

Proposed Scope and Methodology for a Governance Review of Lothian Pension Fund

1. Purpose

This document sets out the proposed scope and methodology for the detailed review of Lothian Pension Fund's corporate governance and key governance operations and arrangements (the "Review").

2. Why do a Review?

Upholding and maintaining sound corporate governance supports our long-term success, leading to better outcomes for our members, employers and partners.

A governance review was last carried out in 2019. Since then, transformational change and the development of business structures and service delivery methods have continued, for example in our personnel, size, and regulatory complexity. Wider profound change has also been seen in recent years, including periods of economic volatility, geopolitical instability and in legislative and regulatory change. It's important that our governance keeps pace and that we ensure it remains fit for purpose.

For those reasons, and others, an objective for improved governance has been articulated, and supported, in each of the 2022/23 and 2023/24 LPF Business Plans approved by the Pensions Committee, as well as supported by our other governance bodies. The intention of the Review was also recognised by the Pensions Committee and Pension Board at the Committee's meeting on 26 June 2024. The Review will support us to identify and build on what is working well and improve where necessary.

3. Background

The Funds

Lothian Pension Fund is an asset backed and multi-employer occupational pension scheme, part of the Local Government Pension Scheme (LGPS) in Scotland with around £10bn of assets. It serves over 90,000 members and 65 employers. It's the second largest LGPS fund in Scotland.

Scottish Homes Pension Fund (SHPF) is a single employer pension fund for former employees of Scottish Homes and the Scottish Special Housing Association. SHPF is a mature, non-active fund, consisting of only deferred and pensioner members.

In this note we use the term **LPF** to refer to both Funds, unless the context otherwise requires.

CEC as administering authority of the Funds

It's important to recognise that LPF is not, in and of itself, a corporate entity and has no separate legal personality. CEC is the legal entity with statutory responsibility for the administration of the Funds and owns and controls all the assets of the Funds, which are statutorily ringfenced within CEC.

Subject to certain matters reserved to the full Council, CEC has delegated its oversight functions as administering authority of the Funds to the Pensions Committee and, in turn, the Pensions Audit Sub Committee. Those bodies are also subject to the scrutiny of the Pension Board, which is a separate statutory body established under the Public Service Pensions Act 2013 and the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015.

CEC delegates authority for the day-to-day exercise of its administering authority functions to its Executive Director of Corporate Services, Dr Deborah Smart, subject to the provisions of CEC's Scheme of Delegation to Officers. CEC has also incorporated two private limited companies as part of LPF's operations - LPFE Limited and LPFI Limited.

LPFE Limited (LPFE)

CEC has established a wholly owned and controlled subsidiary, LPFE Limited, for the purpose of providing specialist pension administration and investment personnel to CEC. LPFE also provides seconded staff to LPFI Limited, as discussed below.

LPFE is a company limited by shares, incorporated under the Companies Act. Its governing body is its board of directors, and its sole shareholder and parent is CEC.

LPFE's remit is to deal with people matters, which includes, amongst other things, recruitment, performance management and remuneration.

All staff engaged in carrying out the administering authority functions of CEC for the Funds, including the LPF CEO, are employed by LPFE Limited and seconded to CEC under an intra group resourcing agreement. As secondees, LPFE staff work for CEC.

LPFI Limited (LPFI)

CEC has established a wholly owned and controlled subsidiary, LPFI Limited, which is authorised by the Financial Conduct Authority to provide regulated investment services to several external clients (including some limited services to CEC in relation to LPF).

LPFI is also a company limited by shares, incorporated under the Companies Act. Its governing body is its board of directors, and its sole shareholder and parent is CEC.

LPFI was established to support collaboration with other likeminded local government pension schemes by delivering investment services on a cost-sharing basis.

All LPFI's staff are employed by, and seconded from, its sister company LPFE.

LPF 'Group'

The term **LPF Group** is used in this note to refer to CEC (in its capacity as administering authority of the Funds), LPFE and LPFI.

The term **LPF Group's Corporate Governance Bodies** is used in this note to refer to the:

- Pensions Committee,
- Audit Sub Committee,
- Pension Board,
- Board of Directors of LPFE, and
- Board of Directors of LPFI.

The LPF Group operates in a highly regulated environment. This impacts how it, LPFE and LPFI, and LPF Group's Corporate Governance Bodies operate. It also, naturally, informs the optimum governance framework. In summary key aspects are:

Legislative and Regulatory Requirements

- LPF is regulated by the Pensions Regulator (**TPR**) as a defined benefit occupational pension scheme and LGPS in the UK and the Scottish Public Pensions Agency (**SPPA**) as an LGPS fund in Scotland. Of relevance is the TPR's new General Code of Practice, 2024.
- Pensions legislation, some of which is specific to LGPS in Scotland, and governance, such as the Public Service Pensions Act 2023 and the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015.

- CEC, the Pensions Committee and the Audit Sub Committee are subject to the Local Government (Scotland) Act 1973, for example, regarding financial standards and the exercising of powers and authority.
- LPFI is regulated by the Financial Conduct Authority. It is, therefore, subject to the regulatory scrutiny of the FCA and the FCA’s requirements and expectations, as are its directors and those LPFE staff who are seconded to and carry out business on behalf of LPFI. The Senior Manager and Certification Regime, for example, applies. LPFE is a close-link entity to LPFI and indirectly impacted.
- The LPF Group is subject to a range of public sector requirements (such as public procurement and freedom of information regimes) and associated specialist regulatory bodies (such as the Scottish Information Commissioner’s Office).
- UK Corporate law, such as the Companies legislation for LPFE and LPFI.

Best Practice Standards

- Best practice corporate governance regimes within the UK, as may be applicable. The revised UK Code of Corporate Governance, 2024, is an example.
- The recommendations of the Good Governance Project of the Local Government Pension Scheme Advisory Board (England and Wales).

The LPF Group also has an existing suite of governance and Constitutional Documents in place. Key documents are:

CEC’s Scheme of Delegations, only insofar as related to LPF
Pensions Committee Terms of Reference
Pensions Audit Sub Committee Terms of Reference
Pension Board Constitution
Articles of Association for LPFE Limited and LPFI Limited
Shareholder Agreements for LPFE Limited and LPFI Limited
LPF’s internal sub-delegations from the LPF CEO
LPF’s Procedural Standing Orders
LPF’s Code of Conduct for Pension Board and Pensions Committee members
LPF’s Nominations and Appointments Policy
LPF’s Training and Attendance Policy

4. Overall Aim

Working closely with key stakeholders, conduct a detailed review of the corporate governance and key governance operations and arrangements across the LPF Group, as set out more fully in the Detailed Scope in Section 5, with a view to ensure the governance model:

- a) meets Legislative and Regulatory Requirements,
- b) aligns with Best Practice Standards, to the extent that may be applicable and appropriate for the LPF Group,
- c) is effective,
- d) is efficient,
- e) is fit for purpose, and
- f) achieves the Target Success Criteria,

and make, reasonable and proportionate, recommendations (including any potential viable alternative approaches) to strengthen and improve governance across the LPF Group.

4. Target Success Criteria

SIMPLE	<p><i>Success Criteria:</i></p> <p><i>Our governance can be operated, understood and explained with relative ease, with effective supporting processes, procedures and policies in place.</i></p>
TRANSPARENT	<p><i>Success Criteria:</i></p> <p><i>We are clear on, and understand, accountabilities, roles, responsibilities, reporting requirements and timescales, across the LPF Group.</i></p>
ENABLING	<p><i>Success Criteria:</i></p> <p><i>The LPF Group is set up for success, enabling effective, efficient and proportionate decision making and oversight, to achieve the purpose, vision and values of LPF.</i></p>

5. Detailed Scope

It’s proposed that the Review considers the following seven themes. More detail has been provided at each theme to highlight areas for consideration, as may be potentially relevant. Due to interdependencies some of the areas identified will be relevant to more than one theme but have only been noted once in the interests of brevity.

Theme 1 CORPORATE GOVERNANCE STRUCTURE AND FRAMEWORK

Included:

- The effectiveness of the corporate governance structure and framework, identifying areas of strength and those for continuous improvement, considering the Legislative and Regulatory Requirements, Best Practice Standards and the Target Success Criteria.
- The effectiveness of the corporate governance structure and framework, in balancing the different, and potentially competing, regulatory ambits which the LPF Group operates within.
- The effectiveness of the corporate governance structure and framework in its alignment and support of efficient and effective continuous improvement in the delivery of objectives and priorities.
- Consider and identify any gaps and inconsistencies in and between the LPF Group's governance framework and practical application.
- Identify and highlight any material barriers to the effectiveness of the existing corporate governance structure and framework.

Theme 2 OVERSIGHT, SCRUTINY AND ASSURANCE

Included:

- An appropriate balance between 'parent' oversight functions and day-to-day management of the LPF Group. For example:
- Is there a clear, systematic, and documented framework which effectively and appropriately underpins the arrangements for the oversight, interface, and engagement across LPF Group's governance?
- Does the current delegation of authority model strike an effective and proportionate balance between:
 - autonomy for the efficient and effective management of the LPF Group, and
 - CEC's oversight and control (in its capacity as administering authority, and Shareholder (where applicable)) to properly undertake its statutory responsibilities,
 for the LPF Group to achieve its strategic and business objectives and outcomes?

- Are the:
 - practices,
 - processes,
 - flow of information, and
 - engagement and communication channels,

currently in place between 'LPF's' staff and CEC Officers, and between the LPF Group's Corporate Governance Bodies for decision-making, oversight and assurance effective and proportionate?

Theme 3 ACCOUNTABILITIES, ROLES AND RESPONSIBILITIES

Included:

- Building on Theme 2 (Oversight, Scrutiny and Assurance) consider the roles and responsibilities and delegations of authority to the Pensions Committee, Audit Sub Committee, LPF Chief Executive Officer, LPFE, and LPFI. For example:
- The efficacy of roles, responsibilities, and accountabilities. Are the following clearly mapped, documented and well understood:
 - Accountabilities,
 - Roles,
 - Responsibilities,
 - Objectives, and
 - Reporting Lines,

for those who are involved in the oversight and operational management of the LPF Group. Are they regularly reviewed and reflect change as the LPF Group has undergone change? This includes identifying any areas of duplication, omissions, or inconsistencies.

Theme 4 PARTICIPATION, REPRESENTATION AND KNOWLEDGE AND EXPERIENCE

Included:

- Participation and representation across the LPF Group's Corporate Governance Bodies, with a view to ensure the optimum composition of each body and the most appropriate mix of skills and expertise to carry out each of their duties effectively.

- The effectiveness of appointment processes and policies.
- Recognising the Legislative and Regulatory Requirements and Best Practice Standards, as well as the inherent complexity of the pensions, financial services and investment sectors, consider members knowledge, expertise and capacity and the effectiveness of the processes and policies in place to support the development, and retention, of skills and experience. For example, are the criteria for representation across each of LPF's Corporate Governance Bodies (as may be applicable) appropriate, clear and documented?
- It is recognised that some conflicts are inherent in the LPF Group's governance. Review the effectiveness of the processes and policies in place to address, manage and limit potential or actual conflicts of interest in respect of LPF Group's Corporate Governance Bodies, including any processes or procedures in place to investigate non-compliance and to take appropriate action where it is not possible to mitigate a potential or actual conflict.

Theme 5 GOVERNANCE DOCUMENTATION

Included:

- Review, as a minimum, the Constitutional Documents to ensure they are:
 - clear,
 - up to date,
 - appropriately reflect Legislative and Regulatory Requirements
 - appropriately reflect Best Practice Standards, as appropriate, and
 - enable the LPF Group to fulfil its obligations and meet its objectives now and in the medium term.
- Identify any omissions and consider potential amendments and updates and, where necessary, the creation of new documents. Ensure commonality of terms and language where appropriate.

Theme 6 ETHICAL CONDUCT

Included:

- The effectiveness of the existing controls and practices in place to ensure strong ethical values and behaviours by members of LPF Group's Corporate Governance Bodies, in

accordance with Legislative and Regulatory Requirements, and Best Practice Standards as may be appropriate.

Theme 7 GOVERNANCE ADMINISTRATION

Included:

- Review of the effectiveness of the administrative support and systems for LPF Group's Corporate Governance Bodies.

6. Excluded from the Scope

The scope does not include:

- Consideration of the detailed management and delivery of Fund matters, such as the appropriateness or accuracy of current Fund administration matters.
- The operational management and workforce of the Fund.
- Consideration of the Joint Investment Forum.
- Except where points may arise related to high-level roles and responsibilities, delegations and assurance, consideration of investment matters, risk management, and business planning processes.

The role of CEC as Administering Authority is a prerequisite.

In addition, as noted at Section 2, improvements to governance are a LPF Business Plan objective. Accordingly, it's recognised that some aspects of continuous improvement are already underway or under consideration. For example, outputs from the Internal Audit of Pensions Committee Operational Effectiveness, enhancements to the LPF Group governance framework including the development and introduction of a Corporate Governance Manual, approach to training and development, corporate policy framework and a TPR gap analysis exercise. LPF will continue to take steps to make continuous improvements, notwithstanding the Review, but shall do so in a considerate manner, recognising the time/benefit analysis and to minimise unnecessary duplication.

7. Methodology

It is proposed that an independent External Consultant is engaged to lead and carry out the Review, in accordance with appropriate procurement processes. LPF's Company Secretary and CEC's Head of Democracy, Governance and Resilience, working collaboratively, shall act as the Executive Leads and day-to-day contacts for, and in support of, the External

Consultant. In addition, it’s proposed that a Governance Working Group is established, comprised of key stakeholder representatives:

- at least one (ideally 2) members of the Pensions Committee,
- at least one (ideally 2) members of the Pension Board,
- the Executive Director of Corporate Services, CEC (and as Chair of the LPFE Board)
- the Chair of the LPFI Board, and
- LPF’s Chief Executive Officer.

A Terms of Reference for the Governance Working Group would be put in place. The Governance Working Group will not be a decision-making body – but, instead, a consultative body and sounding board. LPF’s Company Secretary (or delegate) would provide Secretariat to the Governance Working Group.

While the final methodology will be discussed with the External Consultant, we expect it to include the following steps:

- (a) Paper and Document desktop review
- (b) Stakeholder Survey
- (c) Potential interviews with Key Stakeholders, and
- (d) Potential workshop(s) with the Governance Working Group.

Formal decisions which may be required for example, to amend existing documentation shall be brought to the most relevant approval body or bodies, in accordance with existing constitutional documents, including full Council where required. Regular updates on the Review will be included as part of Quarterly Governance Reports brought to each of LPF Group’s Corporate Governance Bodies.

8. Expected Outputs and Indicative Timescales

<u>Phase 1 - Preparing for the Review</u>	
4 October 2024	Finalise Scope
8 November 2024	External Consultant identified and engaged
Mid November 2024	Initiation period between Leads and External Consultant

<u>Phase 2 – Conducting the Review</u>	
Late November – Mid December 2024	Survey and Potential Interviews
Early January 2025	Option for Governance Working Group Workshop 1

31 January 2025	Fieldwork Complete
February 2025	Initial Draft Report from External Consultant
Early March 2025	Option for Governance Working Group Workshop 2
31 March 2025	Updated Draft Report from External Consultant and the development of draft actions
Mid-April 2025	Option for engagement with Governance Working Group

Phase 3 – Concluding the Review

Late April 2025	Final Report from External Consultant
June Cycle 2025	Report to LPF's Corporate Governance Bodies, with Action Plan for Improvements

Phase 4 – Implementation

Specific timescales for Phase 4 to be considered and agreed as part of the Action Plan for Improvements developed under Phase 3.