Midlothian comment on draft guarantee	LPF response
As drafted the Deed of guarantee and indemnity requires Midlothian to make good deficits on call, and must waive any defences if Edinburgh-controlled LBL do not use its own resources to (in the first instance) make good deficits. The Guarantee should be redrafted to clarify the agreed intentions of the parties: only if LBL (acting reasonably) cannot make good the deficits over a normal recovery period (Pensions Regulator gives guidance here) should the Guarantors be liable.	Under the guarantee, the Council shareholders undertake to pay any sums owed to LPF in connection with LBL's participation in the fund. Furthermore, LPF *"shall not be obliged to require payment from [LBL] or other responsible person or to take any other action before enforcing the terms of this Guarantee and Indemnity"* This is an important provision which relates to the value of the guarantee in protecting LPF's right to payment when it falls due. LPF needs to be able to recover from each of the guarantors in a default scenario. If LBL had any resources available, it would be up to the guarantors to exercise their rights against LBL to recover such sums and it is arguable that they would be in a better position to do so (as LBL shareholders with the ability to influence the LBL board). The shareholders' reserve power referred to in LBL's articles of association allows them to direct the directors to take specific action, which could include payment of amounts owed. LPF cannot agree to further suspend contribution payments over an extended recovery period, as the merger effectively suspends LBL's cessation liability by allowing them to fund it on an on-going (rather than a gilts) basis. In this way, LPF is already taking-on risk, but it needs a robust guarantee as a condition to doing so. The guarantee is a backstop solution and a key feature of LBL's covenant analysis. It should be noted that the Pensions Regulator does not regulate the funding aspects of the Local Government Pension Scheme. It is likely that the Pensions Regulator guidance being referred to relates to recovery plans to mitigate any under-funding, but the guarantee kicks in if LBL defaults under that recovery plan and so further extensions are not appropriate.
As drafted the Guarantees can be called (in effect) by Edinburgh without Edinburgh itself contributing. We would not have any right of subrogation so as to claim back payments, including in scenarios where the business is sold.	If LPF were to enforce the guarantee, it would do so against all 4 Council shareholders at once, and they would be responsible for their proportionate share of the sum owed. Please also refer to our response on the arms' length clause for further comfort on this. As you suggest, if one guarantor pays out but another does not, the first guarantor will have no right to pursue LBL for recovery of the amount it has paid until LPF receives full payment of the sums due and again, this is an important protection that must be included for LPF to agree to the merger. As each Council shareholder has guaranteed different maximum limits, they will contribute proportionately. Under English law, this means that if one guarantor has paid more than its pro rata share of the overall liability, it should have a right to contribution from the other shareholders, to ensure they each contribute in the same proportion. We would expect the same treatment to apply in Scotland.

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As drafted there is no protection against an expansion of a deficit by adoption of differing investment, salary growth or longevity assumptions; or of the superimposition of onerous early retirement terms, commutation factors or transfer values. In fact, it has been suggested that the guarantee structure will enable a more risky (equity oriented longer term) investment policy to be adopted. This risk factor should be disclosed to the guarantors formally since it increases the likelihood of a call. I do not think Midlothian Council were informed of this economic change to the risk strategy of the pension arrangements for LBL.	To confirm, the Lothian Buses sub-fund has been invested in the higher-risk equity-based investment strategy for many years. As it is now closed and maturing, LPF, after taking advice from the actuary and investment advisers, has now decided it is no longer tenable for LBL to remain in this strategy (benefitting from lower contribution rates and a riskier investment strategy) without a stronger covenant. Otherwise, the actuary would asses LBL's contribution rate by applying a more prudent funding approach and revised (higher) contribution rates will become payable with effect from April 2019. The Heads of Finance at each of the Council shareholders have been fully briefed on the implications of the actuarial valuation results which prompted the merger proposal, including the risk-level associated with the different strategies. LPF has consulted with all stakeholders to explain the benefits of the merger and to note the implications of maintaining the status quo. LPF's Statement of Investment Principles and Funding Strategy Statement are policy documents which are publicly available. Investment strategy reviews include discussions with LBL on the impact of strategy on LBL.
It is conceivable that Edinburgh's overall commercial position and economic interest could diverge due to associated properties or other related considerations being linked to a disposal of LBL. These factors could render the making good of the deficit palatable to Edinburgh while disadvantaging the Lothians shareholders. An arms-length clause could cover this scenario.	CEC is a party to the guarantee in two separate capacities: (i) as a shareholder of LBL; and (ii) as administering authority of LPF. CEC maintains separation between these two functions on a basis which is as arms' length as it can be. That is because in its capacity as administering authority of LPF, CEC is subject to separate statutory fiduciary duties to act in the best interests of the stakeholders of the pension funds (employers and members) and the monies of LPF are statutorily ring-fenced. LPF therefore operates from a separate governance structure from the rest of CEC; based in a separate physical location, with staff employed by a separate legal entity, distinct accounting processes and with its governing bodies and business practices acting independently mindful of their separate duties and obligations under the pensions regulations. We are therefore happy to amend the draft guarantee to include a clause making this clear in the guarantee document and suggest the following wording. *Each of the parties acknowledges and agrees that (i) the matters referred to in this Guarantee and Indemnity (including the obligations and terms set out herein) have been negotiated on an arm's length basis and (ii) any actions contemplated or performed in connection with this Guarantee and Indemnity or any other matters relating thereto will be performed solely for the benefit of the Authority acting in the interests of its member and employer stakeholders in accordance with its statutory duties under the Regulations and applicable law.*
It is unclear how the sub fund or sub member group will be separately monitored as it will have	It is correct to say that Midlothian will only be guaranteeing 5.5% of the LBL deficit and not the overall fund.

Midlothian comment on draft guarantee	LPF response
to be since Midlothian is presumably under the Admission Agreement being identified as guarantor purely of 5.5 per cent of the liabilities in respect of LBL pension contributions, and not of some proportion of the overall Lothian fund.	As described in the FSS, LPF will use its employer asset tracking system based on cash flows which it has operated since April 2014. 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 provides an efficient way of accurately apportioning assets to individual employers by allowing for employer cash flows and investment returning achieved by the fund. In addition, it provides a mechanism for facilitating and managing a range of investment strategies within the single fund to meet the need of employers with different maturity profiles, funding levels or investment objectives. This means that the Council shareholders will not be exposed to the liabilities relating to other LPF scheme employers solely as a result of the merger.
Finally it is noted that the LBL fund appears to be recently in an acceptable state, but has been volatile, recording a £20m actuarial loss in y/e 31 12 16. As drafted Edinburgh could require £1m plus to rectify this sort of position if it led to a deficit on a technical provisions basis; and even if an agreed clause states that LBL pay up first, Edinburgh could assert that the cash flow requirements of the business precluded that course of action. Since LBL has c £120 m of net assets and the present stand-alone pension fund has £470m of net assets (2016 figures) the assumption of liability for an adverse trading variance giving rise to call on guarantors is a material possibility. It is a matter on which further professional advice for the minorities would be justified. Needless to say the Companies Act and precedent would provide little or no protection in our shareholder capacity.	As a shareholder, the Councils should be exercising their rights to influence the Board to use LBL resources to make good any deficit. It will be up to the board of LBL to determine whether the cash flow requirements of the business preclude a particular course of action, and not LPF.