Lothian Pension Fund
Annual Seminar
Welcome
Pension Board

Eric Adair,
Chair of Lothian Fund
Pension Board
Governance Overview

The Pensions Regulator

Responsible Authority

Scheme Advisory Board

Scheme Manager
  (Pensions Committee)

Pension Board

National level

Fund level
Review of Local Government Pension Scheme

- Consultation in process for draft regulations November 2014.
- Appointment of Pension Board April 2015.
Pension Board members

Employer representatives

Eric Adair (Chair)
EDI Group

Darren May
Scottish Water

Linda Mcdonald
Handicabs

Rucelle Soutar
The Royal Edinburgh Military Tattoo

Simon Belfer
Napier University*

* Pension Board Representative for the Audit Sub Committee

Photograph To follow
Pension Board members

Member representatives

John Rodgers  
Lothian Buses  
Unite

Thomas Carr Pollock  
West Lothian Council  
GMB

Graeme Turnbull  
Scottish Regional Official  
UCATT

Catrina Warren  
West Lothian Council  
Unison*

Jim Anderson  
Scottish Water  
Unison

* Pension Board Representative for the Audit Sub Committee
What are the Board’s priorities

• Understanding the role of the new Pension Board.

• Establishing the board’s practical arrangements and processes.

• Developing our knowledge and understanding.
What the Board does

Role of Board is to help ensure each scheme complies with governance and administration requirements.
Role of Pension Board

Assisting the Scheme Manager in:

• Securing compliance with the 2014 Regulations and other legislation relating to the governance and administration of the Scheme and any statutory pension scheme that is connected with it.

• Securing compliance with requirements imposed in relation to the Scheme and any connected scheme by the Pensions Regulator.
Powers of Pension Board

To help the Board fulfil its role it has the power to:

• Request reports from the Scheme Manager – on any aspect of the Fund

• Request a review of any decision of the Committee

• Consult independent experts
In Practice

In order to fulfil our role the Pension Board:

- Receive all Pensions Committee and Audit Sub Committee papers.
- Attend all Pension Committee Meetings
- Nominate two Pension Board representatives to attend the Audit Sub Committee meetings
- Hold quarterly Pension Board meetings to discuss Pensions Committee Papers.
In Practice

What we do at a Committee meeting:

• We attend all Committee meetings and participate fully in the discussions.
• Although we don’t take part in the actual decision, our views are sought by the Committee Chair.
• If we wish we can challenge the Committee – but so far this hasn’t happened!
What does a Board member need to know

- Take part in regular training to ensure that we have a sound knowledge of pension matters to be discussed.
- Attend a minimum of 21 hours of training each year.
- Attend external events.
- Understand the items on the committee papers – training is linked to items on the papers.
About me

• Involved with Pension Fund since 2010 as employer representative.
• Member of previous Lothian Pension Fund Consultative Panel until March 2015 and representative for the Panel on the Audit Sub Committee.
• Member of the Pension Board since April 2015.
• Elected Chair of Pension Board in September 2015.
Role of Pension Board Chair

- Chair is appointed the other Board representatives.
- Chair of Board is rotated on an annual basis alternating between employer and member representatives.
- Chair the Pension Board meetings
- Feedback to the Pensions Committee the queries and questions the Board have.
Recent Board discussions

The Board have had two meetings so far and have included discussions such as:

- Committee Papers.
- Appointments (Chair, Audit Sub Committee representatives).
- Agreeing processes and procedures such as: regularity of meetings, minute taking, coordinating feedback on Committee papers.
Thank you for listening

Questions?
Environmental, Social & Governance Investment Focus

Stewart Piotrowicz
Portfolio Manager
Environmental, Social & Governance

• “The Pensions Committee believes that investing responsibly can affect the financial performance of companies”

Statement of Investment Principles June 2015

• ESG considerations prior to investment
• Policy of constructive engagement
• Consistent with fiduciary duty

Responsible Investment
High Profile “Issues”

- Volkswagen emissions scandal
- Talk Talk data breaches
- Accounting “irregularities” – Tesco, Toshiba, Olympus
- BP – Macondo oil spill
Environmental, Social & Governance

- United Nations Principles of Responsible Investment signatories
- Compliance with UK Stewardship Code
- Founding member of Local Authority Pension Fund Forum (LAPFF)
- Participation in Carbon Disclosure Project
- Collaboration on Responsible Investment Reporting
Voting & Engagement

- Baillie Gifford, UBS and State Street take direct responsibility
- Hermes Equity Ownership Services (EOS) for all other equity exposure
- Founding member of Local Authority Pension Fund Forum (LAPFF)

Stewardship
Hermes EOS Voting & Engagement

- Effective use of resources
- 26 person, multi-national team
- £146.6bn in assets under advice (Sep’15) for “some of the world’s leading pension funds”

Hermes website

Effective Use of Resources
Hermes EOS - Voting

• Hermes EOS voted on the Funds’ behalf at 389 meetings on 5,772 resolutions in Q2 2015

• Voted against or abstained on 402 resolutions

• Often vote against management on
  - Board Structure
  - Remuneration

• Have ability to over-ride Hermes

Effective Use of Resources
Hermes EOS - Engagement

- Discussions with company, board & clients

Objectives & next steps of engagement:
- Deal with consequences & address reasons
- Overhaul of corporate governance & culture
- Arrange meeting with supervisory & management board members
- Lead collective action – consider what action to take before and at AGM in April 2016

Volkswagen Emissions Scandal
Hermes EOS – Climate Change

• Member of “Aiming for A” coalition
• Helped to prepare resolutions to be considered at mining company AGMs
• Relates to management & disclosure of climate-related risks & opportunities
• Aim is to be supportive but stretching of management, balancing short & long term considerations

Responsible Investment
Internal Equities & ESG

- UNPRI assessment highlighted scope for improved ESG integration for internal equities
- MSCI provide ESG specific company research and analysis, & highlight issues/areas for improvement
- “MSCI ESG Research is the world’s largest provider of ESG research.....work with 45 of the top 50 global asset managers”

Effective Use of Resources
Recent engagement example

- Electra Private Equity Plc ~£4m investment
- Major investor proposes two Board representatives
- LPF vote in support of two new Board members (against management) and vote is successful
- Electra move towards creating Board independence from the Manager

Improved Corporate Governance
Summary

• Investing responsibly can affect the financial performance of companies
• Policy of constructive engagement
• Effective use of resources
• Refer to www.lpf.org.uk for further information
Environmental, Social & Governance Investment Focus

Stewart Piotrowicz
Portfolio Manager
High Dividend Investment Portfolio

‘Global High Dividend’

Jeff Saunders
A very meaningful activity

Internal ‘Global High Dividend’ Portfolio:

14.5% of Lothian Pension Fund = £716m

28.4% of Lothian Buses Pension Fund = £109m

-> £825m total
A key part of Lothian strategy

1) Shift from focus on high return and high risk to risk/return balance.

2) Shift from external managers to internal managers at much lower cost.

Our Internal costs are around 3 ‘basis points’ = around £3 / per £10,000 managed. Our External managers’ fees are 35-80 basis points.
## Lower Global Equity Costs

<table>
<thead>
<tr>
<th>Asset Category</th>
<th>Lothian Internal Active (Basis Points)</th>
<th>CEM Global Average Internal Active (Basis Points)</th>
<th>CEM Global Average External Active (Basis Points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Equities</td>
<td>3.0</td>
<td>10.1</td>
<td>47.9</td>
</tr>
</tbody>
</table>

External > 10x Lothian’s Internal Cost

Source: CEM Benchmarking 2014 - Independent provider of benchmarking analysis using data from 320 global pension funds with £5.5 trillion in assets.
Lower Total Fund Cost

CEM report Lothian cost saving in 2014 was over £5m per annum
Better risk/return

The Global High Dividend investment opportunity: traditional investment theory says gilts offer higher income (yields) with lower risk but do not grow returns…

… but times have changed

Currently shares offer higher yields than gilts…
Shares now yield more than Gilts
The investment case (2012)

The UK stock market dividend yield looks unusually attractive versus UK gilts and UK index-linked.
Creating the portfolio

Large companies (over $5bn)
High dividend yield (over 4%)
Positive profit
Low debt/profit
Low credit default risk

-> High income and strong finances.
50 Global Companies

- ASTRAZENECA
- AT&T
- BOUYGUES
- BT GROUP
- CANON
- CHINA MOBILE
- COCA-COLA AMATIL
- DAIMLER
- DEUTSCHE POST
- EDF
- etc...

- TESCO!

- N America
- Europe
- Asia
- Rest of World
Results

Since June 2012 to September 2015 portfolio return was 10.2% pa
UK Government Bonds (7-10 years) return was 2.9% pa

Global High Dividend return was 7.3% pa more than gilts
Another way to reduce risk

This strategy focuses on shares in companies that have less debt.

Companies on average have $\frac{1}{3}$ of their (enterprise) value in the form of debt.

Global High Dividend companies have under $\frac{1}{6}$ of their (enterprise) value as debt.
Lower investment risk

Global High Dividend has less leverage than index

Its companies have half as much debt. That makes it less risky and more stable

- if the value of a company falls by half, Global High Dividend has twice as much value left as the index.
as the maths shows…

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>EV Decrease</th>
<th>%</th>
<th>£</th>
<th>Loss</th>
<th>%</th>
</tr>
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<tbody>
<tr>
<td><strong>Global High Dividend Company</strong></td>
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<tr>
<td>Enterprise Value</td>
<td>100,000</td>
<td>-50%</td>
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<td>50,000</td>
<td>-50%</td>
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<tr>
<td>Corporate Debt</td>
<td>15,000</td>
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<td></td>
<td>Debt</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Corporate Equity</td>
<td>85,000</td>
<td>Equity</td>
<td>35,000</td>
<td>-59%</td>
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<td><strong>Index Company</strong></td>
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<tr>
<td>Corporate Debt</td>
<td>33,000</td>
<td></td>
<td></td>
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<td>33,000</td>
<td></td>
</tr>
<tr>
<td>Corporate Equity</td>
<td>67,000</td>
<td>Equity</td>
<td>17,000</td>
<td>-75%</td>
<td></td>
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</table>
and if company values fall 2/3rds..

<table>
<thead>
<tr>
<th>Global High Dividend Company</th>
<th>£</th>
<th>EV Decrease</th>
<th>%</th>
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<th>Loss</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise Value</td>
<td>100,000</td>
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<td></td>
<td></td>
<td>Debt</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Corporate Equity</td>
<td>85,000</td>
<td>Equity</td>
<td>18,000</td>
<td>-79%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Index Company</th>
<th>£</th>
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<td>33,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate Equity</td>
<td>67,000</td>
<td>Equity</td>
<td>0!</td>
<td>-100%</td>
<td></td>
<td></td>
</tr>
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</table>
Actual resilience in recent market fall...

In recent Q3 market fall, Global High Dividend was down -2%, across global markets -6%
Better risk/return

Offers less volatility than the market.

But evidence shows these companies generally return around the same.

-> Better risk/return than the index.
Risk benchmarked returns

10.2% pa portfolio return
June 2012 to September 2015
Risk adjusted benchmark return was 8.4% pa

-> Global High Dividend return
1.8% pa more than benchmark at launch
Global High Dividend
- outperformed gilts by 7.3% pa
- offers higher yield and growing income.

In risk-adjusted terms,
- Beaten benchmark by 1.8% pa because “dull” companies with low leverage are better value: yield 4.5% v index 2.6%.
Further Internal development

‘Global Low Volatility’ Dec 2013. Companies with lowest historic price volatility.
16.9% of Lothian Pension Fund = £858m

6.3% of Lothian Pension Fund = £320m
Encouraging progress so far

Both new low risk funds have returned more than the market since launch.

1) Better risk/return.

Internal Global Equity portfolios now 37% of Lothian Pension Fund. Cost around £½m.

External Global Equity portfolios now just 12% of Fund. Fees around £3m pa.

2) Much lower cost.
<table>
<thead>
<tr>
<th>30 September 2015</th>
<th>Market Value</th>
<th>% of Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£m</td>
<td></td>
</tr>
<tr>
<td>Global High Dividend Yield</td>
<td>686</td>
<td>14</td>
</tr>
<tr>
<td>Global GLOVE</td>
<td>822</td>
<td>17</td>
</tr>
<tr>
<td>Global GLOVAL</td>
<td>306</td>
<td>6</td>
</tr>
<tr>
<td>Other Global Equities</td>
<td>624</td>
<td>12</td>
</tr>
<tr>
<td>Other Equities</td>
<td>821</td>
<td>18</td>
</tr>
<tr>
<td><strong>Total Equities</strong></td>
<td><strong>3,258</strong></td>
<td><strong>68</strong></td>
</tr>
<tr>
<td>Index-Linked Assets</td>
<td>309</td>
<td>6</td>
</tr>
<tr>
<td>Alternatives</td>
<td>1,095</td>
<td>23</td>
</tr>
<tr>
<td>Cash</td>
<td>171</td>
<td>4</td>
</tr>
<tr>
<td><strong>TOTAL FUND</strong></td>
<td><strong>4,833</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Global Equities - Internally Managed Portfolios
High Dividend Investment Portfolio

‘Global High Dividend’

Jeff Saunders
Other Current Issues & Future Developments

Clare Scott
Other Current Issues

- LGPS 2015 Implementation
- Pensions Freedom and Choice
- Actuarial Valuation 2014 - update
- Employer Survey
- Data quality team
- Pensions Administration Strategy
- Future Developments
LGPS 2015 Implementation

- Staff training delivered
- Critical processes reviewed and amended
- Member communications included mailings and roadshows
- System upgrade for transfers and early retirements now resolved
- 2015/16 year-end process the last test

Overall, a smooth transition... so far...
Pensions Freedom and Choice

• Came into effect on 6 April 2015
• Applies only to Defined Contribution Schemes (DC)
• Increase in requests from members considering transferring from LGPS to a DC arrangement offering flexible benefits
Requests for transfer quotes from April ‘15:

- 356 from deferred/early leaver members
- 196 from Independent Financial Advisors (active and deferred members)
- Trend shows increase in requests
- No evidence yet of increased transfers
Actuarial Valuation 2014 – update

- Change of Funding Strategy for 27 employers (gilts basis)
- Granted leave to appeal on grounds of affordability
- 13 employers – some looking to exit
- Considered on a case-by-case basis
- Special meeting of Pensions Committee
Actuarial Valuation 2014 - update

- Increased awareness of cessation
- Deficits generally unaffordable
- Difficult balance – Fund vs. Employer

Conclusions:
- Minimum contribution = Future Service Rate on gilts basis
- More flexible cessation debt repayment

Look to enhance covenant/security
2015 Employer Survey

85% overall satisfaction with the service provided by the Fund (2014 84%)
95% satisfied with monthly bulletin (2014 94%)
81% satisfied with website (2014 76%)
75% overall satisfied with pensionsWEB (2014 79%)
53% rated upload of contributions good/very good
45% rated upload of new entrants good/very good

Number of responses down from 55 to 28
Employer Survey - actions

New Website
• Going live 2016

Data quality
• Creation of Data Quality team
• Focussed data quality and performance measurement
• Return queries much quicker
Data Quality team

• Next steps
  • Contact remaining employers to introduce monthly returns using pensionsWEB, **deadline of April 2016**
    • Currently 75% of employers and 64% of contributions
  • Comprehensive instructions for 2015/16 financial year end
  • Year-end User Group Early 2016
Pensions Administration Strategy

- Introduced in 2010, reviewed in 2013
- Further revised draft under consultation
- Updated to reflect LGPS 2015
- Changes to standards
  - ill-health retirement
  - year-end queries
- Specified charges for failing to provide information

Consultation deadline: XXX
<table>
<thead>
<tr>
<th>Measure</th>
<th>Proposed Charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>Failure to pay monthly contributions by 19th of the month following deduction from pay</td>
<td>Interest payable (in accordance with Scheme Regulations)</td>
</tr>
<tr>
<td>Failure to provide complete Year-end information by 19th April each year</td>
<td>£200 initial fee plus 5p per member per working day late</td>
</tr>
<tr>
<td>Failure to provide information needed to calculate member(s) pension input amounts (for pensions savings statements) by 6 July each year</td>
<td>£200 initial fee plus £10 per member per working day from 7 July to date information is received.</td>
</tr>
<tr>
<td>Failure to submit monthly contribution return via PensionsWEB bulk process</td>
<td>£50 fee per occurrence plus 5p per member.</td>
</tr>
</tbody>
</table>
Over-riding changes

**Lifetime Allowance**
- Reduced from £1.25m to £1m from 1/4/16

**Annual Allowance**
- Remains at £40,000 per year
- Information must be provided to members by 6 October each year

More members being affected
UK Government invites proposals for reform to arrangements for LGPS investments in England & Wales (Summer 2015)

• “pool investments to significantly reduce costs, while maintaining overall investment performance”

• “sufficiently ambitious” proposals

George Osborne, Chancellor of the Exchequer
Investment Reform Criteria & Guidance (25 November 2015)

• “...up to six British wealth funds, each with at least £25bn of Scheme assets...”
• “...will drive down investment costs but also enable the authorities...to become a world leader in infrastructure investment and help drive growth.”

Marcus Jones, Parliamentary Under Secretary of State (Minister for Local Government)
LGPS Investment Pooling

Timetable for England & Wales

– initial proposals by 19 February 2016
– refined submissions by 15 July 2016

4 criteria

– benefits of scale (>£25bn), not mergers
– governance & decision making
– reduced costs & value for money
– improved capacity to invest in infrastructure

Scotland – 2016 review of scheme structure
Internal investment developments

• Legal structure established
• Employment company
• Investment company
• Application to FCA about to be submitted:
  • collaboration with other investors
  • employer investment strategies
  • derivatives
• Falkirk shared services
Other Current Issues

Clare Scott
Close

Please complete the feedback form

Clare Scott