LOTHIAN PENSION FUND

submitted a report in October 2021, which met the high stewardship standards that the FRC sets. The Funds' Stewardship Report is published as a standalone document.

FUNDS' OBJECTIVES

The **primary objective** of the Funds is to ensure that there are sufficient funds available to meet all pension and lump sum liabilities as they fall due for payment.

The **funding objectives** for each Fund are documented in the Committee's Funding Strategy Statement, which is reviewed at least triennially. The funding objectives, together with the rates of return being targeted and levels of risk to be tolerated, are central to each Fund's investment strategy and govern the allocation across various asset classes.

The **investment objectives** of the Funds are to achieve a return on Fund assets which is sufficient over the long term to meet the funding objectives as outlined in the Funding Strategy Statement. Investment returns are generated by a combination of income (from dividends, interest and rents) and gains or losses on capital.

In effect, the Funds' objectives are to generate sufficient long term returns to pay promised pensions and to make the scheme affordable to employers now and in the future, while minimising the risk of having to increase contribution rates in the future.

Committee has set investment strategy with reference to the following **policy groups,** which are regarded as the key determinants of risk and return. The policy groups condense the vast array of investment choices into a manageable number of investment groups with broadly similar characteristics:

- **Equities** provide an equitable share in the assets and profits of companies. Income is provided through discretionary share dividends. Equities are listed in the UK or overseas, or are unlisted (private equity). Equities have historically produced returns above inflation.

- **Other Real Assets** are typically investments in a share of income and capital appreciation of tangible assets, including **property** (land and/or buildings for commercial or residential use), **infrastructure** (assets deemed essential to the orderly functioning of daily life, such as renewable energy generation and transmission assets, water utilities, airports and toll roads) and **timberlands**. Income comes from dividends and rents.

- **Credit~~Non-Gilt Debt~~** instruments are issued by a range of non-sovereign borrowers to finance their activities in various sectors of the economy, which means that they carry varying degrees of credit risk. Income is provided through interest, which is typically paid to the lender on a regular basis until the loan capital is repaid, generally at par by the issuer at a pre-determined date. Bonds can pay a fixed, variable or inflation-linked rate of interest. Bonds are either listed in the UK or overseas or are unlisted (private debt).

- **Sovereigns~~LDI~~** are bonds, which are debt instruments issued by sovereign governments (such as the UK and US). Typically, these provide interest payments on a regular basis over the life of the loan until capital is repaid at maturity. Some bonds provide interest payments and capital repayment value that is directly linked to price inflation (e.g. the Retail Price Index (RPI) in the UK). These are known as Index Linked Gilts and they provide the closest match to the Funds' liabilities, most of which are inflation-linked, albeit to a different measure of price inflation (the Consumer Price Index (CPI)). Some other governments (such as the US) also issue this type of debt, but in different currencies tied to price inflation in their own countries.

- **Cash** is also a form of investment used to provide instant or short-term liquidity, and can be held in both sterling and foreign currencies (including Treasury Bills, Money Market Funds and Secured Investments). Cash generates interest income, but typically at a lower rate than bonds and other debt.

As the returns of the above investments aren't completely correlated, the Funds expect to achieve diversification and better risk-adjusted returns by investing in assets from each policy group.

FUNDS' STRATEGIES

The Committee's agreed investment strategies (presented in Appendix A) are expressed in terms of allocations to various policy groups (or asset classes). These reference portfolios are expected to generate the required return with a reasonable probability of success. The rate of return being targeted and the level of risk to be tolerated are central to the determination of the investment strategy (or asset mix) of each Fund.

To provide suitable investment strategies for differing requirements of employers, **Lothian Pension Fund** currently operates four investment strategies, as follows:

- **Main Strategy** is a diversified portfolio, mostly invested in long-term, return-seeking assets, such as equities, due to the long-term nature of the pension liabilities. Approximately 94% of employers' assets are invested in the Main Strategy.

- **MEG ("Mature Employers Group") Strategy** invests in a portfolio entirely invested in UK gilts and cash to reduce investment risk for employers (except for Transferee Admitted Bodies) that are close to leaving the Fund. These employers have a low tolerance for risk and this

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APPENDIX A – INVESTMENT STRATEGIES (~~21 JUNE 2023~~20 March 2024)

Lothian Pension Fund: Main Strategy

Investment Objectives: to generate returns sufficient to pay pensions as they fall due.

Investment Strategy:

Policy Group	Target Weight 2024 - 2027	Permitted Range
Equities	55%	45 - 65%
Real Assets	20%	10 - 30%
Credit	8%	0 - 20%
Sovereigns	15%	5 - 25%
Cash	2%	0 - 15%
Total	**100%**	

Lothian Pension Fund: MEG ("Mature Employers Group") Strategy

Investment Objective: to achieve a return in line with gilts that match the duration of the liabilities.

Investment Strategy: the MEG Strategy invests exclusively in UK Gilts and Cash matching the duration of employer liabilities with the duration of the invested assets.

Lothian Pension Fund: 50/50 Strategy

Investment Objective: to achieve a return in line with a 50:50 investment in the Main Strategy and the MEG Strategy and generate a return that pays pensions as they fall due.

Investment Strategy:

Policy Group	Target Weight 2024 - 2027	Permitted Range
Equities	27.5%	17 - 37%
Real Assets	10%	5 - 15%
Credit	4%	0 - 8%
Sovereigns	57.5%	47 - 67%
Cash	1%	0 - 10%
Total	**100%**	

Lothian Pension Fund: Buses Strategy

Investment Objective: to generate sufficient returns to pay pensions as they fall due.

Investment Strategy: to achieve its objective, the Buses Strategy invests in a proportion of the MEG Strategy and the Main Strategy that reflects the maturity of liabilities. This is currently ~~45:55~~50:50. Based on the Main Strategy above, the Buses Strategy will have the following exposures.

Investment strategy:

Policy Group	Target Weight 2024 - 2027	Permitted Range
Equities	27.5%	17 - 37%
Real Assets	10%	5 - 15%
Credit	4%	0 - 8%
Sovereigns	57.5%	47 - 67%
Cash	1%	0 - 10%
Total	**100%**	

Scottish Homes Pension Fund

Investment Objective: to match cash flows from gilt income and redemption payments as closely as possible with the expected liability payments of the Fund to minimise the risk of additional employer contributions being required.

Investment Strategy: all assets are invested in UK gilts and cash. As some liabilities are fixed in nature and some are inflation-linked, the Fund invests in both nominal and index-linked gilts to match cash flows with liability payments one year beyond the next actuarial valuation. Longer dated liability payments are duration matched.