actuary

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

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

APPENDIX C: POLICY ON EMPLOYERS LEAVING THE FUND

1. Introduction

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

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

1.1 Scope of Policy

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

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

1.2 Reviews of Policy

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

2. Principles

2.1. Overriding Principles

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

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

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

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

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

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

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

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

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

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

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

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

2.2 Principles for Determining Payment of Exit Debt

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

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

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

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

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

- allowing payment of any exit debt over longer terms rather than insisting on payment as a one-off payment or over shorter terms previously agreed;
- foregoing interest on such longer-term debt;
- agreeing repayment of an amount less than the exit debt in order to avoid the employer's insolvency, with an appropriate agreement which allows the Fund to revisit the repayment of the remaining debt at a future date (i.e. the debt would be a contingent liability and hence not recognised on an employer's balance sheet); and
- seeking, where appropriate, suitable anti-embarrassment provisions in a legal agreement to address future improvements in the employer's financial circumstances. The Fund may take into account the covenant strength of the employer (including the availability of security in respect of the exit debt) and any successor body and/or guarantor which may be in place after the exit date. Interest at a rate advised by the Actuary may be applied to determine the appropriate payments to be made to the Fund.

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

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

the employer's assets; and

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

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

LOTHIAN PENSION FUND

APPENDIX D: CHARGING POLICY

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

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

1. Costs recharged to scheme members

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

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

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

2. Costs recharged to scheme employers

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

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

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

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

3. Schedule

3.1 Actuarial Fees

Activities for which Lothian Pension Fund should be charged:

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

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

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

3.2 Other charges

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

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

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

Activities for which fees will be recharged to an employer:

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

Regulatory recharges

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

Notes:

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

LOTHIAN PENSION FUND

APPENDIX E: CALCULATION OF EMPLOYER CONTRIBUTIONS

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

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

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

The general policy of the fund is to operate a Contribution Stability Mechanism (CSM) which will apply to certain employers in the Fund. A CSM operated between 2013 and 2023. For the period 1 April 2024 – 31 March 2027, the CSM will be suspended. It is expected to be reintroduced following the 2026 valuation. For the purposes of setting employer contribution rates, employers will continue to be classified as stabilised or non-stabilised. Further information is set out in Section 7.5 of the Funding Strategy Statement.

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

~~Type of Employer~~	~~Scheduled~~			~~Transferee Admission Bodies~~	~~Community Admission Bodies~~					
~~Sub-Group~~	~~Group 1~~	~~Group 2~~	~~Group 3~~	~~N/A~~	~~Open 1~~	~~Open 2~~	~~Closed 1~~	~~Closed 2~~	~~Closed 3~~	~~Lothian Buses~~
~~Investment Strategy~~	~~Main~~	~~Main~~	~~Main~~	~~Main~~	~~Main~~	~~Main~~	~~Medium~~	~~Low~~	~~Main~~	~~Lothian Buses~~
~~Stabilised contribution rate?~~	~~Yes~~	~~Yes~~	~~No~~	~~No~~	~~Yes~~	~~No~~	~~No~~	~~No~~	~~No~~	~~No~~
~~Funding Target Basis used~~	~~Ongoing~~	~~Ongoing~~	~~Ongoing~~	~~Ongoing~~	~~Ongoing~~	~~Ongoing~~	~~Gilts~~	~~Gilts~~	~~Ongoing~~	~~Gilts~~
~~Time Horizon (years)~~	~~20~~	~~15~~	~~15~~	~~Shorter of FWL [1]/ contract length~~	~~15~~	~~15~~	~~FWL~~	~~FWL~~	~~FWL~~	~~20~~
~~Likelihood of~~	~~80%~~	~~80%~~	~~[2]~~	~~[2]~~	~~[2]~~	~~[2]~~	~~N/A~~	~~N/A~~	~~N/A~~	~~80%~~

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~~achieving target~~

Type of Employer	Scheduled		Transferee Admission Bodies		Community Admission Bodies							
Sub-Group	Group 1	Group 2	TAB 1	TAB 2	Open 1	Open 2	Open 3	Closed 1	Closed 2	Closed 3	Closed 4	Lothian Buses
Investment Strategy	Main	Main	Main	Main	Main	Main	Main	Medium	Low	Main	Main	Lothian Buses
Stabilised contribution rate?	Yes	Yes	No	No	Yes	No	No	No	No	No	No	No
Funding Target Basis used	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Medium	Gilts	Ongoing	Ongoing	Gilts
Time Horizon (years)	20	15	20	Shorter of FWL [1}/ contract length	15	20	15	FWL	FWL	FWL	20	20
Likelihood of achieving target	80%	80%	[2]	[2}	[2]	[2]	[2]	N/A	N/A	N/A	80%	80%

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

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

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

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

These general principles apply to the majority of the Fund's employers. However, the Fund retains discretion to choose the most appropriate method based on an employer's specific circumstances, and this affects a small number of employers in practice. In particular, contribution rates for certain employers may be frozen to protect the accumulated surplus position at 31 March 2023.

Calculation of employer contribution rates: calculation methodology

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

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

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

The Secondary rate is an adjustment to Primary rate and may be either positive or negative. Where the secondary rate is positive, this is calculated as the balance over and above the Primary rate, such that the total contribution rate is projected to:

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

When the risk-based approach is used, ~~T~~the projections are carried out using an economic modeller (the "Economic Scenario Service") developed by the Fund's Actuary Hymans Robertson: this allows for a wide range of outcomes on key factors such as asset returns (based on the employer's investment strategy), inflation, and bond yields. The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (at the end of the time horizon) is at least equal to the required likelihood.

Additional prudence has been included in the calculation of employer contribution rates from 1 April 2024 by building in the potential for an asset shock of 20% - that is a reduction in the value of current assets applied proportionally across all assets held by the fund. This means in the event of an immediate and permanent loss of assets of this scale, the contribution plan would still meet the minimum likelihood of success.

Actuarial Assumptions used to calculate employer contribution rates

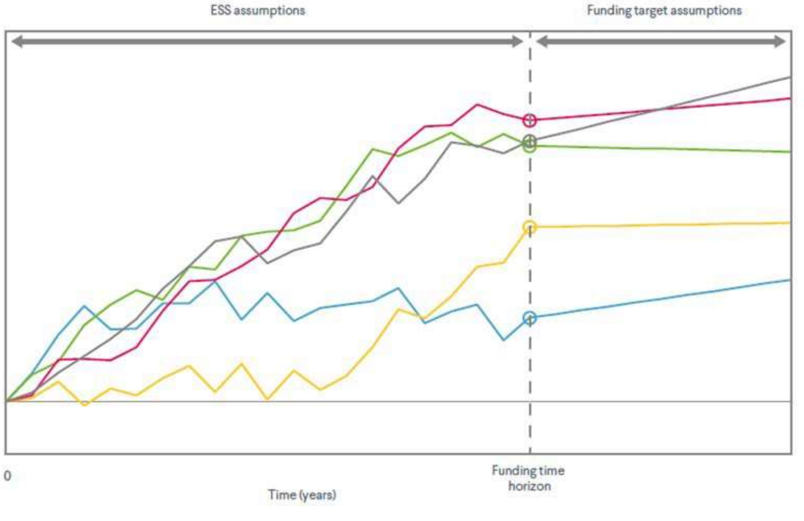
These are expectations of future experience used to place a value on future benefit payments ("the liabilities") and future asset values. Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions).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

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

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

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

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



What assumptions are used in the ESS?

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

The ESS is a complex model to reflect the interactions and correlations between different asset classes and wider economic variables. The table below shows the calibration of the model as at 31 March 2023. All returns are shown net of fees and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to the simulated yields at that time horizon.

LOTHIAN PENSION FUND

		Annualised total returns							Inflation/Yields		
Time Period	Percentile	Cash	All World ex-UK Equity	UK Equity	Index Linked Gilts (medium)	Fixed Interest Gilts (medium)	Property	Corporate Debt	Inflation (CPI)	17 year real yield (CPI)	17 year yield
10 years	16th	2.5%	1.1%	1.3%	0.8%	2.4%	1.2%	2.7%	0.9%	-0.3%	2.7%
	50th	3.6%	7.3%	7.5%	2.8%	3.7%	6.2%	4.3%	2.5%	0.9%	4.1%
	84th	4.7%	13.6%	13.5%	5.1%	4.9%	11.5%	5.8%	4.1%	2.2%	5.9%
20 years	16th	2.3%	2.8%	3.0%	1.0%	3.3%	2.7%	3.7%	0.7%	-0.5%	1.4%
	50th	3.7%	7.4%	7.5%	2.7%	4.1%	6.4%	4.7%	2.3%	1.3%	3.4%
	84th	5.4%	12.2%	12.0%	4.5%	4.8%	10.3%	5.8%	3.9%	2.9%	5.9%
40 years	16th	1.8%	3.7%	3.9%	1.0%	2.9%	3.2%	3.4%	0.6%	-0.6%	1.2%
	50th	3.5%	7.2%	7.4%	2.7%	3.7%	6.2%	4.4%	2.0%	1.3%	3.3%
	84th	5.7%	10.9%	10.9%	4.6%	4.9%	9.5%	5.8%	3.5%	3.2%	6.1%
	Volatility (Disp) (5 yr)	2%	18%	18%	7%	5%	15%	6%	3%	-	-

What assumptions are used in the funding target?

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

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

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

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

Funding Basis	Ongoing basis	Medium-risk basis	Low-risk basis
Employer type	All employers except Community Admission Bodies closed to new entrants*	Community Admission Bodies closed to new entrants with 5 or more active members	Community Admission Bodies closed to new entrants with 5 or fewer active members
Investment return assumption underlying the employer's funding target (at the end of the time horizon)	Long-term government bond yields plus an asset outperformance assumption (AOA) of 1.6% +p.a**	Long-term government bond yields plus an asset outperformance assumption (AOA) of 0.8% +p.a	Long-term government bond yields with no allowance for outperformance on the fund's assets

*See section 7.2 for full information on employers to whom ongoing basis applies.

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

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APPENDIX F: SALARY STRAIN RECHARGING MECHANISM

What is salary strain?

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

Why is a salary strain mechanism in place?

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

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

The salary assumption agreed as part of the 2023 valuation is 3.0%. Although this is higher than the assumption used previously, the salary strain mechanism is retained as part of the Fund's ongoing monitoring and risk management processes.

How does the mechanism work?

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

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

- Where the employer has a funding level in excess of 130% the strain will be waived (although the employer can still pay), subject to the agreement of the scheme employer acting as guarantor (where applicable);

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

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

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

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

What if salary increases are less than expected?

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

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

Appendix 2

Funding Strategy Statement – responses to employer comments

As required under the Local Government Pension Scheme Regulations 2018, the fund reviewed the Funding Strategy Statement (FSS), as part of the 2023 valuation process. The regulations also require that the fund must consult with employers on any changes being made.

The draft revised FSS was approved by Pensions Committee in December 2023 and issued to employers on 21 December 2023 as part of a special edition of the employer bulletin. The bulletin advised that the consultation period would run until 31 January 2024.

Officers received two official responses to the consultation. These comments and our feedback are detailed below:

- 'Regarding the change in setting of employer contribution rates; it is recognised that given the surplus at the most recent valuation, increased prudence to the likelihood of achieving the funding target has been built in, and the contribution stability mechanism has been suspended for the current valuation period. However, it is less clear how an equitable approach has been applied to the proposed reduction for stabilised employers (to pay contributions at a lower rate than previously expected) i.e. given not all long-term stabilised employers were paying the same rate, a revised common rate represents different levels of reduction relative to the current rates payable. How will this variance be addressed at the next valuation if/when the CSM is re-introduced?'

  Employer contribution rates are based on individual circumstances and as noted above, not all stabilised employers have paid the same employer contribution rate in the 2023/24 year. The 2023 valuation results have allowed the fund to propose a suspension in the contribution stability mechanism and a reduction to employer contribution rates for the three years from 1 April 2024. It is unclear however what the results will be at the next valuation and although additional prudence has been built into the valuation, there is a risk that rates may have to revert to previous levels (or higher). In applying contribution reductions, the employers with the largest membership group have seen the greatest reduction. These employers, with their larger membership base, and tax-raising powers, will be better placed to withstand any significant increases in contribution rates at the next valuation.

- 'Appendix E states "In particular, contribution rates for certain employers may be frozen to protect the accumulated surplus position at 31 March 2023". Is there a process and criteria for deciding which employers that this might apply to?'

  The fund is made of a variety of different employer types, from large Councils to small third sector bodies. The largest, most secure bodies were part of the Contribution Stability Mechanism (CSM), but smaller bodies were not. Appendix E of the FSS sets out how employer contributions are calculated. The table sets out the different employer groups and the funding bases which apply. As noted in Appendix E Employer covenant is also an important consideration and discussions with guarantors (where applicable) have also taken place.

- 'It also states in Appendix E that; "Additional prudence has been included in the calculation of employer contribution rates from 1 April 2024 by building in the potential for an asset shock of

20% - that is a reduction in the value of current assets applied proportionally across all assets held by the fund". Will this prudence be built in for future valuations or is it only for this year to take account of the better improvement in the funding position?'

The strong valuation results as at 31 March 2023 have resulted in a significant surplus at the valuation date. This result has been due to greater than expected investment returns and therefore we have taken steps to protect the fund, not only by moving some assets from more volatile equities to less risky assets, but also by ensuring that employer contribution rates set will be able to withstand an asset shock of 20%. We cannot predict the valuation results in 2026, but prudence is always a key consideration in any valuation and should a similarly strong surplus position arise in 2026, we may consider such steps again.

- 'We would like the opportunity to engage in the planned review of the stability mechanism taking place in 2024'.

  The contribution stability mechanism will be reviewed in December 2025 in advance of the 2026 triennial valuation. This will be a full review of asset liability modelling by the actuary and results and recommendations will be presented to Pensions Committee in December 2025. We will advise employers of the results and will also update our FSS to include details of how the mechanism will operate from 1 April 2027. Employers will, as always be consulted on changes to the FSS.

- 'It would be useful if someone could confirm when we might have confirmation of what the maximum change would be when the stability mechanism is reintroduced. We would need these changes to be controlled to allow planning for the increased costs that this may bring'.

  As noted above, we plan to carry out the review of the CSM in 2025 and this will allow us to complete the process in advance of the 2026 valuation which will set employer contributions for the three years from 1 April 2027. We fully understand that employer budgetary planning cycles do not align with the valuation but as always we will give as much notice as possible of changes.

Pensions Audit Sub Committee

2.00pm, Tuesday, 19 March 2024

Actuarial Valuation for Lothian Pension Fund

Item number 6.3

1. Recommendations

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

1.1 Note the results of the 2023 Actuarial Valuation of Lothian Pension Fund.

Alan Sievewright
Chief Finance Officer, Lothian Pension Fund

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

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

Actuarial Valuation for Lothian Pension Fund

2. Executive Summary

2.1 An actuarial valuation of Lothian Pension Fund (LPF) must, by law be carried out every three years. The fund actuary assesses the financial health of the pension fund and sets the employer contribution rates required for the next three years. The last actuarial valuation was carried out as at 31 March 2020.

2.2 The actuarial valuation of LPF, based on data as at 31 March 2023 has been carried out by the fund actuary, Hymans Robertson and the final valuation report is attached as Appendix 1.

3. Background

3.1 The Local Government Pension Scheme (Scotland) Regulations 2018 require each administering authority to obtain:

- An actuarial valuation of the assets and liabilities of each of its pension funds as at 31 March 2020 and on 31 March in every third year afterwards;
- A report by an actuary in respect of the valuation; and
- A rates and adjustments certificate prepared by the actuary.

3.2 The Regulations require that the actuarial valuation based on data as at 31 March 2023 must be completed by 31 March 2024.

3.3 The actuarial valuation has three main purposes:

- To assess whether the funding strategy and assumptions are appropriate;
- To assess the financial health of the pension fund; and
- To set the future rates of contributions payable by the fund employers.

3.4 In December 2023, Pensions Committee approved a draft revised Funding Strategy Statement (FSS) which outlined several key changes introduced for the 2023 valuation. The key change was the suspension of the Contribution Stability Mechanism for the period 1 April 2024 to 31 March 2027.

3.5 A separate report on the revised FSS is provided on this agenda.

4. Main Report

4.1 The 2023 Actuarial Valuation report for Lothian Pension Fund, as submitted by the actuary, is included at Appendix 1.

Funding Level - Summary

4.2 The table below summarises the financial position of the fund as at 31 March 2023.

Past Service Position	2020	2023
Past Service Liabilities £m	£7,071	6,170
Assets £m	£7,479	9,695
Surplus/(Deficit)	408	3,525
Funding Level	**106%**	**157%**

4.3 The results show the funding level has increased from 106% at the previous valuation to 157% at this valuation, and there was a surplus of £3,525 million at 31 March 2023.

4.4 Section 3.5 of Appendix 1 sets out the various factors that have led to the change in the funding position between the 2020 and 2023 valuations.

4.5 Committee will remember from previous training and briefing sessions that the key driver behind the improvement in results was investment performance over the three-year period and a higher discount rate that reduces the present value of accrued liabilities.

Employer Contribution Rates

Whole Fund

4.6 The table below compares the whole fund Primary and Secondary Contribution Rates at this valuation to those set at the previous valuation as at 31 March 2020:

	Last Valuation 31 March 2020		This Valuation 31 March 2023	
Primary rate (% of pay)	23.1		25.0	
Secondary rate (£)	2021/2022	-11,262,000	2024/25	-73,589,000
	2022/2023	-11,378,000	2025/26	-75,809,000
	2023/2024	-11,530,000	2026/27	-78,095,000

4.7 The increase in the primary rate is primarily the result of increasing the level of prudence in the valuation assumptions, whilst the larger negative secondary rate leading to an overall reduction in total contributions reflects the strong funding position of the fund.

Common Contribution rate

4.8 The rates in the table above show the position of the overall fund, however contribution rates are set for each employer depending on their individual funding position and membership. The minimum contributions to be paid by each employer from 1 April 2024 to 31 March 2027 are shown in the Rates and Adjustments Certificate - Appendix 5 of the actuary's report which is included as Appendix 1.

4.9 The actuary must provide a whole fund common contribution rate in the report. The Primary rate is the payroll weighted average of the underlying individual employer Primary rates, and the Secondary rate is the total of the underlying individual employer Secondary rates, calculated in accordance with the Scheme regulations.

4.10 As the common contribution rates are based on the weighted payroll average, the Primary contribution rate is impacted by the fact that the largest employers have seen a reduction in contribution rates. In addition, there has been a reduction in the number of employers since the 2020 valuation, and some of the employers with the highest Primary rates have left the fund.

Individual employer results

4.11 The rates in the table above show the position of the overall fund, however contribution rates are set for each employer depending on their individual funding position and membership. As noted above, the minimum contributions to be paid by each employer from 1 April 2024 to 31 March 2027 are shown in the Rates and Adjustments Certificate - Appendix 5 of the actuary's report which is included as Appendix 1.

4.12 As previously advised to Committee in previous briefings and training sessions, the improved valuation results have meant that the Contribution Stability Mechanism (CSM) has been suspended for the three-year period from 1 April 2024 to 31 March 2027. The CSM would have led to a reduction of no more than 0.5% per annum from 1 April 2027 for stabilised employers. Due to the improved funding position, the fund and the actuary have been able to reduce rates to a greater extent. The majority of stabilised employers will have a flat rate of 17.6% for the three years from 1 April 2024. Any stabilised employer with rates already below this level will have rates frozen at the 2023/24 level.

4.13 The CSM is only available to certain employers, specifically those which are open to new entrants, have sufficiently strong covenant and, where applicable their guarantor agrees to their participation. Further information is set out in Section 7.5 of the FSS. For non-stabilised employers, consideration of specific employer circumstances, including covenant strength and time horizon have been taken into account when setting employer rates.

4.14 Committee will recall that in setting contribution rates, in order to build in additional prudence, the following steps have been taken:

- Building in an asset shock of 20% to protect the fund against a fall in asset values and future expected investment returns;
- Increasing the likelihood of success to 80%; and
- Making a moderate reduction in the amount of assets invested in more volatile assets. More detailed information on this point is set out in the investment strategy review paper.

4.15 Further details about contribution rates for specific employers are detailed in Appendix 2.

Communication

4.16 Indicative employer results were provided to employers in November 2023, following a presentation from the actuary at an employer seminar. Fund officers met with employers on an individual basis to provide further information on their draft valuation results and proposed employer contribution rates.

4.17 Some employers provided information to their employees about their draft valuation results and indicative employer contribution rates which are lower than those paid in the 2023/24 year. This has led to the fund receiving a number of queries from members concerned about the impact this might have on their pension benefits. Fund officers have responded to these queries providing reassurance that as a statutory defined benefit pension scheme, benefits are not based on the amount of contributions paid, but instead on the rules of the scheme which are set out in law.

4.18 A press release and website update regarding the valuation results have been prepared and these will be published following Committee. In future valuations, employers will be reminded that initial results are draft only and information should not be more widely disclosed prior to the Committee approving the FSS, having sight of the final valuation report and thus confirming the new contribution rates.

Confirmation of affordability

4.19 Section 7.7 of the FSS requires employers to provide written confirmation that minimum contribution rates set by the actuary are not unaffordable.

4.20 At the time of writing, such confirmation has been provided by 45 out of 60 employers. Fund officers are continuing to engage with the remaining employers and a verbal update will be provided to Committee.

Climate change risk

4.21 As noted above, several training and briefing sessions were held for members of Committee and the Pensions Board. At these sessions, Committee asked for additional information on how additional information on how climate change risk was being taken into account within the valuation. This followed publication of the report 'The Emperor's New Climate Scenarios' by the Institute and Faculty of Actuaries and the University of Exeter which questioned whether current economic models underestimated the risks of climate change Climate change. Similar views were also expressed by Carbon Tracker at an event hosted by the City of Edinburgh Council.

4.22 To this end, a paper outlining the risks climate change poses to the funding strategy, and the measures currently being taken to manage these risks is attached as Appendix 3.

5. Financial impact

5.1 The funding strategy should ensure that the fund has sufficient assets in the long term to meet its liabilities.

5.2 The results of the actuarial valuation have significant financial impact on the fund's employers. The actuarial valuation sets the minimum contribution rates payable by the employer over the next 3 years.

5.3 The fund is required by law to carry out an actuarial valuation once every three years. Regular actuarial valuations manage the risk of not meeting funding objectives.

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 Training sessions on the draft valuation results were held for members of the Committee and Pensions Board in October and November 2023. The session in October included a presentation by the fund actuary.

6.3 Employers have been consulted on changes to the Funding Strategy Statement.

6.4 Further meetings and discussions were held with employers in December 2023 and January and February 2024 to consider the valuation results in greater detail.

6.5 The requirements of the Local Government Pension Scheme (Scotland) Regulations 2018 as they pertain to the valuation have been met in full.

7. Background reading/external references

7.1 None.

8. Appendices

Appendix 1: Lothian Pension Fund 2023 Valuation Final Valuation Report

Appendix 2: Employer contribution rates.

Appendix 3: Managing Climate Risk.

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LPF PUBLIC DATA

Appendix 1

HYMANS ROBERTSON

Lothian Pension Fund

Report on the actuarial valuation as at 31 March 2023

March 2024

Richard Warden FFA

Julie Baillie FFA

For and on behalf of Hymans Robertson LLP

Hymans Robertson LLP

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hymans.co.uk

Contents

Executive summary

We have been commissioned by City of Edinburgh Council ("the Administering Authority") to carry out a valuation of Lothian Pension Fund ("the Fund") as at 31 March 2023. This fulfils Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2018. This report is a summary of the valuation.

1. Contribution rates

The contribution rates for individual employers set at this valuation can be found in the Rates and Adjustments certificate. Table 1 shows the combined individual employer rates set at this valuation and the last valuation.

Table 1: Whole fund contribution rates compared with the previous valuation

	31 March 2023		31 March 2020	
Primary rate	25.0% of pay		23.1% of pay	
Secondary rate	2024/25	-£73,589,000	2021/22	-£11,262,000
	2025/26	-£75,809,000	2022/23	-£11,378,000
	2026/27	-£78,095,000	2023/24	-£11,530,000

The primary rate has increased due to a combination of higher prudence in funding plans and higher future inflation expectations at 2023, compared to 2020. Further details of this higher prudence are set out in Section 2.2.3. The secondary rate has reduced due to strong investment performance since the last valuation, and higher future investment return expectations, leading to stronger past service funding positions amongst employers.

2. Funding position

At 31 March 2023, the past service funding position has improved from the last valuation at 31 March 2020. Table 2 shows the single reported funding position at this valuation and the last valuation.

Table 2: Single reported funding position compared with the previous valuation

	31 March 2023	31 March 2020
	(£m)	(£m)
Active members	2,272	2,868
Deferred Pensioners	824	1,047
Pensioners	3,074	3,156
Total liabilities	**6,170**	**7,071**
Assets	**9,695**	**7,479**
Surplus (Deficit)	**3,525**	**408**
Fund level	**157%**	**106%**

The required investment return to be 100% funded is 2.2% p.a. (2.7% p.a. at 2020). The likelihood of the Fund's investment strategy achieving the required return is 95% (78% at 2020).

1 Approach to the valuation

1.1 Valuation purpose

The triennial actuarial valuation is an important part of the Fund's risk management framework. Its main purpose is to ensure the Fund continues to have a contribution plan and investment strategy that will achieve the objectives set out in the Funding Strategy Statement.

This report marks the culmination of the valuation process and contains its two key outcomes:

1. Employer contribution rates for the period 1 April 2024 to 31 March 2027
2. The funding level of the whole Fund at 31 March 2023.

Further information on the valuation process, methodology and strategy is set out in the publicly available Funding Strategy Statement, Statement of Investment Principles and published papers of the Fund's Pensions Committee. Additional material is also contained in Hymans Robertson's LGPS 2023 valuation toolkit.

1.2 Setting employer contribution rates

Employer contributions need to be set at a level which ensures the Fund has a reasonable likelihood of having enough money to pay members' benefits. Identifying the amount of benefits that may be paid is complex, as benefits earned today may only start being paid in 50 years' time. Over that period, there is significant uncertainty over factors which affect the cost of benefits eg inflation and investment returns. These uncertainties are allowed for by taking a risk-based approach to setting employer contribution rates. This approach is built around three key funding decisions set by the Fund.

1.2.1 Key funding decisions

Decision 1: What is the funding target for each employer?
Consider: Will the employer remain in the Fund for the long term or exit at some point?

Decision 2: What is the funding time horizon?
Consider: How long will the employer participate in the Fund?

Decision 3: What is the required likelihood of success?
Consider: How much prudence can the employer's covenant support in its funding plan?

1.2.2 Modelling approach

Asset-liability modelling is used to project each employer's assets and benefit payments into the future using 5,000 different economic scenarios. These are generated using Hymans Robertson's Economic Scenario Service (ESS). Further information on this can be found in Appendix 2.

A contribution rate is set for each employer which has (at least) the required likelihood of meeting the funding target over the relevant funding time horizon. The 5,000 projections of the employer's assets and benefits from the asset-liability model are used to quantify the likelihood that a given contribution rate will meet this target.

1.2.3 Risk budgeting

In recognition of uncertainty around climate risk and 'tail risks' in the asset-liability modelling, such as geo-political escalations and rapid reductions to interest rates, the Fund has added prudence into employer funding plans by:

- Increasing the confidence level – the 'likelihood of funding success' parameter described in 1.2.1 above was raised from a minimum of 67% (for some scheduled bodies) at the 2020 valuation to a minimum of 80% across all employers.
- Applying an asset shock – employer assets were reduced by 20% for the purpose of determining contribution rates.

These measures retain money in the Fund to hold as a buffer against future poor experience in the areas mentioned.

Page 99

1.3 Measuring the funding level

The past service funding level is measured at the valuation date. While it is limited in providing insight into a funding plan, it is a useful high-level summary statistic. A market-related approach is taken to calculate both the assets and the liabilities to ensure they are consistent with one another:

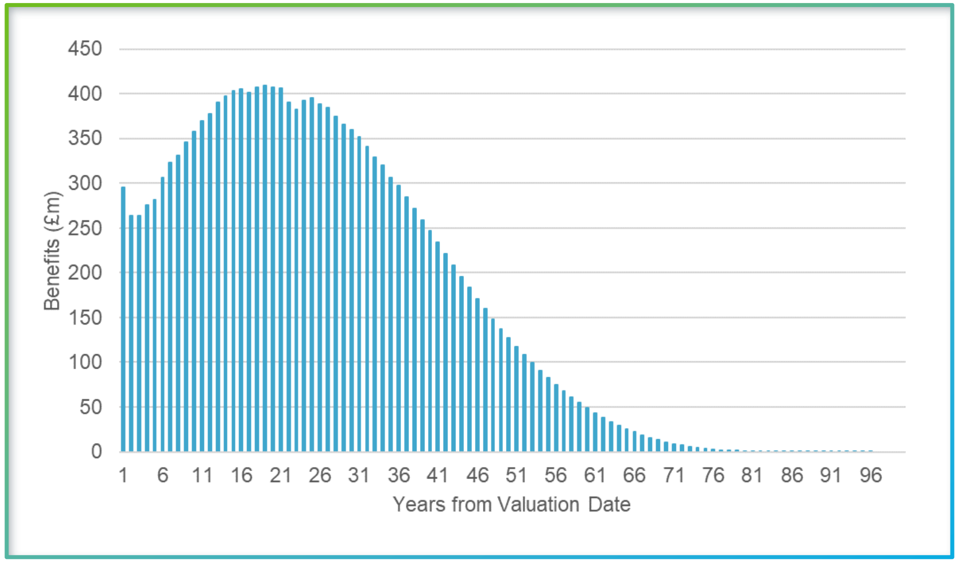
1. The bid-market value of the Fund's assets at the valuation date has been used.
2. The liabilities have been valued using assumptions based on market indicators at the valuation date (these assumptions are detailed in Appendix 2).

1.3.1 Calculating the liabilities

The liabilities are the value of all future payments to members based on all benefits earned up to the valuation date, expressed in today's money.

Chart 1 shows the projected payments for all members in the Fund at the valuation date. The projections are based on the membership data provided for the valuation (Appendix 1), the assumptions (Appendix 2), and our understanding of the LGPS benefit structure as at 31 March 2023 (details at www.scotlgpsregs.org).

Chart 1: Projected benefit payments for all service earned up to 31 March 2023



To express the future payments in today's money, each projected payment is discounted back to the valuation date in line with an assumed rate of future investment return (known as the discount rate').

2 Valuation results

2.1 Employer contribution rates

The primary objective of the Fund is to set employer contribution rates that will enable it to pay members' benefits. A secondary objective is to ensure the rates are as stable as possible. The risk-based approach detailed earlier is used to meet both those objectives.

The employer contribution rate is made up of two components.

1. **A primary rate:** the level sufficient to cover benefits that will be accrued in the future.
2. **A secondary rate:** the costs associated with sufficiently funding benefits accrued up to the valuation date.

Each employer has a contribution rate which is appropriate to their circumstances, and these can be found in the Rates & Adjustments Certificate (Appendix 5).

Broadly speaking, primary rates have increased due to a combination of higher prudence in funding plans and higher future inflation expectations at 2023, compared to 2020. Secondary rates have reduced due to strong investment performance since the last valuation, and higher future investment return expectations, leading to stronger past service funding positions amongst employers.

However, all employers will be different, and the contribution rate will reflect the membership and experience of each employer.

Table 3 shows the total of all employer contribution rates to be paid into the Fund at Whole Fund level over the period 1 April 2024 to 31 March 2027.

Table 3: Whole fund contribution rates compared with the previous valuation

	31 March 2023		31 March 2020	
Primary rate	25.0% of pay		23.1% of pay	
Secondary rate	2024/25	-£73,589,000	2021/22	-£11,262,000
	2025/26	-£75,809,000	2022/23	-£11,378,000
	2026/27	-£78,095,000	2023/24	-£11,530,000

The primary rate includes an allowance of 0.3% of pensionable pay for the Fund's expenses (0.3% of pay at the last valuation).

Employees pay a contribution to the Fund in addition to these rates. These rates are set by the LGPS Regulations. The average employee contribution rate at 31 March 2023 is 6.2% of pay (6.3% at 31 March 2020).

Page 101

2.2 Funding level

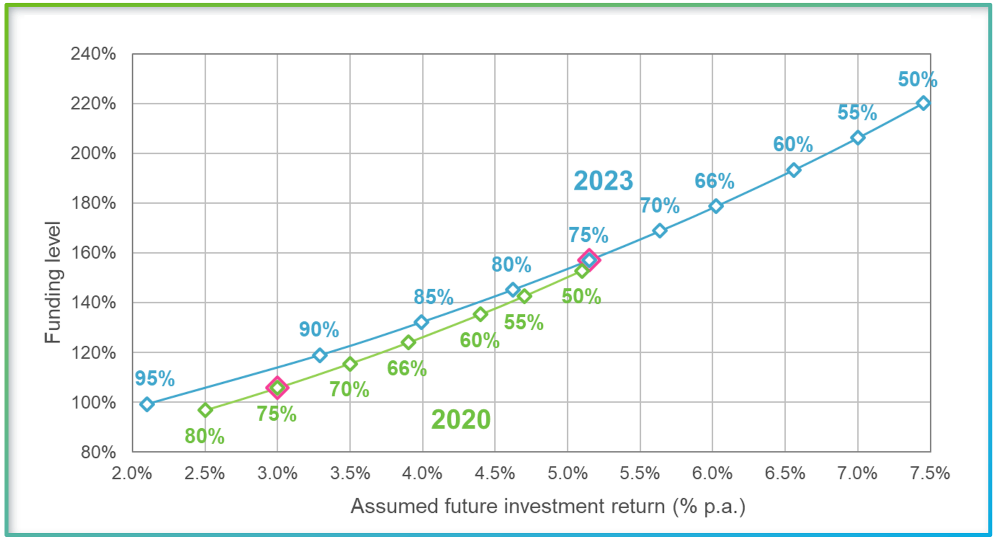
The funding level is the ratio of assets to liabilities. The market value of the assets at the valuation date is known. The value (in 'today's money') of the future benefit payments is uncertain given that the level of future investment returns is unknown.

To help understand funding risk, the liabilities and therefore the funding level have been calculated across a range of different assumptions for future investment returns (also known as 'discount rates'). The likelihood of the Fund's investment strategy (detailed in Appendix 1) achieving those levels of return has also been calculated.

Chart 2 shows how the funding level varies with different future investment return assumptions at 31 March 2023 (blue line). The green line shows the same analysis at 31 March 2020.

- The funding position at 2023 is stronger than it was in 2020.
- The funding level at 2023 will be 100% if future returns are around 2.2% pa. The likelihood of the Fund's assets yielding at least this return is around 95%.
- The comparator at 2020 was a return of 2.7% pa which had a likelihood of 78%.
- There is a 50% likelihood of an investment return of 7.5% pa, so the "best estimate" funding level is 220% at 31 March 2023 (153% at 2020).

Chart 2: Funding level across a range of future investment returns



Figures on each line show the likelihood of the Fund's assets exceeding the level of return over the next 20 years.

2.3 Single funding level as at 31 March 2023

While Chart 2 provides a better understanding of the past service funding position, there is still a requirement to report a single funding level at 31 March 2023.

To report a single funding level and funding surplus/deficit for the 2023 valuation, an assumed future investment return of 5.2% pa has been used. There is a 75% likelihood associated with this level of future investment return.

Table 4 sets out the assets and liabilities at the valuation date. The results at the 2020 valuation are shown for comparison.

The funding level and surplus/deficit figures provide a high-level snapshot of the funding position as at 31 March 2023, but there are limitations:

- The liabilities are calculated using a single set of assumptions about the future and so are very sensitive to the choice of assumptions.
- The market value of assets held by the Fund will change daily.

The future progression of the funding position is uncertain. If the financial and demographic assumptions made at this valuation occur in practice, employers pay contributions in line with the R&A certificate, and there are no other changes in the financial or demographic environment, we project that the funding level at the next valuation (31 March 2026) will stay approximately the same at 159%.

The Fund's long-term sustainable rate is 19.3% of pay (excluding expenses). The represents the required primary contribution rate, with a likelihood of success of 75%. This rate is not included in the R&A certificate and does not reflect any employer's current funding profile, only the cost of future service.

Table 4: Single reported funding position compared with the previous valuation

	31 March 2023	31 March 2020
	(£m)	(£m)
Active members	2,272	2,868
Deferred pensioners	824	1,047
Pensioners	3,074	3,156
Total liabilities	**6,170**	**7,071**
Assets	**9,695**	**7,479**
Surplus/(Deficit)	**3,525**	**408**
Funding level	**157%**	**106%**

The reported funding level does not directly drive the contribution rates for employers. The contribution rates take into consideration how assets and liabilities will evolve over time in different economic scenarios. They also reflect each employer's funding profile and covenant.

2.4 Changes since the last valuation

2.4.1 Events between 2020 and 2023

The most significant external event to occur since the last valuation has been the Covid-19 pandemic. However, the analysis below shows that mortality experience was broadly as expected over the period with minimal impact on the funding position.

A significant factor which has affected the funding strategy is the Fund's better than expected investment returns. This has had a material positive impact on the funding position.

Financial

Table 5: Analysis of investment return experience between 2020 and 2023 valuations

	Expected	Actual	Difference	Impact on funding position
Investment returns				
3-year period	9.3%	28.4%	19.1%	+£1,469m
Annual	3.0% pa	8.7% pa	5.7% pa	

Membership

Table 6: Analysis of membership experience between 2020 and 2023 valuations

	Expected	Actual	Difference	Impact on funding position
Pre-retirement				
Early leavers	8,639	9,441	802	+£3m
Ill-health retirements	458	364	-94	+£25m
Salary increases	3.1% pa	5.4% pa	2.4% pa	-£128m
Post-retirement				
Benefit increases	1.9% pa	4.5% pa	2.5% pa	-£517m
Pension ceasing	£16.8m	£16.3m	-£0.5m	-£8m

2.4.2 Outlook

Expectations about the future, which inform the assumptions used to value the liabilities, have changed since the last valuation. The most significant changes are:

Future inflation: this is expected to be on average higher than at 2020 due to the current high level of inflation.

Investment returns: due to changes in financial markets, future investment returns are now expected to be higher than at the last valuation.

Table 7: Summary of change in outlook

Factor	What does it affect?	What's changed?	Impact on liabilities
Future investment returns	The rate at which you discount back future benefits payments (also known as the 'discount rate' assumption)	Future investment returns are anticipated to be higher than at 2020.	Decrease of £2,625m
Inflation	The rate at which pensions (both in payment and deferment) and CARE pots increase.	Significant increase in short-term future inflation expectations.	Increase of £577m
Salary increases	The rate at which future salaries will increase. This affects benefits that are still linked to final salary, ie accrued before 1 April 2015.	No material change since last valuation given competing factors, eg tighter budgetary conditions vs. strong job market and pressure from National Living Wage increases.	Increase of £30m
Current life expectancy	How long we expect most people to live for based on today's current observed mortality rates.	Slight reduction in life expectancy (not allowing for Covid-related excess deaths)	Decrease of £38m
Future improvements in life expectancy	How we expect life expectancies to change in the future.	Lower rate of improvement in life expectancy through use of updated model of future improvements, including allowance for some recent mortality experience related to the excess deaths from the Covid 19 pandemic.	Decrease of £179m

2.5 Reconciling the overall change in funding position

Tables 8 and 9 provide insight into the funding position change between 31 March 2020 and 31 March 2023. Firstly, the changes expected to happen (Table 8), which relate mostly to assets. Then the impact of actual experience (Table 9), which affects mainly the liabilities.

2.5.1 Expected development

Table 8: Expected development of funding position between 2020 and 2023 valuations

	Assets	Liabilities	Surplus/ deficit
	£m	£m	£m
31 March 2020 valuation	**7,479**	**7,071**	**408**
Cash flows			
Employer contributions paid in	586	0	586
Employee contributions paid in	162	0	162
Benefits paid out	(762)	(762)	0
Other cash flows (eg expenses, transfers in/out)	42	0	42
Expected changes			
Expected investment returns	713	0	713
Interest on benefits already accrued	0	660	(660)
Accrual of new benefits	0	881	(881)
Expected position at 31 March 2023	**8,220**	**7,850**	**370**

2.5.2 Impact of actual events

Table 9: Impact of actual events on the funding position at 31 March 2023

	Assets	Liabilities	Surplus/ deficit
	£m	£m	£m
Expected position at 1 March 2023	**7,479**	**7,071**	**370**
Events between 2020 and 2023			
Salary increases greater than expected	0	128	(128)
Benefit increases greater than expected	0	517	(517)
Early retirement strain (and contributions)	6	0	6
Ill health retirement strain	0	(25)	25
Early leavers more than expected	0	(3)	3
Other membership experience	0	(11)	11
Higher than expected investment returns	1,469	0	1,469
Changes in future expectations			
Investment returns	0	(2,625)	2,625
Inflation	0	577	(577)
Salary increases	0	30	(30)
Longevity	0	(218)	218
Other demographic assumptions	0	(52)	52
Actual position at 31 March 2023	**9,695**	**3,170**	**3,525**

Numbers may not sum due to rounding.

3 Sensitivity and risk analysis

Funding benefits that are going to be paid in the future involves risk and uncertainty. The Fund therefore maintains a risk register which is regularly reviewed. Additionally, as part of the valuation, the Fund reviews sources of risk that may impact its funding position and the contribution rates payable by employers.

This section discusses some of the most significant sources of funding risk (assumptions, regulatory, administration and governance, and climate change). Further information about the Fund's approach to funding risk management, including monitoring, mitigation, and management, is set out in the Funding Strategy Statement.

The valuation results depend on the actual assumptions made about the future. By their nature, these assumptions are uncertain which means it's important to understand their sensitivity and risk levels.

3.1 Contribution rates

The risk-based approach to setting employer contribution rates mitigates the limitation of relying on one set of assumptions. Therefore, there is no need to carry out additional analysis of the sensitivity of contribution rates to changes in financial assumptions, but they are sensitive to changes in demographic assumptions. The results in this section in relation to the funding position can be broadly applied to the contribution rates.

3.2 Funding level

3.2.1 Financial assumptions

In Section 2.2 we set out how the results vary with the assumed future investment return; here we consider inflation in Table 11.

Table 10: Sensitivity of funding position to discount rate assumption

Discount rate assumption	Surplus/Deficit	Funding level
	£m	**%**
4.6% pa	3,019	145%
5.2% pa	**3,525**	**157%**
5.6% pa	3,957	169%

Table 11: Sensitivity of funding position to inflation assumption

CPI assumption	Surplus/Deficit	Funding level
	£m	**%**
2.1% pa	3,680	161%
2.3% pa	**3,525**	**157%**
2.5% pa	3,366	153%

The main area of demographic risk is if people live longer than expected. Table 12 shows the impact of longer-term longevity rates improving at a faster pace (1.75% pa vs 1.5% pa used in the headline results).

Table 12: Sensitivity of the funding to longevity assumption

Long-term rate of improvement	Surplus/Deficit	Funding level
	£m	**%**
1.50% pa	3,525	157%
1.75% pa	3,497	156%

3.3 Other risks

3.3.1 Regulatory, administration and governance risks

Potential risks in this area include change in central government legislation, which alters the future cost of the LGPS, and failures in administration processes leading to incorrect data and inaccuracies in actuarial calculations. At this valuation, specific risks include:

McCloud

Benefits accrued by certain members between 2015 and 2022 may increase following the McCloud case, which ruled that transitional protections introduced in 2015 for older members were discriminatory. We've made an allowance for the cost of these potential improvements, based on the guidance issued by the Scottish Public Pensions Agency on 28 April 2023. Details are set out in guide 12 of Hymans Robertson's LGPS 2023 valuation toolkit.

Cost sharing mechanism

Benefits could change because of the 2020 cost cap valuation; the outcome is currently unknown. We have assumed that there will be no changes required to the benefit structure due to the cost cap.

Goodwin

Benefits of certain dependent pensioners could be affected by the outcome of the Goodwin tribunal. As the remedy to this issue is still uncertain, it is difficult to identify who it would apply to. Given that its impact is estimated to be very small for an LGPS fund, we have made no allowance for this change at the 2023 valuation.

GMP Indexation

We have made an allowance for all increases on GMPs for members reaching State Pension age after 6 April 2016 by assuming that all increases will be paid for by LGPS employers in the Fund with no future support from the State (ie the worst-case scenario from an LGPS perspective). The affected members are a diminishing group, and the financial significance of this allowance will reduce over time. This is the same approach that was taken for the 2020 valuation.

3.3.2 Post-valuation events

Since 31 March 2023, there has been continued volatility in financial markets and rises in interest rates by central banks. These events affect the value of the Fund's assets and liabilities.

- The Fund's investment return since 31 March 2023 is estimated to be somewhere between 0% and 5%.
- Liability valuations are likely to be lower now than at 31 March 2023 due to rises in expected future investment returns and a reduction in long-term inflation expectations.

As an open scheme, with a strong covenant, the Fund takes a long-term view when considering the funding impact of such events. For employers who have a very short time horizon recent volatility may be more immediately impactful, and the Fund has engaged with these employers as appropriate.

No allowance has been made for this volatility in the valuation results or contribution rates detailed in the Rates & Adjustments Certificate. The Fund will continue to monitor changes in the financial and demographic environment as part of its ongoing risk management approach.

3.4 Climate change

3.4.1 Background

Climate change is a major source of uncertainty which could affect future investment returns, inflation, and life expectancies. Therefore, the Fund has explicitly considered the resilience of its funding and investment strategy to future potential climate change outcomes.

It is impossible to confidently quantify the effect of climate risk given the significant uncertainty over the impact of different possible climate outcomes, as well as societal and economic impacts and adaptions. Instead, three different climate change scenarios have been considered as a stress test (instead of trying to predict how climate change affects the funding level in the future).

All the scenarios assume that there will be a period of disruption linked either to the response to climate risk (transition risks) or the effect of it (physical risks). This disruption is expected to lead to high volatility in financial markets, and the later the disruption, the more pronounced it will be.

More information about the scenarios detailed below can be found in guide 10 of Hymans Robertson's LGPS 2023 valuation toolkit.

3.4.2 Outcome of analysis

The Fund has set its funding and investment strategy using asset-liability modelling and considering two main risk metrics.

- **Likelihood of success** – the chance of being fully funded in 20 years' time.
- **Downside risk** – the average worst 5% of funding levels in 20 years' time.

When exploring the potential impact of climate change, the Fund has compared how these risk metrics change under each climate change scenario (against the 'core' model used when setting the funding and investment strategy). The stress-test results for the Fund are shown in Table 13. All results are in absolute terms.

Table 13: Modelling results with additional climate risk testing

Scenario	Likelihood of success	Downside risk
In comparison to 'core' modelling results		
Green revolution	2% higher	4% lower
Delayed transition	Marginally lower	1% higher
Head in the sand	Marginally lower	5% higher

The results are generally worse in the climate scenarios. This is to be expected given that they are purposefully stress tests, with the scenarios mainly being bad outcomes. Whilst the risk metrics are mostly weaker, they are not materially so, and not enough to suggest that the funding and investment strategy are unduly exposed to climate change risk. The Fund will continue to monitor this risk as more information emerges and climate change modelling techniques evolve.

Given the major uncertainty, it is possible that the impacts could be worse, potentially materially worse, than the 'head in the sand' scenario.

4 Final comments

The Fund's valuation operates within a broader framework, and this document should be considered alongside the following:

- The Funding Strategy Statement which, in particular, highlights how different employers in different circumstances have their contributions calculated.
- The Statement of Investment Principles, which sets out the investment strategy for the Fund.
- The general governance of the Fund, including meetings of the Pensions Committee and Local Pensions Board, decisions delegated to officers, the Fund's business plan, etc.

4.1 New employers joining the Fund

Any new employers or admission bodies joining the Fund should be referred to the Fund Actuary to assess the required level of contribution. Depending on the number of transferring members the ceding employer's rate may also need to be reviewed.

4.2 Cessation and bulk transfers

Any employer who ceases to participate in the Fund should be referred to the Fund Actuary in accordance with Regulation 61 of the LGPS regulations.

Any bulk movement of scheme members:

- involving 10 or more scheme members being transferred from or to another LGPS fund.
- involving 2 or more scheme members being transferred from or to a non-LGPS pension arrangement.

should be referred to the Fund Actuary to consider the impact on the Fund.

4.3 Valuation frequency

Under the LGPS regulations, the next formal valuation of the Fund is due to be carried out as at 31 March 2026 where contribution rates payable from 1 April 2027 will be set.

Richard Warden FFA   Julie Baillie FFA

March 2024

For and on behalf of Hymans Robertson LLP

Page 109

Appendices

Appendix 1: Data

Membership data

A summary of the membership data provided by the Fund for the 2023 valuation is set out in Table 14. The corresponding membership data from the previous valuation is also shown for reference.

The results of the valuation are dependent on the quality of the data used. We have carried out a series of validation checks on the data supplied to us by the Administering Authority to ensure that it is fit for purpose.

More information on how we verify the quality of the data used in the valuation has been shared with the Administering Authority in our report ‘ Data Report for the 2023 Valuation, dated 1 December 2023.

Asset data

To check the membership data and derive employer asset values, we have used asset and accounting data and employer level cash flow data provided by the Fund.

Table 14: Whole Fund membership data at this valuation compared with the previous valuation

Whole Fund membership data	31 March 2023	31 March 2020
Active members		
Number	37,287	34,857
Total actual pay (£000)	925,100	788,544
Total accrued pension (£000)	185,906	152,531
Average age (liability weighted)	53.7	51.8
Future working lifetime (years)	9.3	9.1
Deferred pensioners (including undecideds)		
Number	26,229	22,028
Total accrued pension (£000)	65,866	51,867
Average age (liability weighted)	52.4	50.5
Pensioners and dependants		
Number	34,069	30,953
Total pensions in payment (£000)	229,909	185,632
Average age (liability weighted)	68.5	67.3

Investment strategy

The Fund operates four investment strategies The allocations used for the calculation of employer contribution rates and to derive the future investment return assumptions are set out in Table 15 .

This information was provided by Fund Officers.

Table 15: Investment strategy allocation used for the calculation of employer contribution rates

% Allocated	Main Strategy	Medium Risk Strategy	Low Risk Strategy	Lothian Buses Strategy
UK equities	4.3%	2.1%	0.0%	2.3%
Overseas equities	54.3%	27.1%	0.0%	29.9%
Private equities	1.2%	0.6%	0.0%	0.6%
Total growth assets	59.8%	29.8%	0.0%	32.8%
Index linked gilts	10.1%	55.1%	100.0%	50.6%
Fixed interest gilts	0.5%	0.3%	0.0%	0.3%
Total protection assets	10.6%	55.4%	100.0%	50.9%
Corporate debt	1.6%	0.8%	0.0%	0.9%
Infrastructure	15.2%	7.5%	0.0%	8.3%
Private lending	2.9%	1.5%	0.0%	1.6%
Property	5.2%	2.6%	0.0%	2.9%
Total income generating assets	24.9%	12.4%	0.0%	13.7%
Cash	4.7%	2.4%	0.0%	2.6%
Total	100%	100%	100%	100%

Appendix 2: Assumptions

To set and agree assumptions for the valuation, the Fund carried out an in-depth analysis and review in June 2023. The final set of assumptions, along with the Funding Strategy Statement, was approved by the Pensions Committee in March 2024.

Financial assumptions

Setting employer contribution rates

An asset-liability model was used to set employer contributions at the 2023 valuation. This model relies on Hymans Robertson's proprietary economic model, the Economic Scenario Service (ESS). The ESS reflects the uncertainty associated with future levels of inflation and asset returns and the interactions and correlations between different asset classes and wider economic variables. In the short term (first few years), the models are fitted with current financial market expectations. Over the longer term, models are built around views of fundamental economic parameters, for example equity risk premium, credit spreads and long-term inflation. The table below shows the calibration of the ESS at 31 March 2023. Further information on the assumptions used for contribution rate setting is included in the Funding Strategy Statement.

Table 16: ESS individual asset class return distributions at 31 March 2023

Time period	Percentile	Asset class annualised total returns							Inflation/Yields		
		Cash	All World ex UK Equity	UK Equity	Index Linked Gilts (medium)	Fixed Interest Gilts (medium)	Property	Corporate Debt	Inflation (CPI)	17 year real yield (CPI)	17 year yield
10 years	16th	2.5%	1.1%	1.3%	0.8%	2.4%	1.2%	2.7%	0.9%	-0.3%	2.7%
	50th	3.6%	7.3%	7.5%	2.8%	3.7%	6.2%	4.3%	2.5%	0.9%	4.1%
	84th	4.7%	13.6%	13.5%	5.1%	4.9%	11.5%	5.8%	4.1%	2.2%	5.9%
20 years	16th	2.3%	2.8%	3.0%	1.0%	3.3%	2.7%	3.7%	0.7%	-0.5%	1.4%
	50th	3.7%	7.4%	7.5%	2.7%	4.1%	6.4%	4.7%	2.3%	1.3%	3.4%
	84th	5.4%	12.2%	12.0%	4.5%	4.8%	10.3%	5.8%	3.9%	2.9%	5.9%
40 years	16th	1.8%	3.7%	3.9%	1.0%	2.9%	3.2%	3.4%	0.6%	-0.6%	1.2%
	50th	3.5%	7.2%	7.4%	2.7%	3.7%	6.2%	4.4%	2.0%	1.3%	3.3%
	84th	5.7%	10.9%	10.9%	4.6%	4.9%	9.5%	5.8%	3.5%	3.2%	6.1%
	Volatility (5yr)	2%	18%	18%	7%	5%	15%	6%	3%	-	-

Calculating the funding level

Table 17 summarises the assumptions used to calculate the funding level at 31 March 2023, along with a comparison of assumptions at the last valuation.

Table 17: Summary of assumptions used for measuring the funding level, compared to last valuation

Assumption	31 March 2023	Required for	31 March 2020
Discount rate	5.2% pa	To place a 'today's money' value on all the benefits promised to scheme members at the valuation date. The Fund's assets are estimated to have a 75% likelihood of achieving a return that is at least equal the discount rate.	3.0% pa (based on 75% likelihood)
Benefit increases/CARE revaluation	2.3% pa	To determine the size of future benefit payments.	1.95% pa
Salary increases	3.0% pa*	To determine the size of future final-salary linked benefit payments.	2.45% pa†*

*plus a promotional salary scale
†a blended assumption of 2% pa until 2025 followed by CPI + 0.7% thereafter

Demographic assumptions

The same demographic assumptions are used to set contribution rates and to assess the current funding level.

Longevity

Table 18: Summary of longevity assumptions at this valuation compared with the previous valuation

	31 March 2023	31 March 2020
Baseline assumptions	VitaCurves based on member-level lifestyle factors	VitaCurves based on member-level lifestyle factors
Future improvements	CMI 2022 model Initial addition = 0.25% (both Male and Female) Smoothing factor = 7.0 Weighting = 0% (2020 & 2021 data), 25% (2022 data) 1.5% pa long-term rate	CMI 2019 model Initial addition = 0.5% (both Male and Female) Smoothing factor = 7.0 1.5% pa long-term rate of improvement

Page 115

Other demographic assumptions

Table 19: Summary of other demographic assumptions

Death in service	See sample rates in Table 20
Retirements in ill health	See sample rates in Table 20
Withdrawals	See sample rates in Table 20
Promotional salary increases	See sample rates in Table 20
Commutation	70% of future retirements elect to exchange pension for additional tax-free cash up to HMRC limits
50:50 option	0.0% of members (uniformly distributed across the age, service and salary range) will choose the 50:50 option
Retirement age	The earliest age at which a member can retire with their benefits unreduced
Proportion married	A varying proportion of members are assumed to have a dependant at retirement or on earlier death. For example, at age 60 this is assumed to be 85% for males and 60% for females. The dependant of a male member is assumed to be 2 years younger than him and the dependant of a female member is assumed to be 3.5 years older than her.

Sample rates for demographic assumptions

Table 20: Sample rates of male and female demographic assumptions

Males

Age	Salary scale	Death before retirement	Withdrawals		Ill health Tier 1		Ill health Tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.21	240.12	578.87	0.00	0.00	0.00	0.00
25	117	0.21	158.61	382.37	0.11	0.02	0.13	0.02
30	131	0.26	112.51	271.22	0.21	0.03	0.23	0.03
35	144	0.30	87.89	211.87	0.41	0.14	0.46	0.15
40	154	0.51	70.72	170.49	0.62	0.26	0.69	0.24
45	164	0.86	41.33	139.50	0.99	0.51	1.09	0.49
50	174	1.37	32.02	108.06	1.86	1.31	2.59	1.45
55	179	2.15	30.76	103.80	5.83	4.52	4.67	3.11
60	184	3.86	27.39	92.45	9.91	6.97	3.87	2.65
65	185	6.44	0.00	0.00	18.92	13.49	0.00	0.00

Females

Age	Salary scale	Death before retirement	Withdrawals		Ill health Tier 1		Ill health Tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.11	256.99	338.79	0.00	0.00	0.00	0.00
25	117	0.11	172.88	227.90	0.16	0.13	0.09	0.10
30	131	0.16	144.88	190.99	0.21	0.18	0.12	0.13
35	144	0.27	89.25	164.73	0.41	0.34	0.24	0.25
40	150	0.44	74.23	137.00	0.61	0.51	0.36	0.37
45	157	0.71	61.11	112.78	0.82	0.68	0.48	0.50
50	162	1.04	46.56	85.94	1.50	1.23	1.11	1.13
55	162	1.37	43.56	80.39	5.47	4.43	2.32	2.35
60	162	1.75	35.02	64.64	11.52	9.30	2.38	2.40
65	162	2.25	0.00	0.00	20.73	16.76	0.00	0.00

Figures are incidence rates per 1,000 members except salary scale.
FT and PT denoted full-time and part-time members respectively.

Appendix 3: Reliances & limitations

We have been commissioned by City of Edinburgh Council ('the Administering Authority') to carry out a full actuarial valuation of Lothian Pension Fund ('the Fund') at 31 March 2023, as required under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2018 ('the Regulations').

This report is addressed to the Administering Authority. It has been prepared by us as actuaries to the Fund and is solely for the purpose of summarising the main outcomes of the 2023 actuarial valuation. It has not been prepared for any other third party or for any other purpose. We make no representation or warranties to any third party as to the accuracy or completeness of this report, no reliance should be placed on this report by any third party and we accept no responsibility or liability to any third party in respect of it.

This summary report is the culmination of other communications in relation to the valuation, in particular:

- our 2023 valuation toolkit which sets out the methodology used when reviewing funding plans
- our paper dated 9 November 2023 which discusses the funding strategy for the Fund's stabilised employers
- our paper dated 7 June 2023 which discusses the valuation assumptions.
- our initial results report dated 1 September 2023 which outlines the whole Fund results and inter-valuation experience
- our data report dated 1 December 2023 which summarises the data used for the valuation, the approach to ensuring it is fit for purpose and any adjustments made to it during the course of the valuation
- the Funding Strategy Statement which details the approach taken to adequately fund the current and future benefits due to members.

The totality of our advice complies with the Regulations as they relate to actuarial valuations.

The following Technical Actuarial Standards apply to this advice and have been complied with where material and to a proportionate degree. They are:

- TAS100 – Principles for technical actuarial work
- TAS300 – Pensions

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Appendix 4: Glossary

Term	Explanation
50:50 option	An option for LGPS members to pay half contributions and earn half the retirement benefit (pre-retirement protection benefits are unreduced).
Asset-liability modelling	An approach to modelling and understanding risk for a pension fund. The assets and liabilities are projected forwards into the future under many different future scenarios of inflation, investment returns and interest rates. The future scenarios are then analysed to understand the risk associated with a particular combination of contribution rates and investment strategy. Different combinations of contribution rates and/or investment strategies may be tested.
Baseline longevity	The rates of death (by age and sex) in a given group of people based on current observed data.
Club Vita	A firm of longevity experts who Hymans Roberston partner with for longevity analysis. They combine data from thousands of pension schemes and use it to create detailed baseline longevity assumptions at member-level, as well as insights on general longevity trends and future improvements.
Commutation	The option for members to exchange part of their annual pension for a one-off lump sum at retirement. In the LGPS, every £1 of pension exchanged gives the member £12 of lump sum. The amounts that members commute is heavily influenced by tax rules which set an upper limit on how much lump sum can be taken tax-free.
CPI inflation	The annual rate of change of the Consumer Prices Index (CPI). The CPI is the UK government's preferred measure of inflation and is the measure used to increase LGPS (and all other public sector pension scheme) benefits each year.
Deferred pensioner	A former employee who has left employment (or opted out of the pension fund) but is not yet in receipt of their benefits from the fund.
Demographic assumptions	Assumptions concerned with member and employer choices rather than macroeconomic or financial factors. For example, retirement age or promotional salary scales. Demographic assumptions typically determine the timing of benefit payments.

Term	Explanation
Discount rate	An assumption for the annual rate of future investment return. Used to place a single 'today's money' value on a stream of future payments.
Active member	A member who is currently employed by employers who participate in the Fund and are paying contributions into the Fund.
ESS	Economic Scenario Service - Hymans Robertson's proprietary economic scenario generator used to create thousands of simulations of future inflation, asset class returns and interest rates.
Funding position	The extent to which the assets held by the Fund at 31 March 2023 cover the accrued benefits ie the liabilities. The two measures of the funding position are: • the funding level - the ratio of assets to liabilities; and • the funding surplus/deficit - the difference between the asset and liabilities values.
Inflation	Prices tend to increase over time, which is called inflation. Inflation is measured in different ways, using a different 'basket' of goods and mathematical formulas.
Liabilities	An employer's liability value is the single value at a given point in time of all the benefit payments expected to be made in future to all members. Benefit payments are projected using demographic and financial assumptions and the liability is calculated using a discount rate.
Longevity improvements	An assumption about how rates of death will change in future. Typically, we assume that death rates will fall and life expectancies will improve over time, continuing the long-running trend.
Pensioner	A former employee who is in receipt of their benefits from the fund. This category includes eligible dependants of the former employee.
Primary rate	The estimated cost of future benefits, expressed in percentage of pay terms. The primary rate will include an allowance to cover the Fund's expenses.

Term	Explanation
Prudence	To be prudent means to err on the side of caution in the overall set of assumptions. We build prudence into the choice of discount rate by choosing an assumption with a prudence level of more than 50%. All other assumptions aim to be best estimate.
Prudence level	A percentage indicating the likelihood that the assumed rate of investment return will be achieved in practice, based on the ESS model. The higher the prudence level, the more prudent the assumed rate of investment return.
Secondary rate	An adjustment to the primary rate, generally to reflect costs associated with benefits that have already been earned up to the valuation date. This may be expressed as a percentage of pay and/or monetary amount.
Withdrawal	Refers to members leaving the scheme before retirement. These members retain an entitlement to an LGPS pension when they retire but are no longer earning new benefits.

Appendix 5: Rates and Adjustments Certificate

In accordance with Regulation 60(4) of the Regulations, we have assessed the contributions that should be paid into the Fund by participating employers for the period 1 April 2024 to 31 March 2027 to maintain the solvency of the Fund.

The method and assumptions used to calculate the contributions set out in this Rates and Adjustments Certificate are detailed in the Funding Strategy Statement dated March 2024 and in Appendix 2 of the report on the actuarial valuation dated March 2024. These assumptions underpin our estimate of the number of members who will become entitled to a payment of pensions under the provisions of the LGPS and the amount of liabilities arising in respect of such members.

Table 21 summarises the whole Fund primary and secondary contribution rates for the period 1 April 2024 to 31 March 2027. The primary rate is the payroll weighted average of the underlying individual employer primary rates and the secondary rate is the total of the underlying individual employer secondary rates, calculated in accordance with the LGPS regulations and CIPFA guidance. The secondary rate has been shown both as a monetary amount and an equivalent percentage of the projected pensionable pay.

Table 21: Whole fund primary and secondary contribution rates from 1 April 2024 to 31 March 2027

This valuation (31 March 2023)		
Primary rate	25.0% of pay	
Secondary rate	**Monetary amount**	**Equivalent to % of payroll**
2024/25	-£73,589,000	-7.5%
2025/26	-£75,809,000	-7.5%
2026/27	-£78,095,000	-7.5%

The required minimum contribution rates for each employer in the Fund are set out in the remainder of this certificate.

Richard Warden FFA Julie Baillie FFA
March 2024
For and on behalf of Hymans Robertson LLP

Employer code	Employer name	Primary rate (% of pay)	Secondary rate (% of pay)			Total contributions (Primary rate plus secondary rate)			Notes
			2024/25	2025/26	2026/27	2024/25	2025/26	2026/27	
Scheduled/Contribution Stability Mechanism Bodies (Main Investment Strategy)									
Pool	The City of Edinburgh Council	24.3%	-6.7%	-6.7%	-6.7%	17.6%	17.6%	17.6%	
Pool	Midlothian Council	24.3%	-6.7%	-6.7%	-6.7%	17.6%	17.6%	17.6%	
Pool	West Lothian Council	24.2%	-6.6%	-6.6%	-6.6%	17.6%	17.6%	17.6%	
Pool	East Lothian Council	24.3%	-6.7%	-6.7%	-6.7%	17.6%	17.6%	17.6%	
Pool	Scottish Police Authority	27.5%	-9.9%	-9.9%	-9.9%	17.6%	17.6%	17.6%	
Pool	Heriot-Watt University	25.9%	-8.3%	-8.3%	-8.3%	17.6%	17.6%	17.6%	
Pool	Edinburgh College	29.9%	-12.3%	-12.3%	-12.3%	17.6%	17.6%	17.6%	
21	Audit Scotland	29.2%	-11.6%	-11.6%	-11.6%	17.6%	17.6%	17.6%	
30	Queen Margaret University	25.6%	-8.0%	-8.0%	-8.0%	17.6%	17.6%	17.6%	
51	Edinburgh Napier University	25.4%	-7.8%	-7.8%	-7.8%	17.6%	17.6%	17.6%	
105	West Lothian College	30.4%	-12.8%	-12.8%	-12.8%	17.6%	17.6%	17.6%	
134	Lothian Valuation Joint Board	24.3%	-6.7%	-6.7%	-6.7%	17.6%	17.6%	17.6%	
135	Scottish Water	23.8%	-6.2%	-6.2%	-6.2%	17.6%	17.6%	17.6%	
155	Visit Scotland	29.8%	-12.2%	-12.2%	-12.2%	17.6%	17.6%	17.6%	
209	SESTRAN	30.6%	-3.8%	-3.8%	-3.8%	26.8%	26.8%	26.8%	
210	Improvement Service	29.2%	-11.6%	-11.6%	-11.6%	17.6%	17.6%	17.6%	
218	Scottish Futures Trust	26.5%	-8.9%	-8.9%	-8.9%	17.6%	17.6%	17.6%	
899	Scottish Fire and Rescue Service	27.6%	-10.0%	-10.0%	-10.0%	17.6%	17.6%	17.6%	

Employer code	Employer name	Primary rate (% of pay)	Secondary rate (% of pay)			Total contributions (Primary rate plus secondary rate)			Notes
			2024/25	2025/26	2026/27	2024/25	2025/26	2026/27	
Lothian Buses (Buses Investment Strategy)									
900	Lothian Buses	29.2%	-19.3%	-19.3%	-19.3%	9.9%	9.9%	9.9%	
Transferee Admission Bodies (Main Investment Strategy)									
139	CGI	34.3%	-34.3%	-34.3%	-34.3%	0.0%	0.0%	0.0%	
140	Dacoll	37.0%	-37.0%	-37.0%	-37.0%	0.0%	0.0%	0.0%	
200	Forth & Oban Ltd	30.9%	-18.9%	-18.9%	-18.9%	12.0%	12.0%	12.0%	
207	LPFE Limited	22.9%	-4.8%	-4.8%	-4.8%	18.1%	18.1%	18.1%	
212	Skanska	38.0%	-38.0%	-38.0%	-38.0%	0.0%	0.0%	0.0%	
214	NSL Services Group	38.4%	-38.4%	-38.4%	-38.4%	0.0%	0.0%	0.0%	
220	Mitie PFI CEC PP2	33.4%	-33.4%	-33.4%	-33.4%	0.0%	0.0%	0.0%	
222	Compass-Chartwell	42.3%	-42.3%	-42.3%	-42.3%	0.0%	0.0%	0.0%	
224	BaxterStorey	38.3%	-38.3%	-38.3%	-38.3%	0.0%	0.0%	0.0%	
225	Bellrock	27.5%	-20.1%	-20.1%	-20.1%	7.4%	7.4%	7.4%	
227	Sodexo Ltd	38.6%	-38.6%	-38.6%	-38.6%	0.0%	0.0%	0.0%	
228	BEAR	38.0%	-38.0%	-38.0%	-38.0%	0.0%	0.0%	0.0%	
Open Community Admission Bodies (Main Investment Strategy)									
Pool	Canongate Youth Project	25.6%	-10.0%	-10.0%	-10.0%	15.6%	15.6%	15.6%	
15	Newbattle College	33.7%	-19.8%	-19.8%	-19.8%	13.9%	13.9%	13.9%	

Employer code	Employer name	Primary rate (% of pay)	Secondary rate (% of pay)			Total contributions (Primary rate plus secondary rate)			Notes
			2024/25	2025/26	2026/27	2024/25	2025/26	2026/27	
28	Convention of Scottish Local Authorities	25.2%	1.8%	1.8%	1.8%	27.0%	27.0%	27.0%	
46	Museums Galleries Scotland	25.0%	-5.6%	-5.6%	-5.6%	19.4%	19.4%	19.4%	
64	Citadel Youth Centre	25.7%	-6.4%	-6.4%	-6.4%	19.3%	19.3%	19.3%	
87	Family Advice & Information Resource	26.2%	-1.8%	-1.8%	-1.8%	24.4%	24.4%	24.4%	
90	Handicabs (Lothian) Limited	27.2%	-9.4%	-9.4%	-9.4%	17.8%	17.8%	17.8%	
117	Scottish Schools Education Research	25.3%	1.0%	1.0%	1.0%	26.3%	26.3%	26.3%	
121	Edinburgh Development Group	27.3%	-7.4%	-7.4%	-7.4%	19.9%	19.9%	19.9%	
123	Scottish Adoption Agency	26.9%	-1.5%	-1.5%	-1.5%	25.4%	25.4%	25.4%	
133	Children's Hospice Association Scotland	25.8%	-7.8%	-7.8%	-7.8%	18.0%	18.0%	18.0%	
143	First Step	26.4%	-8.1%	-8.1%	-8.1%	18.3%	18.3%	18.3%	
147	Melville Housing Association	32.7%	-9.0%	-9.0%	-9.0%	23.7%	23.7%	23.7%	
154	St Andrew's Children's Society Limited	27.2%	-7.8%	-7.8%	-7.8%	19.4%	19.4%	19.4%	
157	West Lothian Leisure	27.5%	-11.3%	-11.3%	-11.3%	16.2%	16.2%	16.2%	
172	Homes for Life Housing Partnership	26.4%	-5.8%	-5.8%	-5.8%	20.6%	20.6%	20.6%	
174	Capital City Partnership	25.0%	-6.2%	-6.2%	-6.2%	18.8%	18.8%	18.8%	
196	HWU Students Association	25.2%	-8.0%	-8.0%	-8.0%	17.2%	17.2%	17.2%	
219	Enjoy East Lothian	24.0%	-7.4%	-7.4%	-7.4%	16.6%	16.6%	16.6%	

Employer code	Employer name	Primary rate (% of pay)	Secondary rate (% of pay)			Total contributions (Primary rate plus secondary rate)			Notes
			2024/25	2025/26	2026/27	2024/25	2025/26	2026/27	
223	Children's Hearings Scotland	25.6%	-8.4%	-8.4%	-8.4%	17.2%	17.2%	17.2%	
Closed Community Admission Bodies (Main Investment Strategy)									
78	ELCAP	23.2%	-23.2%	-23.2%	-23.2%	0.0%	0.0%	0.0%	
118	Royal Edinburgh Military Tattoo	33.8%	-10.8%	-10.8%	-10.8%	23.0%	23.0%	23.0%	
159	Edinburgh Leisure	27.1%	-27.1%	-27.1%	-27.1%	0.0%	0.0%	0.0%	
193	Health in Mind	31.4%	-31.4%	-31.4%	-31.4%	0.0%	0.0%	0.0%	
Closed Community Admission Bodies (Medium Risk Investment Strategy)									
9	University of Edinburgh (E.C.A.)	23.4%	0.0%	0.0%	0.0%	23.4%	23.4%	23.4%	
104	SRUC	35.2%	7.3%	7.3%	7.3%	42.5%	42.5%	42.5%	
158	Royal Society of Edinburgh	20.4%	0.0%	0.0%	0.0%	20.4%	20.4%	20.4%	
Closed Community Admission Bodies (Low Risk Investment Strategy)									
89	North Edinburgh Dementia Care	29.2%	-16.2%	-16.2%	-16.2%	13.0%	13.0%	13.0%	
173	Pilton Equalities Project	30.2%	-30.2%	-30.2%	-30.2%	0.0%	0.0%	0.0%	

Page 126

Further comments to the Rates & Adjustments Certificate

- Contributions expressed as a percentage of payroll should be paid into the Fund at a frequency in accordance with the requirements of the Regulations.
- Further sums should be paid to the Fund to meet the costs of any early retirements and/or augmentations or salary growth strains using methods and factors issued by us from time to time or as otherwise agreed.
- Payments may be required to be made to the Fund by employers to meet the capital costs of any ill-health retirements that exceed those allowed for within our assumptions. If an employer has ill health liability insurance in place with a suitable insurer and provides satisfactory evidence to the Administering Authority, then their certified contribution rate may be reduced by the value of their insurance premium, for the period the insurance is in place.
- The certified contribution rates represent the **minimum** level of contributions to be paid. Employing authorities may pay further amounts at any time and future periodic contributions may be adjusted on a basis approved by the Fund Actuary.

Appendix 6: Section 13 dashboard

Metric	Unit	2023 Valuation
2023 funding position – local funding basis		
Funding level (assets/liabilities)	%	157%
Funding level (change since previous valuation)	%	51% increase
Asset value used at the valuation	£m	9,695
Value of liabilities (including McCloud liability)	£m	6,170
Surplus (deficit)	£m	3,525
Discount rate (past service)	% pa	5.2%
Discount rate (future service)	% pa	Past service and future service are consistently valued with the same underlying assumptions, methodologies, and models regarding future expected levels of inflation, interest rates and investment returns.
Assumed pension increase (CPI)	% pa	2.3%
Method of derivation of discount rate, plus any changes since previous valuation		There is a 75% likelihood that the Fund's assets will return at least 5.2% over the 20 years following the 2023 valuation date. The same methodology and likelihood was used for the 2020 valuation.

Metric	Unit	2023 Valuation
Assumed life expectancy at age 65		
Life expectancy for current pensioners – men age 65	Years	20.3
Life expectancy for current pensioners – women age 65	Years	23.1
Life expectancy for future pensioners – men age 45	Years	21.6
Life expectancy for future pensioners – women age 45	Years	24.8
Past service funding position – SAB basis (for comparison purposes only)		
Market value of assets	£m	9,695
Value of liabilities	£m	6,985
Funding level on SAB basis (assets/liabilities)	%	139%
Funding level on SAB basis (change since last valuation)	%	6% increase

Metric	Unit	2023 Valuation	2020 Valuation
Contribution rates payable			
Primary contribution rate	% of pay	25.0%	23.1%
Secondary contribution rate (cash amounts in each year in line with CIPFA guidance)			
1st year of rates and adjustments certificate	£m	-73.589	-11.262
2nd year of rates and adjustments certificate	£m	-75.809	-11.378
3rd year of rates and adjustments certificate	£m	-78.095	-11.530
Giving total expected contributions			
1st year (£ figure based on assumed payroll)	£m	171.442	179.980
2nd year (£ figure based on assumed payroll)	£m	176.613	184.577
3rd year (£ figure based on assumed payroll)	£m	181.940	189.254
Assumed payroll (cash amounts in each year)			
1st year rates and adjustments certificate	£m	981.644	827.889
2nd year rates and adjustments certificate	£m	1,011.251	848.291
3rd year rates and adjustments certificate	£m	1,041.752	869.196
Three-year average	% of pay	21.8%	17.5%
Average employee contribution	% of pay	6.2%	6.3%
Employee contribution rate (£ figure based on assumed payroll of £981.644m)	£m pa	60.4	51.3

Page 129

Metric	Unit	2023 Valuation	2020 Valuation
Deficit recovery and surplus spending plan			
Latest deficit recovery period end date, where this methodology is used by the fund’s actuarial advisor.	Year	Methodology not used	Methodology not used
Earliest surplus spreading period end date, where this methodology is used by the fund’s actuarial advisor.	Year	Methodology not used	Methodology not used
The time horizon end date, where this methodology is used by the fund’s actuarial advisor	Year	2043	2040
The funding plan’s likelihood of success, where this methodology is used by the fund’s actuarial advisor.	%	75%	75%
Percentage of liabilities relating to employers with deficit recovery periods of longer than 20 years	%	0%	0%
Additional information			
Percentage of total liabilities that are in respect of Tier 3 employers	%	10%	10%
Included climate change analysis/comments in the 2023 valuation report		Yes	Not applicable
Value of McCloud liability in the 2023 valuation report (on local funding basis)	£m	37.3	Not applicable

by virtue of paragraph(s) 1, 3, 6 of Part 1 of Schedule 7A
of the Local Government(Scotland) Act 1973.

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Appendix 3

Lothian Pension Fund – Managing climate risk

Background

Climate change is a material risk to the fund. It has the potential to significantly disrupt financial markets and economic systems and affect the life expectancy of the fund's members.

Tackling climate change is a global challenge. However, as a holder of significant financial capital, the fund recognises that it has a role to play in the transition to a greener economy. The fund also recognises the need to manage the risks that climate change brings to its funding and investment strategies.

This paper outlines the strategic measures that the fund has taken to tackle climate risk. There are also comments on future developments that are underway, using fresh insights from climate science as it continues to evolve.

1. Funding strategy

1.1 Primary objective

The fund is required to meet all benefit payments as they fall due. Triennial actuarial valuations are used to review and adjust employer contribution rates to meet this objective, after allowing for prudent estimates of future expected investment returns.

1.2 How could climate change affect the funding strategy?

Climate change presents different risks to the funding strategy:

- *Lower economic growth and investment returns* – tackling climate change will require significant capital investment. This may reduce growth and returns on assets during the transition to a greener economy.
- *More climate events* – 'extreme' events, such as heatwaves or flooding, are likely to increase in frequency and adversely affect stock markets and asset valuations.
- *Increased volatility/uncertainty* – the pace of transition to a greener economy is highly uncertain. Financial markets and other economic indicators, such as interest rates and inflation, are likely to be more volatile and unpredictable due to the uncertainty.
- *Life expectancy* – climate change can affect human health and the longevity of the fund's members, possibly either positively or negatively.

1.3 What measures are the fund currently using to manage climate risk?

The 2023 triennial valuation was an opportunity for the fund to review how it manages all key risks and build controls into its Funding Strategy Statement. Climate risk was tackled from two angles.

a) Risk budgeting

With a significant surplus being reported at the 2023 valuation, analysis and modelling was undertaken to 'stress test' the funding position under a range of future contribution scenarios and investment strategies, and scenarios with a sudden permanent loss of assets ('asset shocks'). This provided a risk budget to help fund officers and committee to understand how robust the funding strategy was to future adverse experience, and to make decisions **about the fund's approach to setting employer contribution rates.**

The fund recognised that it was unrealistic and unaffordable for contribution rates to directly target the cost of extreme climate events. Instead, it was agreed to build in extra protection over time against the cost of climate-induced risks. Using the risk budget information, the fund added prudence into its funding strategy by:

- Increasing the confidence level – the 'likelihood of funding success' parameter under the risk-based valuation approach was raised from a minimum of 67% (for some scheduled bodies) at the 2020 valuation to a minimum of 80% across all employers.
- Applying an asset shock – employer assets at the valuation were reduced by 20% for the purpose of determining contribution rates.

Both measures retain money in the fund to hold as shock absorbers against future poor experience. In addition to managing uncertainty around climate risk, they act as a buffer against other 'tail' risks in the modelling, such as geopolitical concerns, or rapid reductions in interest rates.

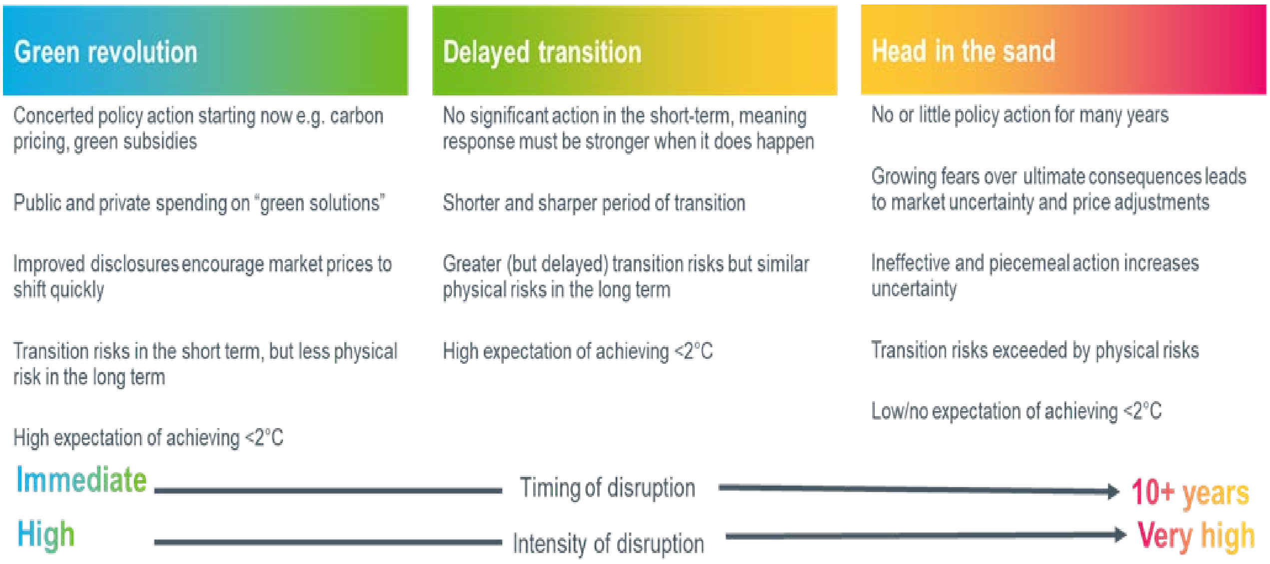
Whilst these measures are prudent and make the fund more resilient to climate risk, the three-yearly valuation process also offers the opportunity to review the funding strategy and make changes in reaction to evolving circumstances eg to recent research from the actuarial profession and other bodies that suggests that modelling techniques may be underestimating the impacts of extreme climate events. The funding strategy ultimate relies on the ability of the fund's employers to pay contributions so that the fund can pay pensions. Overall, the fund's employers have a strong financial covenant and a low risk of failing.

b) Climate scenario modelling

Description of climate scenarios

The impact of climate change is too uncertain to build directly into the valuation modelling. Instead, the results of the core valuation model were 'stress tested' under three different climate change scenarios. This was intended to test the resilience of the modelling, as required under Task Force on Climate-Related Financial Disclosures (TCFD), rather than rerunning the full analysis.

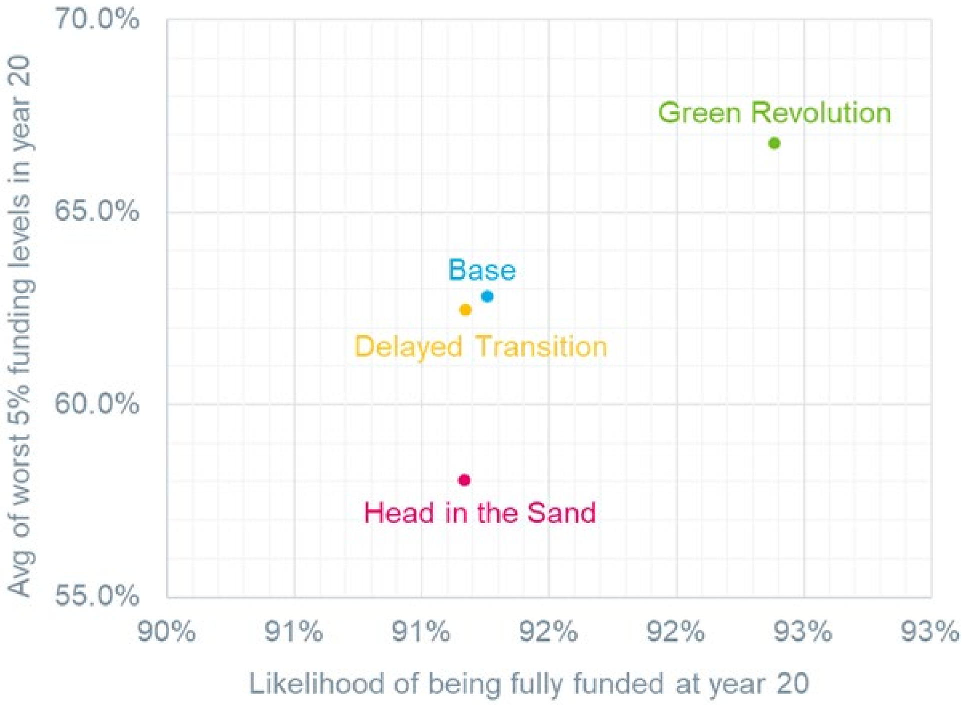
The three climate scenarios considered had differing speeds and strengths of response on climate transition:



Each scenario assumed a period of disruption linked either to the impact of measures to combat climate change (transition risks) or to the fallout from it (physical risks), with the disruption leading to high volatility in financial markets and economic variables such as inflation. The later the period of disruption, the more pronounced it would be.

Stress test results for the fund

The three climate scenarios were stress tested against the results of the core valuation modelling (referred to as the 'Base' scenario). The following chart, which assumes a fixed contribution rate of 20% of pay for modelling purposes, summarises the results:



The chart shows that:

- On the upside, the likelihood of the fund being fully funded in 20 years' time remains high, with little movement in the likelihood percentages across the different scenarios.
- However, on the downside, the differences are more marked. There is less downside risk under the 'Green Revolution' scenario (an average worst-case funding level of 67% at year 20) compared to the 'Base' (63%) and 'Delayed Transition' (62%) scenarios. The downside risk worsens under the 'Head in the Sand' scenario (58%).

Whilst the results differ across scenarios, the differences are not sufficiently material to suggest that the fund's strategy is not resilient to climate change risk. Or, put another way, the results provide assurance that the core valuation model does not appear to be significantly underestimating climate risk. However, it is important to monitor the risk and how it may evolve (see next section). This illustrative modelling uses a fixed contribution rate of 20.0% for 20 years. In practice, the fund would respond to a changing funding environment by varying the employer contributions at each valuation.

1.4. Future measures to manage climate risk

Section 1.3 discussed the measures taken at the 2023 valuation to manage climate risk. Climate science is, however, a rapidly evolving area. Further work is already underway to enhance the information available to the fund for decision making. This is outlined below and will become available during 2024, giving time for officers and the committee to consider ahead of the 2026 valuation.

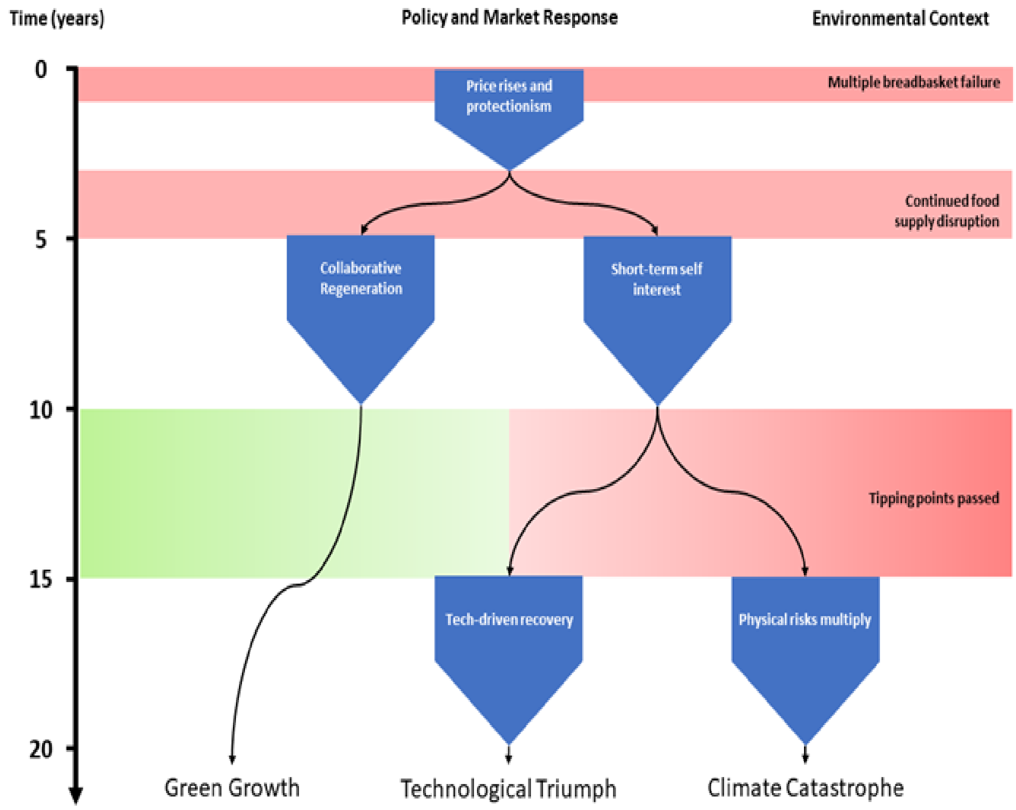
a) Narrative-based climate modelling

The approach at the 2023 valuation stress tested the core model and explored what outcomes might arise if we took account of greater variability. However, it didn't provide detail of what may be going on underneath. Furthermore, when developing climate scenarios, past data may be of limited value. There is no guarantee that the traditional relationships between economic variables will hold under extreme climate change.

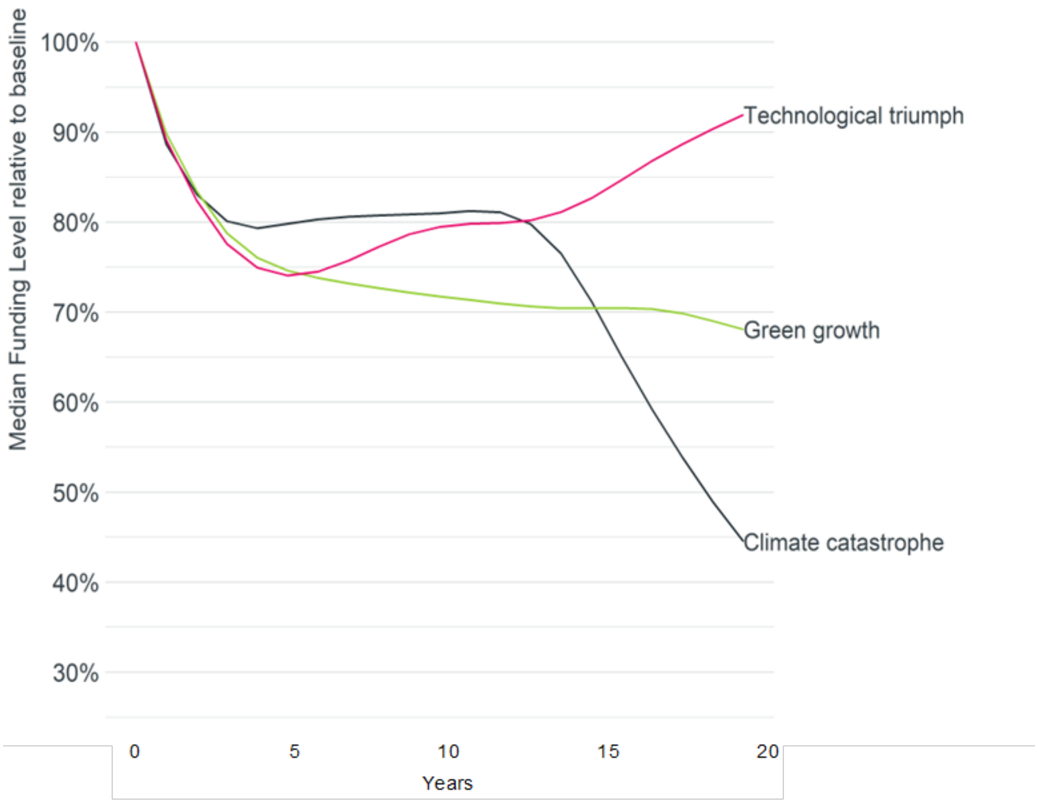
When developing more realistic and useful climate scenarios, consideration needs to be given to how different actors within our global system respond to stress. This adds in the 'human response' i.e. it recognises that different entities may not always take decisions that lead to an optimal outcome. In particular, the actions of global powerhouses such as the EU, China and the US will be influenced by other risk factors and could lead to unexpected outcomes. The risk drivers that are likely to influence policymakers are:

- Environmental severity and feedback
- Energy usage
- Technology progression
- Social policies and adaptation
- Geopolitical tension

Our real-world climate narrative scenario assumes an extreme event acts as a catalyst, changing the dynamics of the global economy. For example, a climate-induced food shock, where adverse weather in a small number of breadbasket regions that produce a disproportionate amount of the world's food leads to chronic crop failures. The diagram below explores the narrative in a step-wise manner, moving along each pathway from the initial catalyst, through two possible medium-term responses and on to potential long-term outcomes.



An example of the output available from this narrative modelling is shown below, based on data from the fund's 2023 valuation. This summarises the impact of our scenario on funding levels, relative to our baseline assumptions. It reports changes in the median funding level along each pathway as a proportion of the baseline median funding level, highlighting the downside risks associated with the scenario. However, care should also be taken when interpreting this output as it omits uncertainty associated with funding levels by focussing on the median outcomes only.



Current climate science provides confidence that scenarios such as this are more likely, but we can't say how much more likely. The broad-ranging nature of the scenarios, and the breadth of possibilities for the nature of the shock, suggest that the risks are "undiversifiable". i.e. they aren't specific to only those entities which seem to be obviously relevant to climate change, rather they are relevant to all entities.

b) Longevity modelling

The fund uses Club Vita, a longevity data analytics company, to help its actuary to set life expectancy assumptions.

Vita produced 'Hot and Bothered?' research in 2018 which examined the impact of climate change on longevity patterns across the same three climate scenarios mentioned in section 1.3 above. The diagram below summarises the research.

This was provided with indicative life expectancies and liability impacts to help funds to stress test their funding plans.

With climate change scenario modelling moving on in recent years, Vita are refreshing their research. Whilst the key features of each scenario will be retained, updates will be made by:

- Allowing for observed longevity experience since 2018
- Refreshing the time horizons and potential magnitude of impacts in light of global events, pledges and initiatives since 2018. For example, allowance will be made for the world being off-track on reaching the target of the Paris Agreement.
- Reflecting the direct impact of Covid-19 on mortality levels, and the potential impact of vector-borne diseases in general.

2. Investment strategy

The Statement of Investment Principles guides the fund’s investment objectives and policies including high-level strategic asset allocation decisions which define risk and return objectives and that owning a diversified portfolio of assets reduces exposure to any particular contingency. The SIP confirms that whilst the fund’s fiduciary duty is the pursuit of financial returns, non-financial considerations can be taken into account, that exercising ownership rights in a responsible way can reduce risk and may improve returns.

The supplementary Statement of Responsible Investment Principles (SRIP) expands on this, highlights the importance of the Paris Agreement of the United Nations Framework Convention on Climate Change, and the risks and opportunities for the fund and sets out a series of commitments to climate monitoring and action.

The methodology used in the valuation considers expected returns and volatilities of asset classes in future but cannot directly model the impacts of climate risk at asset class or geographic level. This same modelling is used to set the strategic asset allocation and for the investment strategy and cannot enable direct capture of investment risk and opportunity at this granular level.

Therefore, the investment strategy, more accurately the strategic asset allocation, is not directly impacted by nor account for the recognition of climate change risk. This undiversifiable and unhedgeable risk this can only be recognised by adopting a more prudent funding strategy and as set out above has been. Even then, the tail risk ie the low likelihood/high impact outcomes cannot be allowed for within an acceptable funding strategy.

The implementation of the investment strategy involves making decisions at the level of stock, bond, property and transaction level. Each decision needs to take account of the full range of risks and opportunities and an assessment of the expected risk adjusted return. Diversification across geographies, industries and investment is intended to reduce both idiosyncratic and systemic risk and provide the expected long-term return required to support the funding assumptions and contribution levels.

The investment holdings will evolve over time seeking to earn an appropriate return for the risks incurred as companies and economies evolve and adapt. Throughout this period the portfolio managers will seek to engage with companies, partner funds and organisations in line with the SRIP to meet the fund’s objectives as a good steward of capital whilst seeking an appropriate risk adjusted investment return and enable the Committee to meet it’s fiduciary duty.

Pensions Audit Sub Committee

2.00pm, Tuesday, 19 March 2024

Actuarial Valuation for Scottish Homes Pension Fund

Item number 6.4

1. Recommendations

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

1.1 Note the results of the 2023 actuarial valuation for the Scottish Homes Pension Fund;

1.2 Note that the funding level of the Scottish Homes Pension Fund at 31 March 2023 was 127%. This Actual Funding Level (AFL) of 127% is greater than the Target Funding level (TFL) of 95.5%, as specified in the Scottish Government Guarantee. Therefore, no deficit contributions are required from the Scottish Government (as Guarantor) for the period form 1 April 2024 to 31 March 2027; and

1.3 Note that the Scottish Government is required to paya total of £90,000 per annum towards the cost of administration expenses over the three years from 1 April 2024 to 31 March 2027.

Alan Sievewright
Chief Finance Officer, Lothian Pension Fund

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

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

Actuarial Valuation for Scottish Homes Pension Fund

2. Executive Summary

2.1 An actuarial valuation of the Scottish Homes Pension Fund must be carried out every three years. The fund's actuary assesses the financial health of the fund and sets the employer contribution rates required for the next three years.

2.2 This report presents the results of the actuarial valuation of the Scottish Homes Pension Fund as at 31 March 2023.

2.3 The funding level at 31 March 2023 was 127%, an improvement from 118% at the 2020 actuarial valuation. The Actual Funding Level (AFL) of 127% is greater than the Target Funding Level (TFL) of 95.5% specified in the Scottish Government Guarantee. Therefore, no deficit contributions are required from the Scottish Government (as Guarantor) for the period 1 April 2024 to 31 March 2027.

2.4 The Scottish Government is however, required to pay £90,000 per annum towards the cost of administration expenses for the three years from 1 April 2024 to 31 March 2027

3. Background

3.1 The City of Edinburgh Council took over the administration of the deferred and pensioner liabilities of the Scottish Homes Pension Fund on 1 July 2005. An agreement between the Scottish Government and the City of Edinburgh Council ('the Guarantee') was put in place in June 2005. The Scottish Government acts as the guarantor for these liabilities.

3.2 An actuarial valuation of the Scottish Homes Pension Fund must, by law take place every three years. The 2023 valuation is based on data as at 31 March 2023 and must be completed by 31 March 2024.

3.3 The actuarial valuation of a pension fund has three main purposes:

- To assess whether the funding strategy and assumptions are appropriate;
- To assess the financial health of the pension fund; and
- To set the future rates of contributions payable by the employer/guarantor.

3.4 The funding strategy for the Scottish Homes Pension Fund and the valuation methodology is set out in the Guarantee. The strategy assesses the funding level using prudent financial assumptions and sets target funding levels for the fund at each actuarial valuation. It is designed to reduce investment risk as the fund is closed to new entrants and the liabilities will mature over time. It also sets out the conditions which will trigger contributions to be payable by the Scottish Government.

3.5 At a funding level in excess of 100%, the Guarantee requires that investments should be fully invested in index-linked gilts to reduce funding level volatility and 'lock-in' the surplus. It should be noticed however, that whilst this represents a low-risk investment strategy, index-linked gilts cannot provide an exact match for the liabilities and longevity risks remain.

3.6 The Guarantee is included at Appendix 2.

4. Main Report

4.1 The 2023 Actuarial Valuation report is included at Appendix 1.

4.2 Liability cashflows (projected benefit benefits) have been estimated based on financial and demographic assumptions, as detailed in the report.

4.3 The table below summarises the financial position of the fund at 31 March 2023, with the result of the 2020 formal valuation shown for comparison.

Valuation Date	2023	2020
	£M	**£M**
Past Service Liabilities	99	141
Assets	126	166
Surplus/(Deficit)	27	25
Actual Funding Level	**127%**	**118%**
Target Funding Level	**95.5%**	**94.5%**

4.4 The valuation includes the assets and liabilities of Homeless Action Scotland which transferred into the Scottish Homes Pension Fund following its exit from Lothian Pension Fund on 12 July 2018.

4.5 With an actual funding level in excess of 100%, the investment strategy of the fund is to be fully invested in index-linked gilts in accordance with the Scottish Government guarantee.

4.6 The TFL, as set out in the Guarantee is 95.5% at 31 March 2023. The AFL is greater than the TFL at the 2023 valuation date, and therefore no deficit contributions are required from the Scottish Government for the period 1 April 2024 to 31 March 2027.

4.7 The Guarantor should however, meet the cost of administration expenses. The CIPFA definition of costs includes:

- Oversight and Governance;
- Administration; and
- Investment Management.

4.8 Following consideration of administration and oversight and governance costs for the Scottish Homes Pension Fund for the 2022/23 financial year, the Guarantor is required to pay a total of £90,000 per annum for the 3 years from 1 April 2024. Investment expenses will be met from the current funding surplus.

5. Financial impact

5.1 The funding strategy, together with the Guarantee from the Scottish Government, should ensure that the fund has sufficient assets in the long term. The results of the actuarial valuation have a financial impact on the Scottish Government as guarantor. The actuarial valuation sets the contribution rates payable by the Scottish Government over the next 3 years.

6. Stakeholder/Regulatory Impact

6.1 The investment strategy of the pension fund is one of the main determinants of risk in terms of volatility of funding level and contributions payable by the Scottish Government.

6.2 The valuation report has been provided to the Scottish Public Pensions Agency on behalf of the Scottish Government.

6.3 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

Appendix 1 – Scottish Homes Pension Fund 2023 Valuation Final Valuation Report.
Appendix 2 – Lothian Pension Fund Scottish Homes Pensioner Transfer: Operation of Scottish Executive Guarantee.

LPF PUBLIC DATA

Appendix 1

HYMANS ROBERTSON

Scottish Homes Pension Fund

Report on the actuarial valuation as at 31 March 2023

March 2024

Richard Warden FFA Julie Baillie FFA

For and on behalf of Hymans Robertson LLP

Hymans Robertson LLP

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Contents

Executive summary

We have been commissioned by City of Edinburgh Council ("the Administering Authority") to carry out a valuation of Lothian Pension Fund ("the Fund") as at 31 March 2023. This fulfils Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2018. This report is a summary of the valuation.

1. Contribution rates

The contribution rates for individual employers set at this valuation can be found in the Rates and Adjustments certificate. Table 1 shows the combined individual employer rates set at this valuation and the last valuation.

Table 1: Whole fund contribution rates compared with the previous valuation

	31 March 2023	31 March 2020
Expense requirement	£90,000 p.a.	£90,000 p.a.

2. Funding position

At 31 March 2023, the past service funding position has improved from the last valuation at 31 March 2020. Table 2 shows the single reported funding position at this valuation and the last valuation.

Table 2: Single reported funding position compared with the previous valuation

	31 March 2023	31 March 2020
	(£m)	**(£m)**
Deferred Pensioners	15	32
Pensioners	84	109
Total liabilities	**99**	**141**
Assets	**126**	**166**
Surplus (Deficit)	**27**	**25**
Fund level	**127%**	**118%**

1 Background

1.1 History

The deferred pensioner and pensioner members of the Fund were transferred to the Administering Authority prior to the wind-up of the Scottish Homes Residuary Body. The Administering Authority assumed the management of its assets and liabilities from 1 July 2005. The Scottish Government (formerly the Scottish Executive) acts as the Guarantor for the transferred liabilities. The Guarantor's intention is that over time the transferred assets together with any additional contributions required should be sufficient to fund the former Scottish Homes Pension Fund liabilities.

1.2 Homeless Action Scotland

The results shown in this paper include the assets and liabilities of Homeless Action Scotland which transferred into the Fund following its cessation from the Lothian Pension Fund on 12 July 2018.

1.3 Contribution rates

The Funding Agreement sets out how payments from the Guarantor should be determined.

2 2 Approach to the valuation

2.1 Valuation purpose

The triennial actuarial valuation is an important part of the Fund's risk management framework. Its main purpose is to ensure the Fund continues to have a contribution plan and investment strategy that will achieve the objectives set out in the Funding Strategy Statement.

This report marks the culmination of the valuation process and contains its two key outcomes:

1. Reviewing the current funding plan
2. Setting the contribution rate for the period 1 April 2024 to 31 March 2027

The Funding agreement with the Scottish Government, as Guarantor, sets out how contribution payments should be determined.

Further information on the valuation process, methodology and strategy is set out in the publicly available Funding Strategy Statement, Statement of Investment Principles and published papers and minutes of the Fund's Pensions Committee.

2.2 Measuring the funding level

The past service funding level, referred to as the Actual Funding Level in the Funding Agreement, is measured at the valuation date. To measure the funding level, a market-related approach is taken to calculate both the assets and the liabilities to ensure they are consistent with one another:

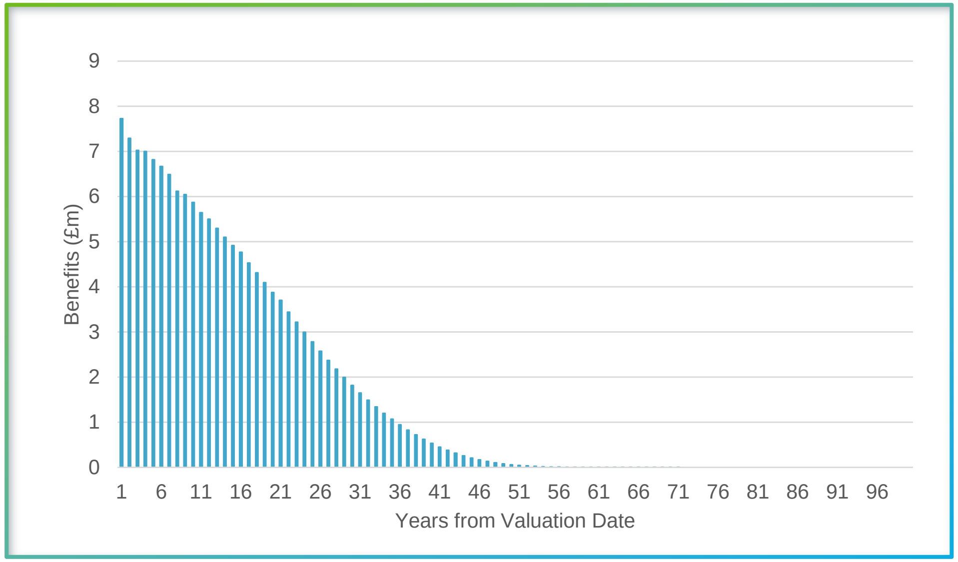
1. The bid-market value of the Fund's assets at the valuation date has been used.
2. The liabilities have been valued using assumptions based on market indicators at the valuation date (these assumptions are detailed in Appendix 2).

2.2.1 Further detail on the liabilities

The liabilities are the value of all future payments to members based on all benefits earned up to the valuation date, expressed in today's money.

Chart 1 shows the projected payments for all members in the Fund at the valuation date. The projections are based on the membership data provided for the valuation (Appendix 1), the assumptions (Appendix 2), and our understanding of the LGPS benefit structure as at 31 March 2023 (details at www.scotlgpsregs.org).

Chart 1: Projected benefit payments for all service earned up to 31 March 2023



To express the future payments in today's money, each projected payment is discounted back to the valuation date in line with an assumed rate of future investment return (known as the discount rate).

3 Valuation results

3.1 Single funding level as at 31 March 2023

Table 3 sets out the assets and liabilities at the valuation date. The results at the 2020 valuation are shown for comparison.

The overall result has been an improvement in the Actual Funding Level (AFL), from 118% to 127% with a larger funding surplus than was reported in 2020.

The funding level and surplus/deficit figures provide a high-level snapshot of the funding position as at 31 March 2023, but there are limitations:

- The liabilities are calculated using a single set of assumptions about the future and so are very sensitive to the choice of assumptions.
- The market value of assets held by the Fund will change daily.

Table 3: Single reported funding position compared with the previous valuation

	31 March 2023	31 March 2020
	(£m)	(£m)
Deferred pensioners	15	32
Pensioners	84	109
Total liabilities	**99**	**141**
Assets	**126**	**166**
Surplus/(Deficit)	**27**	**25**
Funding level	**127%**	**118%**

3.1.1 Projection of the funding position

If the financial and demographic assumptions we have made at this valuation are borne out in practice, and there are no changes to the valuation assumptions, we project that the funding level at the 2026 valuation date will be broadly unchanged.

3.2 Changes since the last valuation

3.2.1 Events between 2020 and 2023

The most significant external event to occur since the last valuation has been the Covid-19 pandemic However, the analysis in Table 5 shows that mortality experience was broadly as expected over the period with minimal impact on the funding position.

CPI inflation was much higher than anticipated by the long-term assumption at the 2020 valuation.

The Fund experience much worse than expected investment returns. This has had a material negative impact on the funding position (Table 4).

Financial

Table 4: Analysis of investment return experience between 2020 and 2023 valuations

	Expected	Actual	Difference	Impact on funding position
Investment returns				
3-year period	0.4%	-13.9%	-14.5%	-£20m
Annual	0.15% pa	-4.9% pa	-5.05% pa	

Membership

Table 5: Analysis of membership experience between 2020 and 2023 valuations

	Expected	Actual	Difference	Impact on funding position
Post-retirement				
Benefit increases	1.3% pa	4.5% pa	3.2% pa	-£14m
Pension ceasing	£1.1m	£1.1m	£0.0m	-£0m

3.2.2 Outlook

Expectations about the future, which inform the assumptions used to value the liabilities, have changed since the last valuation. The most significant changes are:

Future inflation: this is expected to be on average higher than at 2020 due to the current high level of inflation.

Investment returns: due to changes in financial markets, future investment returns are now expected to be higher than at the last valuation.

Table 6: Summary of change in outlook

Factor	What does it affect?	What's changed?	Impact on liabilities
Future investment returns	The rate at which you discount back future benefits payments (also known as the 'discount rate' assumption)	Future investment returns are anticipated to be higher than at 2020.	Decrease of £42m
Inflation	The rate at which pensions (both in payment and deferment) and CARE pots increase.	Significant increase in short-term future inflation expectations.	Increase of £18m
Current life expectancy	How long we expect most people to live for based on today's current observed mortality rates.	Slight increase in life expectancy (not allowing for Covid-related excess deaths)	Increase of £4m
Future improvements in life expectancy	How we expect life expectancies to change (increase) in the future.	Lower rate of improvement in life expectancy through use of updated model of future improvements, including allowance for some recent mortality experience related to the excess deaths from the Covid 19 pandemic..	Decrease of £4m

3.3 Reconciling the overall change in funding position

Tables 7 & 8 provide insight into the funding position change between 31 March 2020 and 31 March 2023. Firstly, the changes expected to happen (Table 7), which relate mostly to assets. Then the impact of actual experience (Table 8), which affects mainly the liabilities.

3.3.1 Expected development

Table 7: Expected development of funding position between 2020 and 2023 valuations.

	Assets	Liabilities	Surplus/ deficit
	£m	£m	£m
31 March 2020 valuation	**166**	**141**	**25**
Cash flows			
Employer contributions paid in	0	0	0
Employee contributions paid in	0	0	0
Benefits paid out	(21)	(21)	0
Other cash flows (eg expenses, transfers in/out)**	0	0	0
Expected changes			
Expected investment returns	1	0	1
Interest on benefits already accrued	0	1	(1)
Expected position at 31 March 2023	**146**	**121**	**25**

***This includes the contributions paid by the Scottish Government each year to cover the administration expenses of the Fund.*

3.3.2 Impact of actual events

Table 8: Impact of actual events on the funding position at 31 March 2023

	Assets	Liabilities	Surplus/ deficit
	£m	£m	£m
Expected position at 31 March 2023	**146**	**121**	**25**
Events between 2020 and 2023			
Benefit increases greater than expected	0	14	(14)
Other membership experience	0	(6)	6
Lower than expected investment returns	(20)	0	(20)
Changes in future expectations			
Investment returns	0	(42)	42
Inflation	0	18	(18)
Longevity	0	0	0
Other demographic assumptions	0	(6)	6
Actual position at 31 March 2023	**126**	**99**	**27**

Numbers may not sum due to rounding.

3.4 Contribution rate payable by the Guarantor

3.4.1 Deficit Recovery Contributions

The Funding Agreement sets out how payments from the Guarantor should be determined. The Target Funding Level (TFL), is 95.5% at 31 March 2023. The AFL (127%) is greater than the TFL at the 2023 valuation date and therefore no deficit contributions are required from the Guarantor for the period from 1 April 2024 to 31 March 2027.

3.4.2 Expense Requirement

The Guarantor has a responsibility to pay towards the cost of the following expenses:

- Administration (including oversight and governance) – estimated to be £90,000 per annum
- Investment management

As required by the Funding Agreement, the liabilities are valued using yield curves that make no allowance for investment returns above gilts. To maintain prudence in future valuations, the Guarantor should also pay for investment expenses otherwise these would act to reduce the returns expected from the gilts-based strategy to below those implied by the yield curves. However, given the Fund is currently in surplus, we and the Administering Authority are comfortable for these expenses to continue to be met by the Fund over the next three years, in line with the approach adopted at the 2020 valuation.

The total Expense Requirement is therefore £90,000 p.a. from 1 April 2024 to 31 March 2027.

3.4.3 Certified contributions

The Guarantor would pay the total of these items to the Fund over the three years from 1 April 2024. This contribution requirement is set out in the Rates and Adjustments Certificate on page 24.

4 Sensitivity and risk analysis

The valuation results depend on the actual assumptions made about the future. By their nature, these assumptions are uncertain which means it's important to understand their sensitivity and risk levels.

4.1 Funding level

4.1.1 Financial assumptions

Future investment returns and future inflation will always be uncertain. The impact of varying levels is set out below.

Table 9: Sensitivity of funding position to discount rate assumption

Discount rate assumption	Surplus/Deficit	Funding level
Per annum	**£m**	**%**
Gilts plus 0.5%	32	134%
Gilts	**27**	**127%**
Gilts less 0.5%	22	121%

Table 10: Sensitivity of funding position to inflation assumption

CPI assumption	Surplus/Deficit	Funding level
	£m	**%**
2.1% pa	29	130%
2.3% pa	**27**	**127%**
2.5% pa	25	125%

It is worth noting that, because the Fund is invested entirely in government bonds, the surplus / (deficit) position is largely immunised against any changes in government bond yields. That is, any increase (decrease) in liabilities as a result of changing bond yields will be offset (partially or fully) by an increase (decrease) in the value of the government bonds held. The extent of this immunisation will depend on how closely the duration and inflation-linkage of the bonds match the characteristics of the Fund's liabilities.

4.1.2 Demographic assumptions

The main demographic risk is that people live longer than expected. A 1-year improvement in life expectancy will result in an increase in the liabilities of around 5%.

4.2 Other risks

4.2.1 Regulatory, administration and governance risks

Potential risks in this area include change in central government legislation, which alters the future cost of the LGPS, and failures in administration processes leading to incorrect data and inaccuracies in actuarial calculations. At this valuation, specific risks include:

McCloud

Benefits accrued by certain members in the LGPS between 2015 and 2022 may increase following the McCloud case, which ruled that transitional protections introduced in 2015 for older members were discriminatory. We've made an allowance for the cost of these potential improvements, based on the guidance issued by the Scottish Public Pensions Agency on 28 April 2023.

Other legal rulings

Benefits could change because of other legal challenges (eg the Goodwin case affecting partner pensions). Given the lack of information about possible benefit changes and their relatively small impact, we have made no allowance for these changes.

Cost cap

This is not relevant since members are no longer accruing benefits.

GMP Indexation

We have made an allowance for all increases on GMPs for members reaching State Pension age after 6 April 2016 by assuming that all increases will be paid for by LGPS employers in the Fund with no future support from the State (ie the worst-case scenario from an LGPS perspective). The affected members are a diminishing group, and the financial significance of this allowance will reduce over time. This is the same approach that was taken for the 2020 valuation.

4.2.2 Post valuation events

Since 31 March 2023, there has been continued volatility in financial markets and rises in interest rates by central banks. These events affect the value of the Fund's assets and liabilities.

However, as mentioned above, the Fund's gilts-based investment strategy provides significant protection against volatile market conditions.

No explicit allowance has been made for this volatility in the valuation results or contribution rates detailed in the Rates & Adjustments certificate. The Fund will continue to monitor changes in the financial and demographic environment as part of its ongoing risk management approach.

4.2.3 Climate change risk

Results may materially change due to the impact of climate change, because of transition and physical risks. We have not quantified the risk exposure here as the Funding Agreement with the Scottish Government as Guarantor means the Fund's exposure to climate risk is reduced.

5 Final comments

The Fund's valuation operates within a broader framework, and this document should be considered alongside the following:

- The Funding Agreement with the Guarantor
- The Funding Strategy Statement
- The Statement of Investment Principles, which sets out the investment strategy for the Fund
- The general governance of the Fund, such as meetings of the Pensions Committee and Local Pensions Board, decisions delegated to officers, the Fund's business plan, etc.
- The Fund's risk register.

5.1 Valuation frequency

Under the LGPS regulations, the next formal valuation of the Fund is due to be carried out as at 31 March 2026 where contribution rates payable from 1 April 2027 will be set.

Richard Warden FFA   Julie Baillie FFA

March 2024

For and on behalf of Hymans Robertson LLP

Appendices

Appendix 1: Data

Membership data

A summary of the membership data provided by the Fund for the 2023 valuation is set out in Table 11. The corresponding membership data from the previous valuation is also shown for reference.

The results of the valuation are dependent on the quality of the data used. We have carried out a series of validation checks on the data supplied to us by the Administering Authority to ensure that it is fit for purpose.

Asset data

To check the membership data, we have used asset and cashflow data provided by the Fund.

Table 11: Whole Fund membership data at this valuation compared with the previous valuation

Whole Fund membership data	31 March 2023	31 March 2020
Active members		
Number	-	-
Total actual pay (£000)	-	-
Total accrued pension (£000)	-	-
Average age (liability weighted)	-	-
Future working lifetime (years)	-	-
Deferred pensioners (including undecideds)		
Number	264	369
Total accrued pension (£000)	566	801
Average age (liability weighted)	57.7	55.7
Pensioners and dependants		
Number	1,089	1,165
Total pensions in payment (£000)	6,859	6,601
Average age (liability weighted)	73.5	72.2

Investment strategy

A summary of the investment strategy allocation used for the calculation of employer contribution rates and to derive the future investment return is set out in Table 12. In practice, the actual allocation may include some holdings in cash.

This information is as set out in the Fund's Statement of Investment Principles.

Table 12: Investment strategy allocation used for the calculation of employer contribution rates

% Allocated	This Valuation 31 March 2023	Last Valuation 31 March 2020
UK gilts	100%	100%
Total	100%	100%

Appendix 2: Assumptions

Financial assumptions

The Scottish Government acts as the 'Guarantor' for the Fund's liabilities. The valuation of these mature liabilities uses more prudent assumptions than those applied to other employers in the Lothian Pension Fund, as set out in the agreed Scottish Executive Guarantee dated June 2005 ('the Funding Agreement').

The terms of the Funding Agreement impose restrictions on the discount rate that is used to calculate the value of the past service liabilities. The Funding Agreement states that there will be no allowance for anticipated outperformance resulting from investment in assets that are riskier than government bonds, and there will be no deduction for investment expenses.

The yield curve used for the discount rate is the Bank of England nominal yield curve. This is the same discount rate that was adopted for the 2020 valuation of the Fund (albeit updated for market conditions as at 31 March 2023). Cash holdings aside, as at 31 March 2023 the Fund is invested entirely in government bonds, which means the discount rate assumption may be considered as a 'best estimate' of the future investment performance. While the Regulations require the funding basis to be prudent, given the low-risk nature of the Fund's investment portfolio, and the associated low-risk nature of the funding strategy, we believe this discount rate is appropriate for the purposes of the valuation.

Table 13: Summary of assumptions used for measuring the funding level, compared to last valuation on 31 March 2020

Assumption	31 March 2023	Required for	31 March 2020
Discount rate	Bank of England nominal yield curve	To place a present value on all the benefits promised to scheme members at the valuation date.	Bank of England nominal yield curve
Benefit increases	Bank of England implied RPI inflation curve less 1% pa before 2030 and 0.1% pa thereafter*	To determine the size of future benefit payments.	Bank of England implied RPI inflation curve less 0.9% pa

** The change in RPI-CPI gap assumption is to reflect changes to RPI from 2030, when it will be redefined to match CPIH. CPIH inflation is historically very similar to CPI inflation hence the gap of only 0.1% pa after that point.*

Page 162

Yield Curves

Chart 2 shows the nominal spot yields for a Government-backed loan (ie the yield to maturity of a zero-coupon bond) as at 31 March 2020 and 31 March 2023 (Source: Bank of England). Chart 3 shows the implied inflation curve (RPI) over a range of maturities at 31 March 2020 and 31 March 2023. This is derived from the yields on both fixed and index linked gilts (Source: Bank of England).

All other assumptions adopted are intended to represent our best estimate of future experience. Taken in aggregate, the funding basis results in a ‘best estimate’ of the Fund’s pension liabilities, which are being funded in a prudent manner.

Chart 2: Gilts nominal yield curve

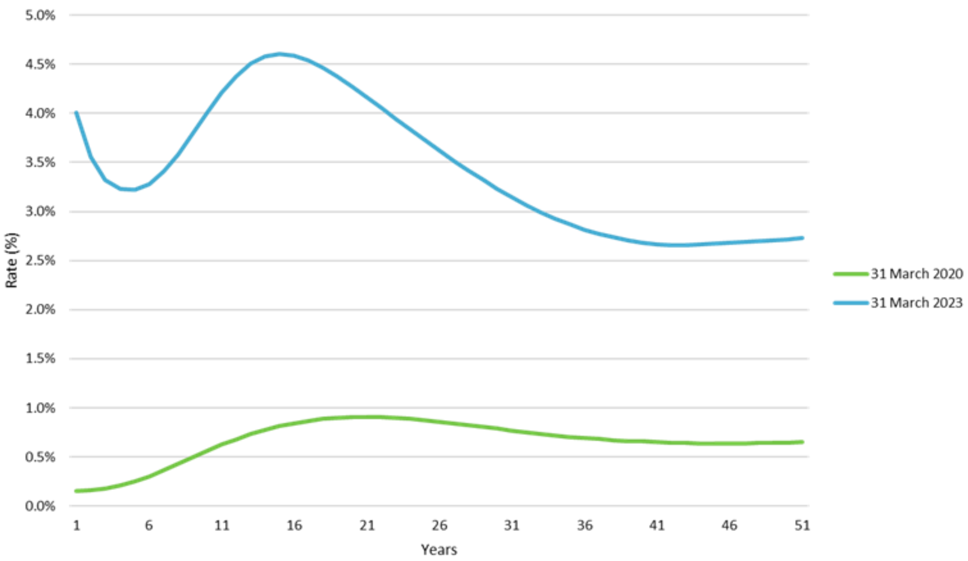
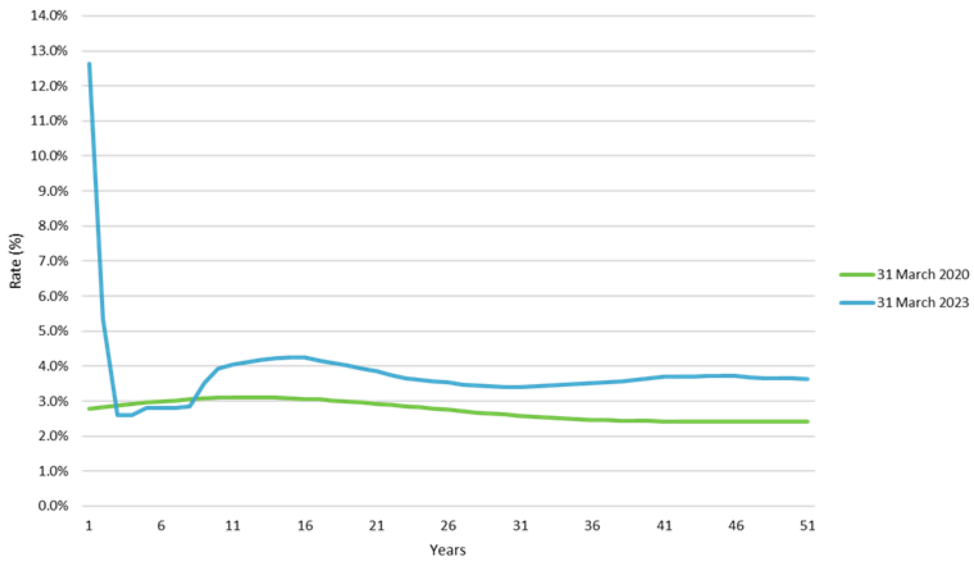


Chart 3: Gilts implied RPI inflation curve



Demographic assumptions

The same demographic assumptions are used to set contribution rates and to assess the current funding level.

Longevity

Table 14: Summary of longevity assumptions at this valuation compared with the previous valuation

	31 March 2023	31 March 2020
Baseline assumptions	Club Vita	Club Vita
Future improvements	CMI 2022 model Initial addition = 0.25% (both Male and Female) Smoothing factor = 7.0 Weighting = 0% (2020 & 2021 data), 25% (2022 data) 1.5% pa long-term rate	CMI 2019 model Initial addition = 0.5% (Male) 0.25% (Female) Smoothing factor = 7.0 2.0% pa long term rate of improvement

Other demographic assumptions

Table 15: Summary of other demographic assumptions

Death in deferment	See sample rates in Table 16
Commutation	70% of future retirements elect to exchange pension for additional tax-free cash up to HMRC limits
Retirement age	The earliest age at which a member can retire with their benefits unreduced
Family details	A varying proportion of members are assumed to have a dependant at retirement or on earlier death. For example, at age 60 this is assumed to be 85% for males and 60% for females. The dependant of a male member is assumed to be 2 years younger than him and the dependant of a female member is assumed to be 3.5 years older than her.

Sample rates for demographic assumptions

Table 16: Sample rates of male and female demographic assumptions

Age	Death in Deferment	
	Males	Females
	FT & PT	FT & PT
20	0.21	0.11
25	0.21	0.11
30	0.26	0.16
35	0.30	0.27
40	0.51	0.44
45	0.86	0.71
50	1.37	1.04
55	2.15	1.37
60	3.86	1.75
65	6.44	2.25

Age	Salary scale	Death before retirement	Withdrawals		Ill health Tier 1		Ill health Tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.11	256.99	338.79	0.00	0.00	0.00	0.00
25	117	0.11	172.88	227.90	0.16	0.13	0.09	0.10
30	131	0.16	144.88	190.99	0.21	0.18	0.12	0.13
35	144	0.27	89.25	164.73	0.41	0.34	0.24	0.25
40	150	0.44	74.23	137.00	0.61	0.51	0.36	0.37
45	157	0.71	61.11	112.78	0.82	0.68	0.48	0.50
50	162	1.04	46.56	85.94	1.50	1.23	1.11	1.13
55	162	1.37	43.56	80.39	5.47	4.43	2.32	2.35
60	162	1.75	35.02	64.64	11.52	9.30	2.38	2.40
65	162	2.25	0.00	0.00	20.73	16.76	0.00	0.00

Figures are incidence rates per 1,000 members
FT and PT denoted full-time and part-time members respectively.

Appendix 3: Reliances & limitations

We have been commissioned by City of Edinburgh Council ('the Administering Authority') to carry out a full actuarial valuation of Scottish Homes Pension Fund ('the Fund') at 31 March 2023, as required under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2018 ('the Regulations').

This report is addressed to the Administering Authority. It has been prepared by us as actuaries to the Fund and is solely for the purpose of summarising the main outcomes of the 2023 actuarial valuation. It has not been prepared for any other third party or for any other purpose. We make no representation or warranties to any third party as to the accuracy or completeness of this report, no reliance should be placed on this report by any third party and we accept no responsibility or liability to any third party in respect of it.

This summary report is the culmination of other communications in relation to the valuation, in particular:

- Correspondence relating to data including the Data Report dated 1 December 2023
- Our Initial Results Report dated 12 October 2023 which outlines the whole Fund results and inter-valuation experience
- The operation of the Scottish Executive Funding Agreement which is dated 29 June 2005, confirming the approach to determine contributions payable to the Fund by the Scottish Government.as Guarantor.
- The Funding Strategy Statement which details the approach taken to adequately fund the current and future benefits due to members

The totality of our advice complies with the Regulations as they relate to actuarial valuations.

The following Technical Actuarial Standards apply to this advice, and have been complied with where material and to a proportionate degree. They are:

- TAS100 – Principles for technical actuarial work
- TAS300 – Pensions

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Appendix 4: Glossary

Term	Explanation
Baseline longevity	The rates of death (by age and sex) in a given group of people based on current observed data.
Club Vita	A firm of longevity experts who Hymans Roberston partner with for longevity analysis. They combine data from thousands of pension schemes and use it to create detailed baseline longevity assumptions at member-level, as well as insights on general longevity trends and future improvements.
Commutation	The option for members to exchange part of their annual pension for a one-off lump sum at retirement. In the LGPS, every £1 of pension exchanged gives the member £12 of lump sum. The amounts that members commute is heavily influenced by tax rules which set an upper limit on how much lump sum can be taken tax-free.
CPI inflation	The annual rate of change of the Consumer Prices Index (CPI). The CPI is the UK government's preferred measure of inflation and is the measure used to increase LGPS (and all other public sector pension scheme) benefits each year.
Demographic assumptions	Assumptions concerned with member and employer choices rather than macroeconomic or financial factors. For example, retirement age or promotional salary scales. Demographic assumptions typically determine the timing of benefit payments.

Term	Explanation
Discount rate	An assumption for the annual rate of future investment return. Used to place a single 'today's money' value on a stream of future payments.
Funding position	The extent to which the assets held by the Fund at 31 March 2023 cover the accrued benefits ie the liabilities. The two measures of the funding position are: • the funding level - the ratio of assets to liabilities; and • the funding surplus/deficit - the difference between the asset and liabilities values.
Inflation	Prices tend to increase over time, which is called inflation. Inflation is measured in different ways, using a different 'basket' of goods and mathematical formulas.
Liabilities	An employer's liability value is the single value at a given point in time of all the benefit payments expected to be made in future to all members. Benefit payments are projected using demographic and financial assumptions and the liability is calculated using a discount rate.
Longevity improvements	An assumption about how rates of death will change in future. Typically, we assume that death rates will fall and life expectancies will improve over time, continuing the long-running trend.
Prudence	To be prudent means to err on the side of caution in the overall set of assumptions.

Appendix 5: Rates and Adjustments Certificate

In accordance with regulation 62(4) of the Regulations we have assessed the contributions that should be paid into the Fund by the Guarantor for the period 1 April 2024 to 31 March 2027 to maintain the solvency of the Fund.

The method and assumptions used to calculate the contributions set out in the Rates and Adjustments certificate are detailed in our report on the actuarial valuation dated March 2024. These assumptions underpin our estimate of the number of members who will become entitled to a payment of pensions under the provisions of the LGPS and the amount of liabilities arising in respect of such members.

The required minimum contribution rates are set out in Table 17.

Table 17: Whole fund primary and secondary contribution rates from 1 April 2024 to 31 March 2027

This valuation - 31 March 2023	
Period	Guarantor's minimum contribution rate
1 April 2024 to 31 March 2025	£90,000
1 April 2025 to 31 March 2026	£90,000
1 April 2026 to 31 March 2027	£90,000

Richard Warden FFA   Julie Baillie FFA
March 2024
For and on behalf of Hymans Robertson LLP

Appendix 6: Section 13 dashboard

Metric	Unit	2023 Valuation
2023 funding position – local funding basis		
Funding level (assets/liabilities)	%	127.5%
Funding level (change since previous valuation)	%	9.8%
Asset value used at the valuation	£m	126
Value of liabilities (including McCloud liability)	£m	99
Surplus (deficit)	£m	27
Discount rate (past service)	% pa	Bank of England nominal yield curve
Discount rate (future service)		Past service and future service are consistently valued with the same underlying assumptions, methodologies and models regarding future expected levels of inflation, interest rates and investment returns.
Assumed pension increase (CPI)	% pa	Bank of England implied RPI inflation curve less 1% pa before 2030 and 0.1% pa thereafter
Method of derivation of discount rate, plus any changes since previous valuation		No change to method of derivation of discount rate since previous valuation

Metric	Unit	2023 Valuation
Assumed life expectancy at age 65		
Life expectancy for current pensioners – men age 65	Years	20.2
Life expectancy for current pensioners – women age 65	Years	23.0
Life expectancy for future pensioners – men age 45	Years	20.7
Life expectancy for future pensioners – women age 45	Years	24.9
Past service funding position – SAB basis (for comparison purposes only)		
Market value of assets	£m	126
Value of liabilities	£m	88
Funding level on SAB basis (assets/liabilities)	%	143%
Funding level on SAB basis (change since last valuation)	%	-46%

Metric	Unit	2023 Valuation	2020 Valuation
Contribution rates payable			
Primary contribution rate	% of pay	0.0%	0.0%
Secondary contribution rate (cash amounts in each year in line with CIPFA guidance)			
1st year of rates and adjustments certificate	£m	0.09	0.09
2nd year of rates and adjustments certificate	£m	0.09	0.09
3rd year of rates and adjustments certificate	£m	0.09	0.09
Giving total expected contributions			
1st year (£ figure based on assumed payroll)	£m	0.0	0.0
2nd year (£ figure based on assumed payroll)	£m	0.0	0.0
3rd year (£ figure based on assumed payroll)	£m	0.0	0.0
Assumed payroll (cash amounts in each year)			
1st year rates and adjustments certificate	£m	0.0	0.0
2nd year rates and adjustments certificate	£m	0.0	0.0
3rd year rates and adjustments certificate	£m	0.0	0.0
Three-year average	% of pay	0.0%	0.0%
Average employee contribution	% of pay	0.0%	0.0%
Employee contribution rate (£ figure based on assumed payroll of £0m)	£m pa	0.0	0.0

Metric	Unit	2023 Valuation	2020 Valuation
Deficit recovery and surplus spending plan			
Latest deficit recovery period end date, where this methodology is used by the fund's actuarial advisor.	Year	Methodology not used	Methodology not used
Earliest surplus spreading period end date, where this methodology is used by the fund's actuarial advisor.	Year	Methodology not used	Methodology not used
The time horizon end date, where this methodology is used by the fund's actuarial advisor	Year	2043	2040
The funding plan's likelihood of success, where this methodology is used by the fund's actuarial advisor.	%	Methodology not used	Methodology not used
Percentage of liabilities relating to employers with deficit recovery periods of longer than 20 years	%	Methodology not used	Methodology not used
Additional information			
Percentage of total liabilities that are in respect of Tier 3 employers	%	0.0%	N/A
Included climate change analysis/comments in the 2023 valuation report		Yes	N/A
Value of McCloud liability in the 2023 valuation report (on local funding basis)	£m	0.01	N/A

→ LOTH | SAP | Scottish Homes Pensioner Transfer

Operation of Scottish Executive Guarantee

Preamble

The Scottish Homes Pension Fund[1] (SHPF) is to be transferred to the Lothian Pension Fund (LPF) prior to the wind up of the Scottish Homes residuary body, with the LPF assuming responsibility for the management of its assets and liabilities with effect from 1 July 2005.

This note documents the funding objective for the transferred liabilities and particularly how any requirement for Scottish Ministers to make payments under the Local Government Pension Scheme (Scotland) Regulations 1998 (as amended by the Local Government Pension Scheme (Scotland) Amendment (No. 2) Regulations 2005) will be determined. Nothing in this note over-rides the regulations. This note has been prepared for the City of Edinburgh Council, as Administering Authority to the LPF, after consultation with the Scottish Executive and Scottish Homes.

Liabilities for payment of the pensions in payment and deferred pensions of the SHPF at 30 June 2005 are being transferred to the LPF along with the residual assets of the SHPF. The first pension instalment being paid by LPF will be on 15 August 2005 in respect of the month from 16 July[2]. The bulk transfer of the assets held in the SHPF will be transferred on 1 July 2005. The transferred assets from the SHPF will be assimilated within the LPF, albeit invested on a different strategy to that used for open ongoing employers.

The Scottish Executive will act as the Guarantor for the transferred SHPF liabilities. The Guarantor's intention is that over time the transferred assets together with any additional contributions that may be made under this agreement should be sufficient to fund the SHPF liabilities. This guarantee will continue until all liabilities of the former SHPF are extinguished.

Notes: All administration costs, including the cost of administering this guarantee will be charged directly to the Scottish Homes element of the LPF. The ongoing contact for operational issues (for example, exercising discretions under the Local Government Pension Scheme (Scotland) Regulations 1998, as amended) will be with Communities Scotland (or its successor) and for funding / guarantee issues will be the Scottish Executive (or its successor).

Any future legislative/regulatory changes affecting the operation of this guarantee should not have an adverse impact on the LPF.

Actuarial valuation procedure and further contributions

The liabilities relating to the SHPF element of the LPF will be valued at 1 July 2005, at 31 March 2008 and subsequently at three yearly intervals. The valuation assumptions, including the assumed future yields on different asset classes, will be set by the LPF actuary and will be demonstrably consistent with those used for the balance of the LPF, except to the extent that the SHPF liabilities exhibit peculiar characteristics that are not already reflected in the valuation assumptions.

However, the funding target for the SHPF element will be different in recognition of the nature of the liabilities and the existence of the guarantee.

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[1] Both the SHPF and LPF operate under the Local Government Pension Scheme (Scotland) Regulations 1998
[2] The final SHPF pension payment will be made on 28 June 2005 in respect of the period from 1 June 2005 to 15 July 2005.

Funding Targets

The Target Funding Level (TFL) is expressed in terms of the valuation of liabilities without anticipating any excess returns from equities. The TFL will rise over time as the liabilities become more mature, as shown in the table below.

Valuation Date	Target Funding Level
2005	85.0%
2008	87.5%
2011	89.5%
2014	91.5%
2017	93.0%
2020	94.5%
2023	95.5%
2026	96.5%
2029	97.5%
2032	98.0%
2035	98.5%
2038	99.0%
2041	99.5%
2044 & thereafter	100.0%

At each three yearly valuation point, regardless of the actual investment strategy by the LPF for the former SHPF liabilities, the LPF actuary will calculate the ratio of the value of the assets to the remaining liabilities discounted using the real redemption yield on index-linked government bonds of appropriate term to the undischarged liabilities. This quantity is called the Actual Funding Level (AFL). There will be no anticipated out-performance from non Government bonds nor any deduction for investment expenses in the valuation of the liabilities.

Guarantor's Payments

The AFL and the TFL will be compared at each triennial valuation to assess whether contributions are required from the Guarantor. Where contributions are required the amortisation period will be determined by the LPF. The initial amortisation period is expected to be 8 years, but this may reduce in future.

Funding Scenario		Guarantor's Contributions (effective from one year after valuation date)
1.	AFL greater than or equal to TFL at current valuation date	No contributions
2.	AFL greater than or equal to TFL at previous valuation date, but less than TFL at current valuation date	Contributions are the lesser of: • current level of contributions; or • the contributions that would result from current AFL if calculated by reference to TFL at this valuation date, as in (3) below.
3.	AFL less than TFL at previous valuation date	Shortfall relative to current target (i.e. TFL at this valuation x capitalised value of liabilities minus assets) is spread over period not exceeding 8 years[3]

Whatever the outcome of the valuation as at 1 July 2005, there would be no contributions levied on the Guarantor. The 2008 valuation would be the first assessment that could lead to the Guarantor making extra contributions in the 2009/10 financial year.

The LPF will use its best endeavours to give the Guarantor at least 2 (two) months notice of any change in contributions.

A worked example illustrating how the funding objective is expected to work in practice is included in Annex A.

[3] shortfall would be amortised over 8 years (or less) assuming level monthly payments starting one year after effective date of valuation.

Investment Strategy

The investment strategy of the LPF is set by the City of Edinburgh Council, as administering authority. The LPF will consult the Guarantor on any changes to investment strategy.

Initially, the intention is to adopt an investment strategy comprising of broadly:

	Proportion of Total Assets
Global Equities	45%
Bonds	45%
Property	10%
Total	100%

It is expected that the global equities component will be reduced over time, by around five percentage points every three years. These reductions need not be linked to triennial valuations. Indeed, the desire of the Guarantor is to lock away any *surpluses* that may occur over time by accelerating the transfer of assets into bonds. Here a surplus is defined as assets in excess of the Target Funding Level as defined above.

The Administering Authority will consider how this objective may be implemented in practice.

W Douglas B Anderson FIA
Actuary to the Lothian Pension Fund
For and on behalf of Hymans Robertson LLP
29 June 2005

Signed on behalf of City of Edinburgh Council:

Name: GEIK DREUER

Position: HEAD OF INVESTMENT & PENSIONS

Date: 1 July 2005

Signed on behalf of Scottish Executive: Malcolm Chisholm

Name: Malcolm Chisholm

Position: Minister for Communities

Date: 6-7-05

Annex – Worked Example of Funding Objectives

Consider the position at the 2008 valuation. The figures used below are hypothetical and do not represent the extremes of the range of outcomes which could occur.

The Target Funding Level (TFL) would be 87.5% of the then liabilities valued on a minimum risk discount rate (i.e. based on Government bond yields of appropriate duration to the liabilities).

Suppose, for simplicity, that bond yields remain the same at around 4.7% pa. The value of the undischarged liabilities in 2008 might be around £128m.

The TFL in 2008 is therefore £128m x 87.5% = £112m

Consider these scenarios for actual assets:-

Scenario 1 (AFL>TFL in 2008)

Assets are £115m in 2008, giving an AFL of 115/128 = 89.8%

As this is higher than the TFL of 87.5% (£112m), no contributions are payable

Scenario 2 (AFL<TFL in 2008, but AFL>TFL in 2005)

Assets are £110m in 2008, giving an AFL of 110/128 = 85.9%

This is lower than the TFL at 2008, but is higher than the TFL at 2005 of 85%. There are therefore no contributions payable. This position will be reviewed at the 2011 valuation. For no contributions to continue beyond 2011/12, the AFL would have to rise to be at least 87.5%. (since 87.5% is the TFL for 2008).

Scenario 3.0 (AFL<TFL in 2008 and AFL<TFL in 2005)

Suppose assets fall to £90m by 2008, giving an AFL of 90/128 = 70.3%

This is less than the TFL in 2008 of 87.5% <u>and</u> the TFL in 2005 of 85%. Therefore contributions become payable from April 2009.

The shortfall relative to the TFL is £112m - £90m = £22m

The recovery of this deficit is to be targeted over 8 years. It is assumed that monthly contributions will be made and allowance is included for the "lost" investment returns on the deficit.

Assuming bond yields of 4.7%, the monthly contributions would be calculated to be

$$\frac{£22m \times 1.047}{12 \times 6.69^{4}} = £287{,}000 \text{ per month}$$

The funding position would be reviewed again at the 2011 valuation, against a TFL of 89.5%. Thus these contributions from the Guarantor would be payable for at least 3 years (2009/10 to 2011/12), but may be reduced (or increased) following the 2011 actuarial valuation.

Scenario 3.1 (AFL<TFL in 2011 and AFL>TFL in 2008)

Suppose there is a dramatic improvement in the AFL from 2008 to 2011, but not sufficient for the AFL to exceed the TFL in 2011 (89.5%).

Suppose in 2011, that the undischarged liabilities are valued at £126m. The assets are £108m in 2011, giving an AFL of 85.7% and a deficit relative to the 2011 TFL of £4.8m.

Again, assuming that bond yields remain at 4.7%pa, the monthly contributions would be calculated to be:

$$\frac{£4.8m \times 1.047}{12 \times 6.69} = £62{,}600$$ per month payable from April 2012 for 8 years, but reviewed again at. 2014 valuation

Notes – these examples assume:

(a) bond yields remain unchanged

(b) we make no allowance for the shape of the yield curve today

(c) demographic experience and pension increases are in line with assumptions

[4] 6.69 is derived as the value of a level annuity payable for eight years at 4.7%pa interest. The actual annuity would be calculated at the prevailing redemption yield on bonds of appropriate duration.

Pensions Audit Sub-Committee

2pm, Tuesday, 19 March 2024

Lothian Pension Fund - Internal Audit Update – March 2024

Item number 6.5

1. Recommendations

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

1.1 Progress with delivery of the approved 2023/24 the Lothian Pension Fund Internal Audit plan with three audits now complete.

1.2 The outcomes of the recently completed Information Security audit.

1.3 The proposed audit of Project Forth has now been removed from the 2023/24 Plan.

1.4 The outcomes of the annual validation review of a sample of previously closed LPF audit actions.

1.5 Progress with implementation of agreed management actions from previously completed internal audits.

1.6 Timescales for the Lothian Pension Fund Internal Audit Annual Report and Opinion for 2023/24.

Colin McCurley

Principal Audit Manager, City of Edinburgh Council

Legal and Assurance, Corporate Services Directorate

E-mail: colin.mccurley@edinburgh.gov.uk | Tel: 0131 529 3680

Lothian Pension Fund - Internal Audit Update – March 2024

2. Executive Summary

2.1 This report provides details of the progress of Internal Audit's (IA) assurance activity on behalf of Lothian Pension Fund (LPF) overseen by the City of Edinburgh Council's (the Council) IA function across the period from November 2023 to 5 February 2024.

2.2 Delivery of three of the five audits in the approved 2023/24 IA annual plan are now complete.

2.3 Due to project cessation, Committee is asked to note removal of the audit Project Forth which was proposed in the 2023/24 IA annual plan. As a result, the 2023/24 IA plan now includes a total of four audits.

2.4 A report detailing the outcomes of the recently completed Information Security audit is presented for Committee review and scrutiny.

2.5 The Business Continuity audit is currently in reporting and will be presented to the next Committee meeting.

2.6 An annual validation review was completed during 2023/24 to validate whether a sample of LPF management actions closed between 1 January 2022 and 31 December 2022 continue to be effectively sustained.

2.7 As at 6 February 2024, LPF had 13 open management actions with 11 actions passed the original implementation date. 11 actions have been closed since November 2023.

2.8 The LPF Internal Audit Annual Report and Opinion which will provide IA's annual opinion on the adequacy and effectiveness of LPF's governance, risk and control frameworks for the year ended 31 March 2024, will be presented to Committee in June 2024.

3. Background

3.1 **2023/24 Internal Audit Annual Plan**

The 2023/24 LPF IA plan agreed by the Pensions Audit Sub-Committee in March 2023 included five audits.

Internal Audit Follow-Up Process

3.2 IA follow-up and report on progress with implementation of management actions arising from IA reports.

4. Main Report

4.1 The 2023/24 IA annual plan agreed by Committee in March 2023 included the following five audits:

- People Processes – Complete August 2023
- Senior Managers and Certification Regime – Complete November 2023
- Information Security Arrangements – Complete February 2024
- Business Continuity – Due to complete March 2024
- Project Forth

4.2 Delivery of three of the five audits is now complete, with the outcomes of the Information Security audit presented in this paper for Committee review and scrutiny.

4.3 The Business Continuity Audit is currently in reporting and will be presented to the Committee at the next meeting.

4.4 Due to the project no longer progressing at this time, the proposed audit of Project Forth has now been removed from the 2023/24 IA plan.

4.5 In addition, the 2023/24 Internal Audit Plan includes an annual validation review, which consists of a review of a sample of previously completed LPF management actions to confirm whether these have been effectively implemented and sustained.

Information Security audit

4.6 The Information Security audit is now complete and a report detailing the outcomes is included at Appendix 1 for review and scrutiny by Committee.

4.7 The overall assurance rating for this audit was ***Substantial Assurance***, with 1 Medium rated finding, 1 Low rated finding, and 1 Advisory finding raised.

4.8 The review concluded that the adequacy and operating effectiveness of the controls in place for Information Security are generally satisfactory and support the achievement of LPF objectives. The findings are intended to enhance and strengthen LPF's information security control framework across the following areas:

- Incident Management Policy
- LPF's Policies

Annual Validation review

4.9 In January 2024, Internal Audit completed an annual validation review to validate whether a sample of LPF management actions closed between 1 January 2022 and 31 December 2022 continue to be effectively sustained.

4.10 Audit testing confirmed that the actions below which were reviewed as part of the sample continue to operate as agreed by management:

Audit Code and Title	Rating	Date Closed	Validation summary
LPF2103 Employer Contributions	Low	28/12/2022	Controls are still in place and continue to operate effectively.
LPF2003 Technology Model Development	Medium	21/12/2022	Controls are still in place and continue to operate effectively.

Status of Open IA management actions

4.11 As at 6 February 2024, LPF had a total of 13 outstanding management actions (3 High, 7 Medium and 3 Low) which were raised across the following audits:

- Information Governance (7)
- Third Party Supplier Management (3)
- Senior Managers and Certification Regime (3).

4.12 Eleven management actions have passed their original implementation date. Revised dates and a management update on progress for each action is included at Appendix 2.

4.13 The remaining two management actions are not yet due for completion and implementation is currently being progressed by LPF.

2023/24 Internal Audit Annual Report and Opinion

4.14 The LPF Internal Audit Annual Report and Opinion which will provide a summary of IA work completed during the year, and an opinion on the adequacy and effectiveness of LPF's governance, risk and control frameworks for the year ended 31 March 2024, will be presented to Committee in June 2024.

5. Financial impact

5.1 Failure to close management actions and address the associated risks in a timely manner may have financial impacts which are not yet measurable.

6. Stakeholder/Regulatory Impact

6.1 IA recommendations are raised when control gaps or deficiencies are identified during audits. If management actions are not implemented, LPF will be exposed to the risks associated with the key processes, including the potential risk of non-compliance with applicable regulations.

7. Background reading/external references

7.1 Public Sector Internal Audit Standards

7.2 Lothian Pension Fund – 2023/24 Internal Audit Annual Plan – March 2023

8. Appendices

Appendix 1 Internal Audit Report: Information Security - January 2024

Appendix 2 LPF outstanding audit actions as at 6 February 2024

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Appendix 1

Internal Audit Report

Lothian Pension Fund – Information Security Arrangements

22 February 2024

LPF2303

Overall Assessment	Substantial Assurance

Contents

This Internal Audit review is conducted by the City of Edinburgh Council for the Lothian Pension Fund under the auspices of the 2023/24 internal audit plan approved by the Pensions Committee in March 2023. The objective of this audit is to perform a high-level review of the relevant IT policies that have been published by the end of June 2023, and to provide a high-level assessment of the security improvements that have been put in place to address identified risks.

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

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

Executive Summary

Overall Assessment	Substantial Assurance

Overall opinion and summary of findings

There is a sound system of governance, risk management and control in place for the design and planned rollout of Lothian Pension Fund's (LPF) IT policies.

The following areas for improvement were noted:

- development of an overarching Incident Management Policy to be used as a policy guideline in developing incident identification, response and reporting across the various systems/vendors. This would help to ensure a proactive and structured approach to the handling of IT and cyber incidents
- of the 39 policies in LPF's policies roadmap tracker, 2 are still in draft and 9 have yet to be prepared.

Areas of improved controls and good practice

- a comprehensive suite of IT security policies is in place and has been made available in a central location (SharePoint portal) so as to be easily accessed by employees
- the policies have been aligned with the ISO27001 standards
- LPF also has a cyber strategy plan (2023-2026) in place to improve the security and resilience of the IT systems
- there is a formalised risk management policy and risk management standard, and a risk log is in place which is reviewed on a weekly basis by the Head of IT
- there is a robust training programme in place that covers training on compliance with policies and phishing testing to help awareness of potential cyber-attacks.

LPF overall management response

As described in the background section, a number of information security improvement activities have taken place in the last three years. Information Security remains a focus for LPF for the foreseeable future, and these recommendations will be incorporated into ongoing work.

Audit Assessment

Audit Area	Control Design	Control Operation	Findings	Priority Rating
IT Policies and Procedures			Finding 1 – Incident Management Policy	Medium Priority
			Finding 2 - Policies Rollout	Low Priority
			Finding 3 - Policies Version History	Advisory
IT Security Governance Framework			No findings noted	N/A
Training and Awareness			No findings noted	N/A

See Appendix 1 for Control Assessment and Assurance Definitions

Background and scope

At the end of 2021, Lothian Pension Fund (LPF) was assessed against the NIST (National institute of Standards and Technology) Cybersecurity Framework, which provides a recognised set of standards, guidelines, and best practices to manage cybersecurity risk. The assessment concluded that whilst the LPF has several IT policies in place, some of these did not meet best practice. During 2022, LPF has focused on addressing identified gaps, with the IT team working to implement a full suite of policies, standards and procedures which set out on how information security will be managed.

LPF initially obtained Cyber Essentials certification in June 2022 and attained Cyber Essentials Plus in March 2023. The suite of information security policies was launched in June 2023. The policies follow the ISO27001 framework, although no decision around attaining the certification itself has been made.

LPF's current information security and information governance arrangements

Over the last 24 months, LPF have made material changes and improvements to their information security and information governance frameworks, including establishing new policies, procedures, and standards. Some of these improvements have just been launched and are not fully embedded.

These activities were a result of the procurement of a new technology managed service for LPF in 2021, and the move from the Council's IT provider (CGI) to Cased Dimensions. A number of assurance activities were carried out:

- August 2021 - Data Protection Impact Assessment on Cased Dimensions governance and security arrangements. Carried out by the Council's Information Governance Unit
- December 2021 – Cyber Security Maturity Assessment. Carried out by Bridewell (an independent cybersecurity consultant).

Two formal projects were established to address findings and recommendations arising from these assurance reviews – Information Security, and Information Governance. Both projects are now complete with any residual activities handed over to business as usual.

Scope

The objective of this audit was to perform a high-level review of the relevant IT policies that have been published by the end of June 2023, and to provide a high-level assessment of the security improvements that have been put in place to address identified risks.

Risks

The review also provided assurance in relation to the following LPF risk:

- 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.

Limitations of Scope

The assessments outlined in the scope were reviewed at a point in time and are not intended to provide ongoing or retrospective assessment of the controls over a period. This audit did not consider third-party supplier policies as this was reviewed as part of the third-party supplier management audit completed separately as part of the 2022/23 internal audit plan.

Reporting Date

Testing was undertaken between 1 November and 22 November 2023.

Our audit work concluded on 22 November 2023, and our findings and opinion are based on the conclusion of our work as at that date.

Findings and Management Action Plan

Finding Rating	Medium Priority

Finding 1 – Incident Management Policy

LPF has a Security Incident Response policy for managing cyber security incidents. It defines the scope, key incident response team members, procedures for incident analysis, logging, categorisation and resolution, thereby enhancing the overall cyber security posture of LPF's IT systems and data.

We also inspected an incident management handbook for Cased Dimensions (Managed Service provider). This handbook provides an outline of the incident reporting and resolution processes, change control processes, and contacts for escalations from Cased Dimensions.

However, there is no overarching incident management policy in place to be used as a guide for developing incident identification, response and reporting agreements with the suppliers who provide varying IT support to LPF. An overarching Incident Management policy will help ensure a proactive and structured approach to the handling of IT and cyber security incidents, thereby managing the risk of system failures or disruptions that may impact the organisation.

Risks

- **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
- **Data Management** - mismanagement or poor maintenance and protection of data could lead to operational errors, regulatory breaches/fines, or reputational damage
- **Business Interruption** - significant and/or extended business interruption (including third-party suppliers) leading to a failure or inability to complete key LPF processes
- **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.

Recommendations and Management Action Plan: Incident Management Policy

Ref.	Recommendation	Agreed Management Action	Owner	Lead Officers	Timeframe
1.1	Management should introduce an overarching incident management policy that serves as a baseline guideline in developing incident identification, response and reporting by IT service providers within baseline requirements of LPF. The policy may include, but is not limited to, the following elements: • **Objectives:** clearly defined objectives for the incident management process	LPF will create an overarching IT incident management policy, and communicate to staff. Where necessary, this will co-ordinate with, and refer to, existing policies and procedures on incident management and security incident response.	Chief Executive Officer	Head of IT	31/12/2024

	• **Scope:** specifics on the systems, personnel, and types of incidents covered by the policy • **Roles and Responsibilities:** identification of key roles and responsibilities related to incident management • **Incident Identification:** procedures for recognising and reporting potential IT incidents • **Incident Categorisation:** criteria for classifying incidents based on severity and impact • **Initial Response:** actions to be taken immediately upon identifying an IT incident • **Resolution and Recovery:** steps for resolving the incident, restoring normal operations, and preventing recurrence • **Training and Awareness:** guidelines for educating personnel on incident management procedures. LPF should then ensure that the policy is communicated to all relevant staff, and there is a periodic review of the policy (at least annually).				

Finding 2 – Policies Rollout

Finding Rating	Low

LPF maintains an IT policy roadmap tracker that comprehensively catalogues essential details pertaining to IT policies. This includes policy name, group categorisation, status (draft/not created/live), designated personnel responsible for delivery, individuals accountable for approval, target completion dates, and relevant comments.

At the time of our review, it was observed that there are 39 IT policies within management's oversight. Among these, 28 policies have received approval and are operational, 2 are currently in draft status, while 9 policies have not been created. Among the 11 policies (2 in draft and 9 not created), a total of 9 policies have surpassed their designated target completion dates and therefore a delay has occurred in the rollout of these policies. Management have advised that this was primarily due to the staffing challenges and delays in the rollout of the Security Improvement Plan. Please see Appendix 2 for a list of these 39 policies.

Delays in the rollout of policies may result in setbacks to achieving the cyber strategy plan objectives in a timely manner. Consequently, it may impede the overall objective of aligning the IT policies with the cyber strategy plan (2023-2026).

Risks

- **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
- **Data Management** - mismanagement or poor maintenance and protection of data could lead to operational errors, regulatory breaches/fines, or reputational damage
- **Business Interruption** - significant and/or extended business interruption (including third party suppliers) leading to a failure or inability to complete key LPF processes.

Recommendations and Management Action Plan: Policies Rollout

Ref.	Recommendation	Agreed Management Action	Owner	Lead Officers	Timeframe
3.1	All relevant IT policies should be completed, approved, and implemented in a timely manner. Additionally, a reassessment of the policy timelines and resource allocation should be considered to ensure timely alignment of the IT policies with the established cyber strategy plan.	LPF will identify a defined list of remaining IT policies to be completed, and a timeframe for completing them. This timeline will be reviewed and approved by the IT Oversight Group, and progress on completion of these policy reported to ITOCG.	Chief Executive Officer	Head of IT	31/03/2025

Finding 3 – Policies Version History

Finding Rating	Advisory

Following our review of the IT policies, we noted some further improvement opportunities:

- full name (rather than initials) to be provided for individuals responsible for amending and approving the policies
- job titles to be included for individuals amending and approving the policies
- policy owner details to be provided in case of any queries.

Appendix 1 – Control Assessment and Assurance Definitions

Control Assessment Rating		Control Design Adequacy	Control Operation Effectiveness
Well managed		Well-structured design efficiently achieves fit-for purpose control objectives	Controls consistently applied and operating at optimum level of effectiveness.
Generally Satisfactory		Sound design achieves control objectives	Controls consistently applied
Some Improvement Opportunity		Design is generally sound, with some opportunity to introduce control improvements	Conformance generally sound, with some opportunity to enhance level of conformance
Major Improvement Opportunity		Design is not optimum and may put control objectives at risk	Non-conformance may put control objectives at risk
Control Not Tested	**N/A**	Not applicable for control design assessments	Control not tested, either due to ineffective design or due to design only audit

Page 193

Overall Assurance Ratings	
Substantial Assurance	A sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied to support the achievement of objectives in the area audited.
Reasonable Assurance	There is a generally sound system of governance, risk management and control in place. Some issues, non-compliance or scope for improvement were identified which may put at risk the achievement of objectives in the area audited.
Limited Assurance	Significant gaps, weaknesses or non-compliance were identified. Improvement is required to the system of governance, risk management and control to effectively manage risks to the achievement of objectives in the area audited.
No Assurance	Immediate action is required to address fundamental gaps, weaknesses or non-compliance identified. The system of governance, risk management and control is inadequate to effectively manage risks to the achievement of objectives in the area audited.

Finding Priority Ratings	
Advisory	A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.
Low Priority	An issue that results in a small impact to the achievement of objectives in the area audited.
Medium Priority	An issue that results in a moderate impact to the achievement of objectives in the area audited.
High Priority	An issue that results in a severe impact to the achievement of objectives in the area audited.
Critical Priority	An issue that results in a critical impact to the achievement of objectives in the area audited. The issue needs to be resolved as a matter of urgency.

Appendix 2 – List of IT Policies

	Policy Name	Group	Status
1	Asset Management Standard	Information Security	Live
2	Backup Policy	Information Security	Live
3	Bring Your Own Device (BYOD) Policy	Information Security	Live
4	Call Recording Policy	Information Security	Live
5	Change Management Policy - Non-MSP	Information Security	Live
6	Cryptography Policy	Information Security	Live
7	Data Classification and Handling Standard	Information Security	Live
8	Information Security Policy	Information Security	Live
9	Information Security Risk Management Policy	Information Security	Live
10	Information Transfer Policy	Information Security	Live
11	Logging and Monitoring Policy	Information Security	Live
12	Management of Non-Conformance and Corrective Action Policy	Information Security	Live
13	Media Handling Policy	Information Security	Live
14	Network Security Policy	Information Security	Live
15	Vulnerability and Patch Management Policy	Information Security	Live
16	Business Continuity Plan	BCP	Live
17	Business Continuity Report Template	BCP	Live

18	Acceptable Use Policy	Information Security	Live
19	Bring Your Own Device (BYOD) Standard	Information Security	Live
20	Change Management Policy	Information Security	Live
21	Clear Screen and Clear Desk Policy	Information Security	Live
22	Cryptography Standard	Information Security	Live
23	Identity and Access Management Standard	Information Security	Live
24	Information Asset Owner Role	Information Security	Live
25	Information Security Risk Management Standard	Information Security	Live
26	Logging and Monitoring Standard	Information Security	Live
27	Security Incident Response Plan	Information Security	Live
28	Vulnerability and Patch Management Standard	Information Security	Live
29	Third Party and Suppliers Information Security Policy	Information Security	Draft
30	Business Continuity Policy	BCP	Draft
31	Third Party Security Assurance Standard	Information Security	Not created
32	Phishing and Penetration Test Schedule	Information Security	Not created
33	Physical and Environmental Security Policy	Information Security	Not created
34	IT Risk Assessment and Treatment Methodology	Information Security	Not created
35	IT Controls Exception Log	Information Security	Not created
36	Password Policy	Information Security	Not created

37	Supply Chain Security Standard	Information Security	Not created
38	Access Control Procedure	Information Security	Not created
39	Disaster Recovery Policy	BCP	Not created
40	Cyber Security Strategy 2023-2026	-	Live
41	People & Communications Governance Manual	-	Live
42	Disciplinary and Dismissal Policy	Information Security	Live
43	Lothian pension fund managed services handbook	Information Security	Live

Appendix 2 - LPF Internal Audit Overdue Management Actions as at 06 February 2024

LPF PUBLIC DATA

Ref	Audit	Audit progress	Rec Title	Agreed Management Action	Rating	Status	Est Date	Revised Date	Management Update
1	**LPF2202 Information Governance**	**53%** 15 actions 8 complete 7 outstanding 7 overdue	Rec 1.1 - Policy, Standards & Procedures Implementation	LPF will incorporate data strategy, data archiving, and information governance controls into new or existing documentation. RACI will be covered at 4.2.	**High**	**Pending**	31/12/2023	30/06/2025	LPF are raising a business case/project for a comprehensive approach to data management/governance, which will include an appropriate risk based data strategy and framework. Notwithstanding that there are some distinct standalone enhancements focussing on the technical controls that can and will be introduced sooner, a holistic approach to data strategy and management is considered to be more sustainable and resilient. Revised date of 30/06/2025 for all actions dependent on this, except: -Rec 1.3 Policy management, revised date 30/06/2024 as it can be actioned seperately. -Rec 5.1 Compliance monitoring, revised date 30/04/2024, enhanced monitoring has been integrated however monitoring will not be completed and evidenced until end of Q1.
2			Rec 1.3 - Centralised management of policies and procedures	LPF will implement a group-wide approach for centralised management of policies and procedures.	**High**	**Started**	31/12/2023	30/06/2025	
3			Rec 3.1 - Review of existing documents and data classification	As part of LPF's planned data classification implementation, existing documents will be reviewed to ensure they reference, and align with, data classification approach.	**Medium**	**Started**	31/12/2023	30/06/2024	
4			Rec 3.3 - Retention schedule guidance	LPF will:1. create documented guidance on how retention periods are determined, including how CEC's requirements are tailored to LPF.2. update retention schedule to align with LPF's data assets	**Medium**	**Pending**	31/12/2023	30/06/2025	
5			Rec 5.1 - Compliance Monitoring	LPF will incorporate information governance measures into existing compliance monitoring plan.	**Medium**	**Pending**	31/12/2023	30/04/2024	
6			Rec 6.1 - Information Asset register review and update	LPF will review and update its information asset register, and ensure the asset register, system list, third party supplier list, and retention schedule align.	**Low**	**Pending**	31/12/2023	30/06/2025	
7			Rec 6.2 - Update of registers to illustrate system dependencies	LPF will update existing registers (which may include third party supplier list, system lists, refreshed information asset register) to capture details; and create overview diagram(s) to illustrate the flow of business-critical systems.	**Low**	**Pending**	31/12/2023	30/06/2025	
	LPF2203 Third Party Supplier Management	**79%** 14 actions 11 complete 3 outstanding **3 overdue**	Recs 1.2 and 1.3 Training for Tier 1 supplier owners / due diligence	LPF will carry out targeted training for Tier 1 supplier owners on monitoring and consider appropriate oversight via RMG reporting. 1.3 As part of action 1.2, targeted training will cover annual due diligence. Supplier framework document review will consider due diligence templates or checklists with set items, tailored to specific tiers.	**High**	**Pending**	30/09/2023	31/12/2023	Revised date 30/04/2024. All actions from Supplier Management audit completed other than training on refreshed framework. General training and specific training for critical supplier relationship owners has been scheduled to be delivered by 30/04/2024.
			Rec 5.1 Enhancements to and review of supplier database	LPF will enhance existing supplier database to include additional data fields, including dates of IT assessment and DPIA, and links to full records. A review of the database will be established, with results provided to senior management as part of RMG oversight.	**Medium**	**In review**	30/09/2023	31/12/2023	Now complete following RMG meeting on 30 Jan 24. Closure request submitted.
10			Rec 6.1 Supplier management training and awareness	LPF will carry out training and awareness following update of all documents and processes referred to in other actions; and consider how to incorporate into existing annual training plan and onboarding.	**Low**	**Pending**	31/12/2023	30/04/2024	Revised date 30/04/2024. All actions from Supplier Management audit completed other than training on refreshed framework. General training and specific training for critical supplier relationship owners has been scheduled to be delivered by 30/04/2024.
11	**LPF2304 Senior Managers and Certification Regime (SM&CR)**	**0%** 3 actions 0 complete 3 outstanding 1 **overdue**	Recommendation 1.1: Senior Managers and Certification Regime governance arrangements	LPFI will finalise our draft SMCR document and ensure suggested points are covered. This document also contains a Handover Policy and Responsibilities Map.LPFI only provides services to professional clients who are out of scope of Consumer Duty. LPFI will include a statement in our internal documentation noting we are currently out of scope of this regulation and should our business model change that we will revisit this regulation and update documentation, governance and processes as required.	**Medium**	**Pending**	31/01/2024	30/04/2024	Revised date 30/04/2024. Although work has been undertaken to close both actions regarding SMCR documentation, extension of due date is appropriate to leverage insights and observations from LPF's new Company Secretary who started in January 24.

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Pensions Audit Sub Committee

2.00pm, Tuesday, 19 March 2024

Lothian Pension Fund – Proposed Internal Audit plan for 2024/25

Item number 6.6

1. Recommendations

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

1.1 review the proposed Lothian Pension Fund 2024/25 Internal Audit plan and recommend to the Pensions Committee for approval.

1.2 note the approach to developing a forward-looking approach to assurance by considering indicative audits over a three-year period, which will be reviewed and approved annually.

Laura Calder
Head of Internal Audit

Legal and Assurance, Corporate Services Directorate

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Lothian Pension Fund – Proposed Internal Audit plan for 2024/25

2. Executive Summary

2.1 The purpose of this paper is to present the Lothian Pension Fund (LPF) proposed Internal Audit (IA) plan for the period 1 April 2024 to 31 March 2025 to the Committee for review and approval.

2.2 The audit universe covers the LPF group structure and will provide assurance for the LPFI and LPFE boards where appropriate.

2.3 The plan will also include ongoing IA follow up on implementation of management actions arising from previous internal audit reports.

2.4 In discussion with management, a forward-looking approach to assurance which provides an indicative internal audit plan over a three-year period has been considered.

3. Background

3.1 The LPF IA plan is driven by requirements of section 2010 of the Public Sector Internal Audit Standards (PSIAS) which requires IA to establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organisation's goals.

3.2 IA has reviewed LPF's organisational objectives and priorities, and completed an assessment of the risks that could prevent LPF from meeting those objectives and providing pension services to employers and members.

3.3 The PSIAS specifies that the risk-based plan must consider the requirement to produce an annual IA opinion. IA work performed must be appropriately scoped to cover LPF's most significant risks, with an appropriate depth of testing performed to provide sufficient assurance on the control environment, governance, and risk management frameworks to support provision of the annual opinion.

3.4 PSIAS also specifies that internal audit activity must evaluate the effectiveness of risk management processes and contribute to their improvement.

3.5 In 2023/24, the audit universe was expanded to include the LPF group structure and to provide a single integrated audit programme and provide assurance for the LPFE and LPFI Boards where appropriate.

3.6 It should be noted that Internal Audit is not the sole source of assurance provision for LPF, as several additional external second line assurance providers are engaged (in addition to the annual external audit review of LPF's financial statements) to provide additional assurance coverage.

Co-source internal audit provision

3.7 Following a request from LPF in 2019/20, all LPF internal audit services are currently provided by the City of Edinburgh Council's co-source professional services provider PwC with oversight from the Council's Head of Internal Audit.

3.8 In addition, the Boards of LPFI and LPFE may seek additional assurance where necessary to fulfil required obligations, where either the Council Internal Audit service or the co-source provider does not have capacity or expertise.

Internal Audit Charter

3.9 PSIAS also specify that the purpose, authority, and responsibility of IA must be formally defined in an Internal Audit Charter (the Charter) that is periodically reviewed and presented to senior management and the board for approval. The Council's IA charter, approved by the Council's Governance, Risk and Best Value Committee in March 2024 fulfils this requirement for LPF.

New Global Internal Audit Standards

3.10 In January 2024, the Institute of Internal Auditors launched new Global Internal Audit Standards (GIAS), which will come into effect in January 2025. The new standards will require several changes to Internal Audit practice including the introduction of 'topical requirements' for all internal audits.

3.11 Guidance on the full requirements of the new GIAS will be released by the Institute of Internal Auditors as it develops. It is proposed that relevant updates are provided as part of the quarterly update paper and supported by necessary training sessions for both LPF colleagues and committee members delivered by IA.

4. Main Report

Scope of Internal Audit Assurance

4.1 The scope of IA assurance provided to LPF in relation to regulatory compliance is specifically limited to confirming LPF's ongoing compliance with Local Government Pension Scheme (Scotland) requirements.

4.2 The audit universe was expanded across the LPF group in 2023/24 with the inclusion of the operation of the Fund's two wholly owned subsidiary companies LPFE and LPFI Ltd that are responsible for providing employee resources to administer the pension funds, and provision of Financial Conduct Authority regulated services to both LPF and other Local Government Pension Scheme Funds.

Preparation and content of the proposed plan

4.3 The areas proposed for inclusion in the plan were identified by considering the key risks included in the LPF risk register as at January 2024, and discussions with the LPF management team, Pensions Audit Sub Committee members and External Audit.

4.4 The LPF risk register as at January 2024 included a total of 26 risks, of which there were nil very high, 3 high, 15 moderate, 7 low and one insignificant rated risk.

4.5 The 3 high and 15 moderate risks were considered together with the outcome of previously completed audits, other assurance sources and key regulatory requirements.

Proposed 2024/25 Internal Audit Plan

4.6 The proposed IA plan for 2024/25 includes the following five audits:

- <u>Pensions Committee Governance & Operational Effectiveness:</u> Governance - discharge of responsibilities and accountabilities and best practice governance are high and moderate rated increasing LPF risks. This audit will be completed in Quarter 1 and will consider governance and operational effectiveness in line with the delegated functions set out in the Pensions Committee Terms of Reference and relevant regulations as well as consideration of fiduciary duties. It will also consider member skills, knowledge, and training.

- <u>Member Payments:</u> Process and Execution – operation errors is a moderate rated risk. This audit will be completed in Quarter 2 and will review key controls for ensuring member payments are accurate and on time, including payment administration of regular payments, pro-rata payments, one-off lump sum payments, change of bank details, and management of under/overpayments.

- <u>Infrastructure Asset Selection, Management & Oversight:</u> Investment Management – investment performance; investment services delivery and investment strategy are moderate rated risks. This audit will be completed in Quarter 3 and will consider how infrastructure assets are selected and managed including the investment strategy, costs, investment risk management, investment performance and consideration of climate change.

- <u>Investment Governance Improvement Plan (IGIP) Implementation</u>**:** This audit will be completed in Quarter 4 and will provide assurance on a range of moderate rated risks aligned to implementation of the improvement actions set out in the IGIP, developed to address the gaps and weaknesses identified in the themed review of Investment Services.

- <u>Annual Validation Review:</u> This review will be completed in Quarter 4 and will include a review of a sample of previously implemented and closed audit actions to confirm that they have been effectively sustained.

4.7 Reports detailing outcomes of each review will be presented to the Pensions Sub Committee. All reviews completed for LPFI/LPFE will also be presented to the relevant Board.

4.8 The proposed Internal audit reviews planned for the year 1 April 2024 to 31 March 2025 should provide assurance on 1 high and 9 moderate rated risks included in the

LPF risk register. Extending this to include follow-up of work performed in 2023/24 provides assurance for a total of 16 of the 18 high and moderate risks.

4.9 As part of preparation of the 2024/25 IA plan, a forward-looking assurance approach which provides indicative audit coverage across the LPF group risks on a three-year basis was considered through discussion with IA and LPF colleagues. Proposed indicative audit titles for 25/26 and 26/27 are included at Appendix 2. These areas will be reviewed as part of annual planning processes to ensure they remain appropriately aligned to LPF's top scoring risks.

4.10 It is important that the Committee confirms that appropriate assurance coverage will be provided across LPFs remaining population of moderate risks and (in particular) the risks associated with 'business as usual' operational activities by the additional assurance providers engaged by the Fund.

4.11 Table 2 of the 2024/25 IA plan provides an initial assurance mapping across the high and moderate LPF risks. It is proposed this will be developed further during 2024/25 with LPF colleagues to provide members details of where sources of assurance across the risks is provided. It is envisaged that the updated assurance map will be presented to the September 2024 meeting.

Delivery of the 2024/25 IA plan

4.12 The co-source provider contract is now due for re-tender, and an exercise to select a co-source provider for 2024 to 2026 (with an option to extend) will commence in March 2024. LPF colleagues have been invited to participate in the selection process.

4.13 During 2024/25 some audits may be conducted by the Council's in-house IA team, as agreed with LPF management.

Risk Management

4.14 PSIAS requires that an appropriate depth of testing is performed to provide sufficient assurance on the control environment, governance, and risk management frameworks to support provision of the annual IA opinion.

4.15 Whilst sufficient information is generally collated across multiple audits to provide an understanding of the effectiveness of risk management processes to support the annual opinion, IA typically also performs targeted risk management audits to assess and provide assurance on the adequacy and effectiveness of the risk management framework across the entire organisation. The most recent audit of risk management was completed in August 2022.

4.16 LPF undertook a comprehensive review of its Risk Management Framework during 2023 which resulted in a simplified methodology and a revised risk register. During 2024/25, where appropriate, IA will consider how well the new framework is being embedded and LPF's risk culture as a core element of the audits completed.

Follow-up activity

4.17 Follow-up work will also be performed in line with a risk-based approach to confirm whether agreed management actions implemented to support closure of findings raised in previous LPF audits have been effectively implemented.

New Global IA Standards

4.18 During 2025, IA will prepare for the introduction of the new Global IA standards including update of key documents, audit team training and colleague/committee member training and awareness.

5. Financial impact

5.1 The estimated costs associated with delivery of the LPF 2024/25 IA plan are estimated to be circa £86,000 which reflects:

- current direct recharging of costs based on agreed rates as specified in the Council's IA co-source contract
- direct recharging of costs for audits completed by the Council's IA team which will be charged on an actual costs' basis through completion of IA timesheets
- costs associated with plan delivery and administration including preparation of the annual plan, annual opinion, review and oversight of all IA reviews, preparation of Committee reports, attendance at Committee meetings, as well as ongoing review and validation of previously raised audit actions. This will be charged on an actual costs' basis through completion of IA timesheets.

6. Stakeholder/Regulatory Impact

6.1 The LPF management team, members of the Pensions Audit Sub Committee and External Audit were consulted when developing the 2024/25 IA plan.

7. Background reading/external references

7.1 [Public Sector Internal Audit Standards]

7.2 Internal Audit Charter

8. Appendices

Appendix 1 – Lothian Pension Fund 2024/25 Internal Audit Plan
Appendix 2 – Indicative proposed audit areas for 2025/26 and 2026/27

Internal Audit

2024/25 Annual Plan

Contents

Introduction and approach

Introduction

In line with the Internal Audit Charter, Internal Audit provides independent and objective assurance on the overall effectiveness of the Lothian Pension Fund's (LPF) governance, risk, and control frameworks.

This document sets out the scope of the Internal Audit 2024/25 annual plan with the objective of delivering independent assurance on the key controls established across the LPF group to mitigate high and moderate risks.

Approach

The approach to preparing the annual plan is set out at Figure 1. The plan is driven by LPF's objectives and priorities, and an assessment of the risks that could prevent LPF from meeting its objectives.

The audit universe includes the LPF group structure and provide assurance for the LPFI and LPFE Boards where appropriate.

LPF's Business Plan centres around the following four broadly defined strategic goals:

- ***develop and deliver a member and employer proposition for service excellence***
- ***earn an appropriate risk adjustment investment return as responsible officers***
- ***extend collaboration and services to existing partners and deepen where possible***
- ***achieve greatness in our people, teams, and culture.***

Other sources of assurance

Internal Audit is only one of several sources of assurance over the LPF groups risks. In developing our risk assessment and plan we have considered other sources of assurance and have considered the extent to which reliance can be placed upon these other sources (for example, external audit, BDO, Mercer and LPF's Risk and Compliance function).

IA does not intend to place formal reliance upon these other sources of assurance but would not seek to duplicate the work they do. Key stakeholders including senior management, committee members and external audit (Azets) have been invited to provide input into the IA annual plan to help ensure that the relevant areas are targeted for review.

***Figure 1**: Approach to developing the 2024/25 IA Annual Plan*

Step 1 *Understand LPF's corporate objectives*	Review the LPF business plan to understand strategic objectives and priorities.
Step 2 *Review LPF's risk profile*	Review the LPF's risk profile, risk appetite and consider any other external and internal risks that could impact LPF.
Step 3 *Consider the audit universe*	Identify all auditable areas across LPF.
Step 4 *Consider other sources of assurance provided*	Consider other sources of assurance across the audit universe and the extent to which reliance may be provided on such work.
Step 5 *Consult with key stakeholders*	Consult with key stakeholders to ensure areas which may be of risk to operations are considered for inclusion within the IA work programme.
Step 6 Determine the audit plan	Based on the outcomes of steps 3, 4 and 5, determine the timing and scope of audit work required.
Step 7 *Other considerations*	Consider any requirements in addition to those identified from the risk assessment process.

Risk Assessment

To ensure a risk-based approach to the LPF Group IA annual plan which is proportionate and aligned to business-critical risks and emerging issues, consideration was given to the LPF group's priorities as detailed in the 2023-24 Business Plan.

LPF undertook a comprehensive review of its Risk Management Framework during 2023 which resulted in a simplified methodology and revised risk registers. The IA risk assessment considered the LPF group risk profile as at January 2024 (Table 1). All high and moderate risks (a total of 15 risks) were reviewed, together with the outcome of previously completed audits, other assurance sources and key regulatory requirements (Table 2).

Table 1: LPF Risk Summary as at January 2024

Total risks	Very High	High	Moderate	Low	Insignificant
26	0	3	15	7	1

Table 2: High and Moderate risks assessment and assurance map

Risk Ref	Level 1 Risk	Level 2 Risk	Risk Name	Entity	Rating	Previous IA Assurance			Proposed 24/25 coverage	Other sources of assurance
						21/22	22/23	23/24		
7	Governance, Legal & Compliance	Governance	Discharge of Accountabilities & Responsibilities	LPF	H	Risk Management	Project Forth Programme Health Check	Follow-up	**Pensions Committee Governance & Operational Effectiveness**	
16	People & Culture	People & Culture	Recruitment & Retention	All	H	-	-	People Processes	Follow-up of 2023/24 People Processes Audit	Azets People review 2022
17	People & Culture	People & Culture	Resources	All	H	-	-	People Processes Business Continuity	Follow-up of 2023/24 People Processes Audit and 2023/24 Business Continuity Audit	Azets People review 2022
25	Governance, Legal & Compliance	Governance	Best Practice Governance	All	M	Risk Management	Project Forth Programme Health Check	Follow-up	**Pensions Committee - Governance & Operational Effectiveness**	BDO Compliance Assurance Monitoring Programme (LPFI)
2	Information Security IT & Data	Data	Data Management	All	M	Bulk Transfers	Information Governance	Information Security	Follow-up of 2022/23 Information Governance Audit and 2023/24 Information Security Audit	
13	Business Operations	Third Party	Supplier Performance and Oversight	All	M	Capital Calls Employer Contributions	Third-Party Supplier Management Information Governance	Follow-up	Follow-up of 2022/23 Third-Party Supplier Management Audit	
19	Investment Management	Investment Management	Investment Strategy	LPFI LPF	M	-	-	-	**IGIP Implementation Infrastructure Asset Selection, Management & Oversight**	Themed Services Investment Reviews

Page 208

Risk Ref	Level 1 Risk	Level 2 Risk	Risk Name	Entity	Rating	Previous IA Assurance			Proposed 24/25 coverage	Other sources of assurance
						21/22	22/23	23/24		
11	Information Security IT & Data	Information Security & Cyber	Cyber Security	All	M	-	-	Information Security	Follow up of 2023/24Information Security Audit	Independent cyber security maturity assessment completed Dec 2021
4	Governance, Legal & Compliance	Regulatory Compliance	Regulatory Breach	All	M	-	-	Senior Manager Certification Regime	**IGIP Implementation** Follow-up of 2023/24 Senior Manager Certification Regime Audit	Themed Services Investment Reviews
21	Strategy	Strategy	Strategic Goals	All	M	-	Risk Management	-	No internal audit work in 2024/25 proposed. Audit of Responsible Investment / ESG proposed for 2025/26 and further review of Risk Management to be considered in 2026/27	
18	Strategy	Climate	Climate Change and Responsible Investing	All	M	-	-	-	Responsible Investment/ ESG review proposed for 25/26	
9	Business Operations	Business Continuity	Business Interruption	All	M	-	-	Business Continuity	Follow-up of 2023/24 Business Continuity Audit	
1	Investment Management	Investment Management	Investment Performance	All	M	Capital Calls	-	-	**Infrastructure Asset Selection, Management & Oversight**	Mercer Systems and Controls Review (LPFI)
6	Business Operations	Processing and Execution	Investment Operations Errors	All	M	Capital Calls	-	-	**IGIP Implementation**	
27	Business Operations	Processing and Execution	Operational Errors	LPF	M	Bulk Transfers	-	-	**Member Payments**	
8	Business Operations	Processing and Execution	Investment Services Delivery	LPF	M	Cessations	-	-	**Infrastructure Asset Selection, Management & Oversight**	
5	Scheme	Employer Contributions	Employer Failure	LPF	M	Employer Contributions	-	-	No internal audit work in 2024/25 proposed.	
10	Information Security IT & Data	Technology	IT systems	All	M	Technology Model Development		Information Security	Follow up of 2023/24 Information Security Audit	

2024/25 Internal Audit Plan

The following table sets out the LPF internal audit work programme for the period 1 April 2024 to 31 March 2025. Reports detailing outcomes of each review will be presented to the Pensions Sub-Committee. Reviews completed for LPFI/LPFE will also be presented to the relevant Board.

While the audit plan includes a short summary of the area proposed for review, IA will meet with key officers prior to commencing each audit to further understand the key risks and to develop and refine the scope of each review. It should be noted, that if areas are identified during testing that are outwith scope but impact the risk and control framework, findings and recommendations will still be raised and reported on, where appropriate.

Audit	Entity	Risks	Quarter
Pensions Committee Governance & Operational Effectiveness – review of the governance arrangements for the Pensions Committee to provide assurance on operational effectiveness in line with the delegated functions set out in the Terms of Reference and relevant regulations as well as consideration of fiduciary duties. Will also consider member skills, knowledge, and training.	LPF	7 and 25	Q1
Member Payments – review of design adequacy and operating effectiveness of key controls and processes established to ensure member payments are accurate and on time, including payment administration of regular payments, pro-rata payments, one-off lump sum payments, change of bank details, and management of under/overpayments.	LPF	27	Q2
Infrastructure Asset Selection, Management & Oversight – review of will consider how infrastructure assets are selected and managed including the investment strategy, costs, investment risk management investment performance and consideration of climate change.	LPFI	1, 8, 19	Q3
Investment Governance Improvement Plan (IGIP) Implementation – review of progress with implementation of the improvement actions set out in the IGIP, to address the gaps and weaknesses identified in the themed review of Investment Services	LPFI	4, 6, 8 13, 19	Q4
Annual Validation review - review of a sample of previously implemented and closed audit actions to confirm that they have been effectively sustained.	All	Dependent on sample	Q4
Other IA activities including annual planning and reporting, committee reporting and attendance, and officer/member support including training on the New Global IA Standards.			Ongoing

Appendix 2 – Indicative proposed audit areas for 2025/26 and 2026/27

During the 2024/25 annual audit planning process consideration was given to developing a forward-looking approach to assurance planning through identifying potential areas for future internal audit reviews over a three-year period.

Details of the indicative areas for 2025/26 and 2026/27 are provided below for information. These areas would be reviewed as part of the annual planning process to ensure alignment with LPF top scoring risks and emerging issues.

2025/26	2026/27
Invoicing	Settlement & Custody Arrangements
Payroll	Supplier Management
Death Process Management	Risk Management
Corporate Board Governance & Operational Effectiveness	
McLeod Implementation	
Responsible Investment / ESG	

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Pensions Audit Sub Committee

2.00pm, Tuesday, 19 March 2024

External Audit Annual Plan 2023/24 by Azets

Item number 6.7

1. Recommendations

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

1.1 note the planned programme of work to support the statutory audit 2023/24. This is shown at Appendix 1 - "Lothian Pension Fund External Audit Annual Plan 2023/24" by Azets;

1.2 note that progress against the Lothian Pension Fund External Audit Annual Plan 2023-24 will be reported to future meetings of the Pensions Audit Sub-Committee and the Committee.

Alan Sievewright
Chief Finance Officer, Lothian Pension Fund

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External Audit Annual Plan 2023/24 by Azets

2. Executive Summary

2.1 Azets, the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2023/24. This is shown in full at Appendix 1.

2.2 Azets representative(s) will present the External Annual Audit Plan 2023/24 to Committee.

2.3 To meet independence requirements the audit signatory for the Funds has changed from Nick Bennett to Chris Brown.

3. Background

3.1 Azets has been appointed by Audit Scotland as the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund ("the Funds") for the period 2022/23 to 2026/27.

4. Main Report

4.1 Azets, the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2023/24. This is provided in full at Appendix 1.

4.2 Additionally, the Code of Audit Practice requires Azets to perform a wider scope audit over the following areas:

4.2.1 Financial sustainability
4.2.2 Financial management
4.2.3 Vision, leadership and governance
4.2.4 Use of resources to improve outcomes.

4.3 Progress against the plan will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Committee.

5. Financial impact

5.1 The proposed audit fee for 2023/24 is £54,680 (a 6% increased on the 2022/23 fee of £51,590).

5.2 The audit fee is addressed in detail by Azets in Appendix 1, pages 20 to 21.

6. Stakeholder/Regulatory Impact

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

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

7. Background reading/external references

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

8. Appendices

Appendix 1 – "Lothian Pension Fund External Audit Annual Plan 2023/24" by Azets.

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Lothian Pension Fund

External Audit Annual Plan

Year ended 31 March 2024

March 2024

Table of Contents

Introduction

Purpose

This audit plan highlights the key elements of our proposed audit strategy and provides an overview of the planned scope and timing of the statutory external audit of Lothian Pension Fund and Scottish Homes Pension Fund ("the Funds") for the year ended 31 March 2024 for those charged with governance.

Our audit work will cover:

- the financial statements within the 2023/24 annual report and accounts;
- the wider scope of public audit;
- any other work requested by Audit Scotland.

Adding value through the audit

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

Feedback

If there are any elements of this audit plan to which you do not agree or you would like to discuss, please let us know as soon as possible.

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

This plan has been prepared for the sole use of those charged with governance and management and should not be relied upon by third parties. No responsibility is assumed by Azets Audit Services to third parties.

Openness and transparency

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

Audit scope and general approach

Responsibilities of the auditor and the Funds

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

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

The Funds have primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts that are in accordance with proper accounting practices. The Funds are also responsible for complying with legislation and putting arrangements in place for governance and propriety that enable it to successfully deliver its objectives.

Appendix 3 provides further details of our respective responsibilities.

Risk-based audit approach

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

Discussions with senior officers	**Our understanding of the public pension funds sector, its key priorities and risks**	**Attending & observing the Pensions Committee**
Guidance from Audit Scotland	**Discussions with Audit Scotland and public sector auditors**	**Discussions with internal audit and review of plans and reports**
Review of the Funds' corporate strategies and plans	**Review of the Funds' corporate risk registers**	**Consideration of the work of other inspection bodies**

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

Communication with those charged with governance

Auditing standards require us to make certain communications throughout the audit to those charged with governance. These communications will be through the Pensions Committee.

Partnership working

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

Audit Scotland

Although we are independent of Audit Scotland and are responsible for forming our own views and opinions, we do work closely with Audit Scotland throughout the audit. This helps identify common priorities and risks, treat issues consistently across the sector, and improve audit quality and efficiency. We share information about identified risks, good practices and barriers to improvement so that lessons to be learnt and knowledge of what works can be disseminated to all relevant bodies.

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

During the year we may also be required to provide information to Audit Scotland to support the national performance audits.

Delivering the audit

Hybrid audit approach

We adopt a hybrid approach to our audit which combines on-site visits with remote working; learning from the better practices developed during the pandemic.

All of our people have the equipment, technology and systems to allow them to work remotely or on-site, including secure access to all necessary data and information.

All of our staff are fully contactable by email, phone call and video-conferencing.

Meetings can be held over Microsoft Teams or by telephone.

We employ greater use of technology to examine evidence, but only where we have assessed both the sufficiency and appropriateness of the audit evidence produced.

Secure sharing of information

We use a cloud-based file sharing service that enables users to easily and securely exchange documents and provides a single repository for audit evidence.

Regular contact

During the ‘fieldwork’ phases of our audit, we will arrange regular catch-ups with key personnel to discuss the progress of the audit. The frequency of these meetings will be discussed and agreed with management.

Signing annual accounts

Audit Scotland recommends the electronic signing of annual accounts and uses a system called DocuSign.

Electronic signatures simplify the process of signing the accounts, which can be signed using any device from any location. There is no longer a need for duplicate copies to be signed, thus reducing the risk of missing a signature and all signatories have immediate access to a high-quality PDF version of the accounts.

Approach to audit of the financial statements

Our objective when performing an audit is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement and to issue an independent auditor’s report that includes our auditor’s opinion.

As part of our risk-based audit approach, we will:

- perform risk assessment procedures including updating our understanding of the Funds, including their environment, the financial reporting framework and their system of internal control;
- review the design and implementation of key internal controls;
- identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement level and the assertion level for classes of transaction, account balances and disclosures;
- design and perform audit procedures responsive to those risks, to obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion; and
- exercise professional judgment and maintain professional scepticism throughout the audit recognising that circumstances may exist that cause the financial statements to be materially misstated.

Materiality

"Reasonable assurance" is a high level of assurance, but is not a guarantee that an audit 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 the financial statements. 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. We include an explanation in the auditor's report of the extent to which the audit was capable of detecting irregularities, including fraud, and respective responsibilities for prevention and detection of fraud.

We apply the concept of materiality in planning and performing the audit, and in evaluating the effect of misstatements within the financial statements identified during the audit.

Judgments about materiality are made in the light of surrounding circumstances and are affected by our perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both. The basis for our assessment of materiality for the year is set out in Appendix 1.

Any identified errors greater than £7.35 million in relation to investments and £0.66 million in relation to dealings with members will be recorded and discussed with you and, if not adjusted, confirmed as immaterial as part of your letter of representation to us.

Accounting systems and internal controls

We will follow a substantive testing approach to gain audit assurance rather than relying on tests of controls. As part of our work, we consider certain internal controls relevant to the preparation of the annual accounts such that we are able to design appropriate audit procedures. However, this work will not cover all internal controls and is not designed for the purpose of expressing an opinion on the effectiveness of internal controls. If we identify significant deficiencies in controls, we will report these to you in writing.

Specialised skill or knowledge required to complete the audit

Our audit team will consult internally with our Technology Risk team in assessing the information technology general controls (ITGC).

Going Concern

In most public sector entities (including pension funds), the financial reporting framework envisages that the going concern basis for accounting will apply where the entity's services will continue to be delivered by the public sector. In such cases, a material uncertainty related to going concern is unlikely to exist.

For many public sector entities, the financial sustainability of the entity is more likely to be of significant public interest than the application of the going concern basis. Our wider scope audit work considers the financial sustainability of the Funds.

Prevention and detection of fraud or error

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

- involve the misappropriation or theft of assets or cash which are facilitated by weaknesses in internal control and;
- are over £5,000.

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

Anti-money laundering

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

Best Value

Appointed auditors have a duty to be satisfied that local government bodies have made proper arrangements to secure best value.

Under the Code of Audit Practice, the audit of Best Value in Lothian Pension Fund is fully integrated within the annual audit work performed by appointed auditors. We are required to evaluate and report on the performance of Lothian Pension Fund in meeting the Best Value duties.

Reporting our findings

At the conclusion of the audit we will issue:

- an independent auditor's report setting out our formal audit opinions within the annual report and accounts, and
- an annual audit report describing our audit findings, conclusions on key audit risks, judgements on the pace and depth of improvement on the wider scope areas, and any recommendations.

Definitions

We will 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 the achievement of corporate objectives

No major weaknesses in arrangements but scope for improvement exists

Pace and depth of improvement are adequate

Risks exist to the achievement of operational objectives

Effective and appropriate arrangements are in place

Pace and depth of improvement are effective

Risks to the achievement of objectives are managed

Financial statements - significant audit risks

Significant risks are risks that require special audit consideration and include identified risks of material misstatement that:

- our risk assessment procedures have identified as being close to the upper range of the spectrum of inherent risk due to their nature and a combination of the likelihood and potential magnitude of misstatement; or
- are required to be treated as significant risks due to requirements of ISAs (UK), for example in relation to management override of internal controls.

Significant risks at the financial statement level

The table below summarises significant risks of material misstatement identified 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.

Management override of controls	Audit approach
Auditing Standards require auditors to treat management override of controls as a significant risk on all audits. This is because management is in a unique position to perpetrate fraud by manipulating accounting records and overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the 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. Specific areas of potential risk include manual journals, management estimates and judgements and one-off	Procedures performed to mitigate risks of material misstatement in this area will include: • Documenting our understanding of the journals posting process and evaluating the design effectiveness of management controls over journals. • Analysing the journals listing and determining the criteria for selecting high risk and/or unusual journals. • Testing high risk and/or unusual journals posted during the year and after the draft accounts stage back to supporting documentation for appropriateness, corroboration and to ensure approval has been

Management override of controls	Audit approach
transactions outside the ordinary course of the business. **Risk of material misstatement: Very High**	undertaken in line with the Funds' journals policy. • Gaining an understanding of the key accounting estimates and critical judgements made by management. We will challenge assumptions and consider for reasonableness and indicators of bias which could result in material misstatement due to fraud. • Evaluating the rationale for any changes in accounting policies, estimates or significant unusual transactions.

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

Fraud in revenue recognition	Audit approach
Material misstatement due to fraudulent financial reporting relating to revenue recognition is a presumed risk in ISA 240 (The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements). 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. In respect of the contributions received from the Funds' funding partners, we do not consider the risk of revenue recognition to be significant due to a lack of incentive and opportunity to manipulate transactions of this nature. The risk of fraud in relation to revenue recognition is however present in all other income streams. **Inherent risk of material misstatement:** **Revenue (occurrence/completeness): High**	We will perform the procedures below based on their value within the financial statements: • Documenting our understanding of the Funds' systems for income to identify significant classes of transactions, account balances and disclosures with a risk of material misstatement in the financial statements. • Evaluating the design of the controls in the key accounting systems, where a risk of material misstatement was identified, by performing a walkthrough of the systems. • Obtaining evidence that income is recorded in line with appropriate accounting policies and the policies have been applied consistently across the year. • Substantively testing material income streams using analytical procedures and sample testing of transactions recognised for the year.

<table>
<tr><th>Investments valuations (key accounting estimate)</th><th>Audit approach</th></tr>
<tr><td>
The Funds held investments of £9.64 billion as at 31 March 2023, of which 39% (£3.75 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.
Inherent risk of material misstatement:
Investments (valuation/existence): High
</td><td>
Procedures performed to mitigate risks of material misstatement in this area will include:

Evaluating management processes and assumptions for the calculation of the estimates, the instructions issued to the investment managers and the scope of their work.
Evaluating the competence, capabilities and objectivity of the investment managers.
Considering the basis on which the valuation is carried out and the challenge in the key assumptions applied.
Testing the information used by the investment managers to ensure it is complete and consistent with our understanding.
Ensuring that the year end valuations have been reflected correctly in the ledger and that accounting treatment within the financial statements is correct.

</td></tr>
</table>

Investment property valuations (key accounting estimate)	Audit approach
LPF hold a portfolio of investment properties which, as at the 31 March 2023, was valued at £366 million. 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. **Inherent risk of material misstatement:** **Investment property (valuation/ existence): High**	Procedures performed to mitigate risks of material misstatement in this area will include: • 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.

Disclosure of present Value of retirement obligations (key accounting estimate)	Audit approach
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, which may result in material misstatement of this disclosure note. **Inherent risk of material misstatement:** **Retirement obligations (valuation): High**	Procedures performed to mitigate risks of material misstatement in this area will include: • Reviewing the controls in place to ensure that the data provided to the actuary is complete and accurate. • Considering the reasonableness of the assumptions used in the calculation against other local government pension fund actuaries and other observable data. • Agreeing the disclosures in the financial statements to information provided by the actuary.

The wider scope of public audit

Introduction

The Code of Audit Practice frames a significant part of our responsibilities in terms of four wider scope audit areas:

- Financial sustainability
- Financial management
- Vision, leadership and governance
- Use of resources to improve outcomes.

Our audit approach to the wider scope audit areas

Appointed auditors are required to consider the wider scope areas when:

- identifying significant audit risks at the planning stage of the audit;
- reaching conclusions on those risks;
- making recommendations for improvement;
- where appropriate, setting out conclusions on the audited body's performance.

When reporting on such arrangements, the Code of Audit Practice requires us to structure our commentary under the four areas identified above. Appendix 3 provides further detail on the definition, scope and audit considerations under each wider scope area.

Our planned audit work against these four areas is risk based and proportionate. Our initial assessment builds upon our understanding of the Funds' key priorities and risks along with discussions with management and review of Funds and committee minutes and key strategy documents.

Wider scope significant risks

At this stage, we have not identified any significant risks in relation to the wider scope areas. Audit planning is a continuous process and we will report all identified significant risks, as they relate to the four wider scope areas, in our annual audit report.

In formulating our audit plan, we identified areas of possible significant risk in relation to vision, leadership and governance and use of resources to improve outcomes. Our audit approach will include reviewing and concluding on the following considerations to substantiate whether significant risks exist:

Financial management

- Whether the quality of the financial performance information presented to the Pensions Committee allows appropriate scrutiny of Lothian Pension Fund's performance and supports effective decision making.

Vision, leadership and governance

- Based on expected favourable funding levels resulting from the latest triennial valuation the Fund has reduced employer contribution rates to 17.6% which is below the contribution stability mechanism ("the CSM") low bracket of 18%. We will review the governance around the decision to suspend the CSM for that purpose.
- Whether the decisions on Project Forth have been clearly communicated to key stakeholders.

Use of resources to improve outcomes

- Whether the Funds can evidence the achievement of value for money in the use of resources.
- How the Funds demonstrate a focus for improvement in the context of continuing financial challenge.
- How the Funds provide a clear link between investment decisions and actual performance achieved.

Audit team and timetable

Audit Team

Our audit team will be as follows:

Role	Name	Email
Key Audit Partner	Chris Brown	Chris.Brown@azets.co.uk
Engagement Manager	Adrian Kolodziej	Adrian.Kolodziej@azets.co.uk
Auditor in Charge	Thomas McCormick	Thomas.McCormick@azets.co.uk

Timetable

Please find below confirmation of our proposed timetable for the audit as previously discussed with management:

Audit work/output	Target month/s
Audit planning meeting	30 January 2024
Pension Committee to consider audit plan	20 March 2024
Interim audit	February-March 2024
Pension Committee to consider accounts	June 2024
Receipt of draft accounts and commencement audit fieldwork	June - July 2024
Independent auditor’s report	September 2024
Annual Audit Report to the Pension Committee and the Controller of Audit	September 2024

Our Requirements

The audit process is underpinned by effective project management to co-ordinate and apply our resources efficiently to meet your deadlines. It is essential that the audit team and the Funds’ finance team work closely together to achieve the above timetable.

In order for us to be able to complete our work in line with the agreed fee and timetable, we require the following:

- draft financial statements of a good quality by the deadlines you have agreed with us. These should be complete including all notes, the performance report and the accountability report;
- good quality working papers at the same time as the draft financial statements. These will be discussed with you in advance to ensure clarity over our expectations;
- relevant staff to be available and on site (as agreed) during the period of the audit;
- prompt and adequate responses to audit queries.

Audit Fee

Audit Scotland sets an expected audit fee that assumes the body has sound governance arrangements in place, has been operating effectively throughout the year, prepares comprehensive and accurate unaudited accounts and meets the agreed timetable for audit.

The expected fee is reviewed by Audit Scotland each year, based on Audit Scotland's overall budget proposals. The budget proposal and fee levels (for the 2023/24 audits) have been developed in the context of a challenging economic environment, increased expectations on the audit profession and the ongoing process of recovery following the Covid-19 pandemic.

As auditors we negotiate a fee with the Funds during the planning process. The fee may be varied above the expected fee level to reflect the circumstances and local risks within the body.

The expected fee set by Audit Scotland for the 2023/24 audit of the Funds is £54,680. Which represents a 6% increase on the 2022/23 fee. This increase is applied on a sector basis and reflects the conditions of the public sector market.

The breakdown of the fee for 2023/24 is shown in the table below.

Fee element	2023/24	2022/23
Auditor remuneration	£88,450	£64,360
Pooled costs	£3,220	-
Contribution to PABV costs	-	-
Audit support costs	-	£2,440
Sectoral cap adjustment	-£36,990	-£15,210
Total fee	**54,680**	**£51,590**

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

Audit independence and objectivity

Auditor Independence

We are required to communicate on a timely basis all facts and matters that may have a bearing on our independence.

In particular, 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.

Azets provides accounts preparation, corporation tax services and ad hoc VAT advice to LPFE Ltd and LPFI Ltd which are subsidiaries of Lothian Pension Fund. In 2023/24 non-audit fees are estimated to be c.£6,500.

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

We have considered our integrity, independence and objectivity in respect of non-audit services provided and we do not believe there are any significant threats or matters which should be brought to your attention.

Appendices

Appendix 1: Materiality

An omission or misstatement is regarded as material if it would reasonably influence the users of the financial statements. The assessment of what is material is a matter of professional judgement and is affected by our assessment of the risk profile of the Funds and Group and the needs of the users.

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

Under ISA (UK) 260 we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA (UK) 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

When planning, we make judgements about the size of misstatements which we consider to be material, and which provide a basis for determining the nature and extent of our audit procedures. Materiality is revised as our audit progresses, should we become aware of any information that would have caused us to determine a different amount had we known about it during our planning.

Our assessment, at the planning stage, of materiality for the year ended 31 March 2024 was calculated as follows.

Group and Funds Materiality

	Group £million	Lothian Pension Fund £million	Scottish Homes Pension Fund £million
Overall materiality for the financial statements	149	147	1.9
Performance materiality (75% of materiality)	111.75	110.25	1.43
Trivial threshold	7.45	7.35	0.01

Materiality	Our initial assessment is based on approximately 1.5% of the group and Funds' estimated net assets as at 2023/24. We consider this to be the principal consideration for the users of the annual accounts when assessing financial performance of the Funds' and the group.

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. In accordance with Azets methodology we have set a trivial threshold at 5% of the overall materiality level. We will consider appropriateness of this level during the audit. Individual errors above this threshold are communicated to those charged with governance.

Special materiality for dealings with members

	Group £million	Lothian Pension Fund £million	Scottish Homes Pension Fund £million
Dealings with members materiality	13.64	13.3	0.34
Performance materiality (75% of materiality)	10.23	9.95	0.25
Trivial threshold	0.68	0.66	0.02

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 audit them. Our initial assessment is based on approximately 5% of the group and Funds' 2022/23 gross expenditure as disclosed in the

	2022/23 audited 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. We have set our trivial threshold at 5% of overall materiality as explained above.

The Remuneration Report and Related Parties disclosures are material by nature.

In performing our audit, we will consider any errors which result in a movement between the relevant bandings on the disclosure table to be material.

For related party transactions, in line with the standards we will consider the significance of the transaction with regard to both Funds and their counter parties, the smaller of which will drive materiality considerations on a transaction by transaction basis.

Appendix 2: Group audit scope and risk assessment

As Group auditor, under ISA (UK) 600 we are required to obtain sufficient appropriate audit evidence regarding the financial information of the components and 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.

Group audit scope

The Group consists of the following entities:

Component	Significant	Level of response required
LPFE Ltd	No	Analytical
LPFI Ltd	No	Analytical

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

Appendix 3: Responsibilities of the Auditor and the Funds

The Accounts Commission and Audit Scotland

The Accounts Commission is an independent public body. Its members are appointed by Scottish Ministers and are responsible for holding local government to account.

Under statute, the Accounts Commission appoints a Controller of Audit to consider the results of the audit of accounts, including the wider-scope responsibilities and Best Value auditing. The Controller of Audit makes reports to the Accounts Commission on matters arising from the accounts and on Best Value and acts independently of the Accounts Commission when reporting to it.

Audit Scotland is an independent statutory body that co-ordinates and supports the delivery of high-quality public sector audit in Scotland. Audit Scotland oversees the appointment and performance of auditors, provides technical support, delivers performance audit and Best Value work programmes and undertakes financial audits of public bodies.

Code of Audit Practice

The Code of Audit Practice (the 2021 Code) describes the high-level, principles-based purpose and scope of public audit in Scotland.

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

Our responsibilities

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 Pensions Committee 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.

Best value

Appointed auditors have a duty to be satisfied that local government bodies have made proper arrangements to secure best value.

Our work in respect of the Funds' best value arrangements is integrated into our audit approach, including our work on the wider scope areas as set out in this plan.

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 Quality of public audit in Scotland: Annual report 2022/23 | Audit Scotland (audit-scotland.gov.uk)

Funds' responsibilities

The Funds have primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enables it to successfully deliver its objectives. The features of proper financial stewardship include the following:

Area	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 and its 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; • ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority; and • preparing and publishing, along with the financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report in accordance with prescribed requirements. Management commentaries should be fair, balanced and understandable. Management is responsible, with the oversight of those charged with governance, for communicating relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.

Area	Funds responsibilities
	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 by putting proper arrangements in place.
Financial position	The Funds are responsible for putting in place proper arrangements to ensure the 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.
Best value	The Funds have a specific responsibility to make arrangements to secure Best Value. Best Value is defined as continuous improvement in the performance of the body's functions. In securing Best Value, the local government body is required to maintain an appropriate balance among: • The quality of its performance of its functions. • The cost to the body of that performance.

Area	Funds responsibilities
	• The cost to persons of any service provided by it for them on a wholly or partly rechargeable basis. In maintaining that balance, the Funds shall have regard to: • Efficiency • Effectiveness • Economy • The need to meet the equal opportunity requirements. The Funds should discharge its duties in a way which contributes to the achievement of sustainable development. In measuring the improvement of the performance of a local government body's functions for the purposes of this section, regard shall be had to the extent to which the outcomes of that performance have improved. The Scottish Government's Statutory Guidance on Best Value (2020) requires bodies to demonstrate that they are delivering Best Value in respect of seven themes: 1. Vision and leadership 2. Governance and accountability 3. Effective use of resources 4. Partnerships and collaborative working 5. Working with communities 6. Sustainability 7. Fairness and equality. Specified audited bodies are required to prepare and publish performance information in accordance with Directions issued by the Accounts Commission.

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by virtue of paragraph(s) 1, 3, 6 of Part 1 of Schedule 7A
of the Local Government(Scotland) Act 1973.

Agenda Item 9.1

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