



Appendix 1

Risk Appetite Statement November 2024

1. Context

Lothian Pension Fund (LPF) administers the Local Government Pension Scheme (LGPS) in Edinburgh and the Lothians. LPF is an asset-backed and multi-employer scheme with around £10 billion of assets and the second largest LGPS fund in Scotland, serving over 93,000 members and 57 contributing employers. LPF was 157% funded at the most recent valuation in 2023.

LPFE and LPFI were established within the LPF group (Group) to facilitate activities and provide services in the most efficient way to administer the pension fund and leverage in-house investment management operations and to deliver investment and advisory services for like-minded LGPS clients. LPFI is authorised by the FCA (Financial Conduct Authority) to deliver these investment services which enables part of our core strategy regarding collaboration with other LGPS funds.

Risk management is an integral part of good governance and effective and meaningful risk management involves taking a balanced view of risk and opportunity in delivering LPF's strategic objectives. LPF's Risk Appetite Statement (RAS) is a core part of our risk management framework and sets out the level of risk we are willing to take to achieve our business and strategic objectives.

2. Purpose

The purpose of the Risk Appetite Statement is to articulate the risk appetite of LPF group, ie. the degree of risk that the group is prepared to accept to achieve its business and strategic objectives.

The RAS sets out the risk appetite for each of LPF's key risk categories and underlying risk tolerances which will be monitored and managed in compliance with LPF's strategy and business changes as well as any other material changes.

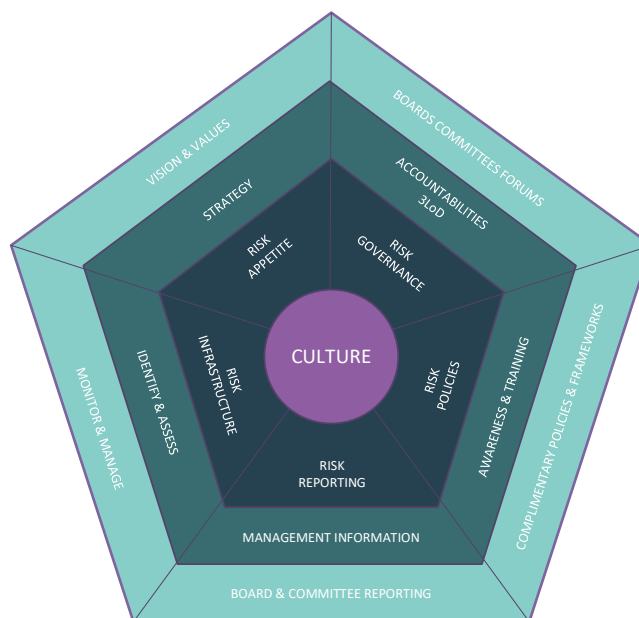
The Pensions Committee is responsible for ensuring the systematic appraisal of LPF's control environment and framework of internal controls, and consequently has overall accountability for the RAS. The RAS will be reviewed at least every three years to align with the Fund's triennial valuation. On a practical basis, the LPF Risk Management Committee (RMC) will review the RAS on an ongoing and routine basis to ensure adequate oversight of LPF's risk profile and that the RAS remains appropriate and enables LPF's strategy, escalating as required.

3. Risk Culture

LPF acknowledges that risk appetite is a foundational element of a sound risk culture. LPF's risk culture is based on doing the right thing by our members, employers, clients and employees, founded on the principles of LPF's values that inform, inspire and instruct day to day behaviour. The Pensions Committee, LPFE and LPFI Boards, senior management and employees are expected to be risk-aware and understand the role they play in managing risk, and the value that effective risk management adds to the organisation.

4. Risk Management Framework

The RAS is an important element of LPF's Risk Management Framework (RMF). It is LPF's mechanism for identifying, assessing, managing and reporting on material risks and provides key information to support effective, risk-informed decision making. The RMF is practically facilitated by a toolkit and methodology that helps define and guide appropriate risk management in line with LPF strategy, vision and values.



5. Operationalising the Risk Appetite Statement and Monitoring Risk

All LPF's employees are responsible for the appropriate management of risks and when seeking approval for key strategic and operational decisions, risk appetite must be considered.

All risks which are determined as unacceptable and outside of risk appetite will be reported to the Senior Leadership team/RMC in the first instance, and subsequently as appropriate to the Pensions Committee and/or Boards. Remedial action plans will be put in place to reduce these risks back to acceptable levels and within risk appetite.

The risk appetite is monitored collectively through components of the LPF RMF and leverages the use of metrics, known as Key Risk Indicators, with defined boundaries, to help inform this monitoring. Factors which contribute to determining these indicators include:

- Impacts from severe but plausible scenarios
- Internal and external loss experience
- Expectations of potential changes in the business
- Financial forecasts based on potential future strategies
- Reputational impacts

The LPF Risk & Compliance team monitor and report LPF's risk position in relation to various aspects of RMF management information.

Where risk tolerances are exceeded, action is taken to escalate, report and remediate so as to revert the risk back to acceptable levels and within risk appetite.

6. Risk Appetite Descriptors

The risk appetite statements across LPF risk categories are outlined below:

LPF RESTRICTED DATA

Risk Appetite Levels

No Appetite – LPF has no appetite for risk taking which has no direct link to the pursuit of our strategy and/or where there are potentially severe negative impacts on members, employers, or clients or damages or losses (to the Fund) associated with the risk

Low Appetite – LPF has a low appetite for risk taking which has a casual or indirect link to the pursuit of our strategy and/or where there are potentially significant negative impacts on members, employers or clients, or damages or losses (to the Fund) associated with the risk

Moderate Appetite - LPF has a moderate appetite for responsible risk taking which has a clear link to the pursuit of our strategy and where the risk has been evaluated with no material negative impact on members, employers or clients, and the expected benefits (to the Fund) outweigh any potential damages or losses

High Appetite - LPF has a high appetite for responsible risk taking in pursuit of our strategy and where the risk has been evaluated as having no unacceptable negative impact on members, employers or clients, and the expected benefits (to the Fund) significantly outweigh any potential damages or losses



7. Risk Appetite Statement

The Pensions Committee ensures the RAS is aligned to LPF’s vision, purpose, values and strategy. LPF’s vision is to deliver outstanding pension and investment services for the benefit of members and employers. This is supported through LPF’s purpose which is to administer LGPS in Edinburgh and the Lothians, and by paying pensions and benefits to members, helping their own, and their families, financial wellbeing in retirement. LPF’s enduring values that inform, inspire and instruct day to day behaviour help deliver this.

As the second largest LGPS in Scotland, the success of LPF achieving its vision and purpose is reliant on its ability to operate within risk appetite while striving to meet and deliver on the strategic pillars above. The RAS enables this by addressing current and emerging risks under both normal and stressed operating environment, socio-political, market and macroeconomic conditions and sets clear boundaries and expectations for the LPF group’s appetite across its risk categories (outlined below).

8. Key Risk Categories

The RAS sets out the risk appetite for each of LPF’s material risk categories. Within each material risk category underlying risks are assigned tolerance levels defining an acceptable degree of variability or deviation from the expected level of risk that LPF is prepared to withstand to achieve objectives.

Information Security, IT & Data

LPF's operations rely heavily on a broad suite of technology which is characteristic of today's complex and technology enabled environment. The nature of data leveraged by LPF requires robust technical security architecture and implementation, and data quality management and handling.

Key underlying risk categories: Technology (low tolerance); Information Security & Cyber (low tolerance); and Data (low tolerance)

LPF will manage these risks in accordance with a ***Low risk appetite***. A low risk appetite helps foster a culture of stability, compliance and control over technology and data use. An information security incident or cyber-attack would most likely have significant operational, legal, regulatory and reputational impacts by virtue of the data LPF holds.

Governance, Legal & Compliance

LPF's ability to manage its legal and compliance risk is imperative to maintaining regulatory trust, ensuring market integrity, and achieving the best outcomes for members, employers, clients and employees. The complexity of governance arrangements across different structures and sectors leverages expertise from a broad range of stakeholders and ensuring these arrangements are effective, appropriate and transparent is key.

Key underlying risk categories include: Legal (low tolerance); Financial Crime (low tolerance); Regulatory Compliance (low tolerance); and Governance risks (moderate tolerance).

LPF will manage these risks in accordance with a ***Low risk appetite***. The fund and the corporate entities are subject to legal, regulatory and statutory requirements that need to be harmoniously implemented. A low risk appetite helps to promote and support a strong risk culture and acknowledges a robust and responsible approach to managing legal or regulatory risk.

Business Operations

LPF's business operations are key to enabling the delivery of services to members, employers and clients. Failures to manage its business operations will have flow on effects in member, employer and client experience, and potentially result in reputational damage and financial loss. The reliance on a number of key third parties and external suppliers to deliver services, or failings caused by, or relating to, these external parties, may restrict LPF's ability to operate effectively.

Key underlying risk categories include: Processing & Execution (low tolerance); Physical Security & Safety (low tolerance); Business Continuity (low tolerance); Business Change (moderate tolerance); External & Internal Fraud (low tolerance); Third Party (low tolerance); and Communication & Digitalisation (moderate tolerance).

LPF will manage these risks in accordance with a ***Low risk appetite***. Paying the right pension to the right member at the right time is at the heart of LPF's purpose and managing the variables that could prevent this is key. A low risk appetite helps provide LPF with stability, control, and a solid reputation for reliability in this regard.

People & Culture

LPF's ability to create an attractive culture and attract and retain an engaged workforce across a range of levels and functions is core to support delivery of LPF strategy and to operate effectively. Although LPF's small size contributes to key person dependencies and from time to time, capacity constraints, ensuring LPF can rely on the required resources, particularly regarding subject matter experts and specialist skills and competencies who are engaged and invested in LPF, is foundational to the people strategy and how this facilitates LPF strategy consistent with LPF vision and values.

Key underlying risk categories include: Employment practices & relations (low tolerance); Workplace safety & employee wellbeing (low tolerance); Diversity & Inclusion (low tolerance); Vision & Values (low tolerance); Workforce planning (moderate tolerance).

LPF will manage these risks in accordance with a **Moderate risk appetite**. A moderate risk appetite for people and culture encourages controlled agility and moderate change, promoting ability to adapt without sacrificing stability and quality. This minimises the likelihood of alienating employees or causing cultural misalignment while still fostering an environment where innovation and development are encouraged.

Financial

Although the fund operates in an environment fortunate to benefit from the local government guarantee for local government pension funds, LPF must effectively manage financial risk around liquidity and cash flows to ensure liabilities and capital requirements can be met as and when required and remain compliant with statutory and regulatory obligations. Consideration of the impacts of economic conditions and legal and regulatory frameworks must be integrated.

Key underlying risk categories include: Credit (low tolerance); Market (moderate tolerance); Statutory Reporting & Tax (low tolerance); Capital Adequacy (low tolerance); and Liquidity (zero tolerance).

LPF will manage these risks in accordance with a **Low risk appetite**. A low risk appetite promotes stability and safeguards against potential losses, retaining stakeholder confidence through the focus on security and long-term sustainability through capital preservation, minimising exposure to market volatility and ensuring liquidity.

Conduct

Inappropriate actions or poor governance that compromise the integrity, financial health or operational effectiveness of LPF must be managed to ensure ethical decision making, transparency and effective regulatory and governance practices are in place and Codes of Conduct for LPF stakeholders involved in the running of the pension fund are established.

Key underlying risk categories include: Deficiencies in employee or representative actions or omissions (low tolerance); Client or member mis-treatment or account mis-management (low tolerance); and Market Integrity (low tolerance).

LPF will manage these risks in accordance with a **Low risk appetite**. A low risk appetite signals that LPF values ethical behaviour and risk management, helping drive a culture where employees feel

accountable for their actions, operate within defined boundaries, and are more likely to report unethical behaviour.

Model

LPF relies on models to some extent to help determine fund valuations, contribution rates, capital modelling, forecasting and budgeting. Models are also used from time to time as part of the analysis supporting investment management processes. Basic principles regarding the use of models focus around solid design, methodologies and data quality and a risk based approach is taken to development and use of models.

Key underlying risk categories include: Data deficiencies (low tolerance); Estimation uncertainty (low tolerance); Inappropriate Usage (low tolerance).

LPF will manage these risks in accordance with a **Low risk appetite**. A low risk appetite helps ensure a conservative approach when considering the factors that could compromise accuracy, reliability and validity of models used in LPF decision making and manage the potential for material model failures, which could be critical where model errors might lead to significant financial or reputational damage.

Investment Management

LPF's ability to effectively mitigate investment management risk is integral to its business and vision to deliver outstanding pension and investment services and through using our influence as a leading responsible investor. LPF seeks to deliver sufficient investment returns over the long term to meet funding targets and seeking to have a positive impact on the economy and society by continuing to integrate Environmental, Social and Governance considerations into investment process and demonstrating good stewardship of assets.

Key underlying risk categories include: Investment Performance (moderate tolerance); Responsible Investment (low tolerance); and Investment liquidity (moderate tolerance).

LPF will manage these risks in accordance with a **Moderate risk appetite**. A moderate risk appetite allows LPF to strike a balance between risk and return through a diversified portfolio that allows the scheme to meet its fiduciary duty to ensure stable and sustainable returns to meet future pension liabilities, aligning with long term financial sustainability.

Strategic

LPF's strategy sets the vision and direction for LPF. Key to LPF's success is that any risks to strategy are appropriately managed without impeding LPF's ability to continue to meet the core strategic goals, and importantly continue to develop and deliver high standards of member, employer and client value.

Key underlying risk categories include: Strategic (low tolerance); Reputation (low tolerance); and Climate (low tolerance).

LPF will manage these risks in accordance with a **Moderate risk appetite**. A moderate risk appetite reflects a balanced approach to decision-making. It indicates a willingness to take calculated risks to

achieve strategic objectives while maintaining an appropriate level of caution to safeguard the value of the fund and protect members interests.

Scheme

LPF seeks to ensure that sufficient resources are available to meet all scheme liabilities as they fall due. It invests the scheme’s assets, seeking an appropriate return that will manage the cost of the scheme to employers. LPF endeavours to manage employer’s liabilities and enable reasonable optimal contribution rates at reasonable cost to both members and employers.

Key underlying risk categories include: Funding (low tolerance); and Member payments (low tolerance).

LPF will manage these risks in accordance with a **Low risk appetite**. A low risk appetite safeguards the financial and intrinsic value of the fund to members and employers, providing certainty around pension payments and employer contributions.

9. LPFI

Inherent within the RAS and risk appetites and tolerances described, LPFI will meet the regulatory expectations of the FCA, including as these relate to governance, financial, operational, conduct and business process requirements and standards.

Document Control

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LPF Risk Appetite

