

REPORT PREPARED FOR

Dorset County Pension Fund

**Meeting of the Pension Fund
Committee on 13th June 2013**

Governance Compliance Update

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Introduction

This is my fifth report on the governance arrangements for the Dorset County Pension Fund, providing an update on the current position, based on issues considered by the Committee since my previous report in February 2012 and those currently under review.

While progress is being made nationally on the new LGPS 2014 legislation, the development of revised governance requirement is painfully slow, less than clear and subject to arbitrary change as I explain later in my report.

Notwithstanding the upheaval in operational and transitional arrangements, the Committee continues to maintain a high standard of governance in the administration of its responsibilities, and to make changes and improvements both to strengthen governance and to adopt industry-wide developments.

Executive overview

- ✓ An updated governance compliance statement was agreed in June 2012 and the Committee is fully compliant in virtually all respects.
- ✓ There have been no regulatory changes affecting the governance arrangements.
- ✓ Significant progress has been made in developing a training policy.
- ✓ I have reviewed the business and minutes of Committee meetings since February 2012 and I am satisfied that governance standards are being maintained and improved.
- ✓ The implications of the Public Sector Pensions Act 2013 are considered.
- ✓ The governance landscape seems set to change but is uncertain.

Recommendations

- [1] That the Governance Compliance Statement is updated with immediate effect in relation to Principles E, F and G, and that the more detailed responsibilities agreed are included in the "Council and democracy" section of the website.
- [2] That the Committee ensure that the 2012-13 Annual Report contains references to the new training policy and training log, the new Pensions Administration Strategy, and compliance with the CIPFA Knowledge and Skills Framework.
- [3] That monitoring of the Business Plan is used to demonstrate compliance with Myners Principle #4.
- [4] That developments on proposed new regulations on governance and on the Government's proposed review of efficiency and cost effectiveness, including investment regulations, are closely monitored.

Governance compliance statement

I note the revised statement agreed by the Committee in June 2012 and welcome the adoption of a broader role as defined and the more detailed description of responsibilities now included in the statement.

The following, relatively minor comments should be addressed:

- Principle E - Training should be updated to reflect the new training policy approved by the Committee in June 2012 and part (a) updated to show “fully compliant”.
- Principle F - Meetings and Principle G - Access. The “comments on the ratings” have been shown incorrectly in the box for “reasons for non-compliance”. This would appear to be a typographical error and should be corrected.

With these changes, compliance will be shown as “fully compliant” in all areas with the minor exception of representative structure [Principle A (b)], which I have mentioned previously and the Committee’s position has been clearly explained in the statement. Subject to the development of new governance regulations, the Committee may be required to return to this issue in the future - see comment later in this report.

In my view, the minor changes noted above can be made to the statement if agreed without the need for the formal submission of a revised statement to a future meeting. The revised version can be updated on-line and used for reference in the Annual Report for 2012-13.

I would also suggest that the more detailed responsibilities are included in the description of the Pension Fund Committee in the “Council and democracy” section of the main website at a suitable opportunity.

Annual Report

Due to the different timing of my report this year, I have only been able to review the Annual Report for 2011-12, which is fully compliant with the regulatory requirements.

I note the abbreviated references to the key policy documents, e.g. Governance Compliance Statement, as a change from past years and concur with this approach as it makes the document much easier to read and all the policy documents are available through a link to the website. It is important to ensure these documents are kept up-to-date.

As an aside and having recently reviewed the similar regulations in Scotland, the requirement on Scottish funds is less onerous in terms of including full documents in the annual report and permits web links. The wording of the guidance in Scotland is very similar to that in England & Wales but was introduced some two years later. This could indicate more thought having been given to the precision of the wording, often a problem with regulations and guidance related to governance issues.

The 2012-13 Annual Report will need to maintain these standards of compliance and disclosure, and I would suggest these two additions:

- 1) Reference should be made to the new training policy and the training log.

2) While the development of the Pensions Administration Strategy (agreed in February 2013) is essentially still work in progress and too soon to report performance, reference should be made to this important step forward in administration improvement and governance.

In addition, and as reported to the Committee previously, 2012-13 is the first year in which the annual report should include a report on how policies on knowledge and skills have been put into practice throughout the financial year, in line with CIPFA guidance.

Myners Principles

I note the revised Statement of Investment Principles agreed in June 2012 and the increased compliance with the Myners Principles. In particular, I am pleased to note the adoption of the business plan, the policy on under-performance, the references to risk in the annual report, and the clarification of voting policy on stocks out on loan.

The SIP is now showing the fund as being fully compliant except in one area only, i.e. assessment of the Committee's performance. This remains for most pension funds, the most difficult area to tackle other than on a subjective basis. However, I would suggest that monitoring performance against the business plan each year would qualify as performance assessment and allow the fund to state full compliance with Principle #4.

Training - Knowledge and skills framework

As noted above, 2012-13 is the first year for reporting implementation. The Committee agreed a new training policy in June 2012 and to adopt the CIPFA Knowledge and Skills Framework which puts the Committee in a strong position in terms of governance.

Implementation in practice is crucial, particularly for new members joining the Committee, and I would encourage all members to complete the self-assessment of training requirements and to develop their own training plan to acquire a suitable level of knowledge and skills.

I would also endorse the comment made by officers in June that the Committee should collectively possess the requisite knowledge and skills. In practicable terms, it is not necessary for every member to know every single aspect of the framework. It is however important for every member to contribute to collective decision making.

I refer later to further developments in governance but make the point here as I have previously, that I have a concern that some level of qualification will be introduced either by regulation or by guidance. I believe such a move to be inappropriate but it has been mooted on a number of occasions going back over the years.

Even without compulsion in this respect, it is quite likely that the Committee will be required to demonstrate in some form the collective knowledge and skills of those appointed to the Committee, and it will be important to include the skills of the officers and the advisers in that pool of knowledge as a fundamental component of effective decision making.

Committee business during the year

As in past years, I have reviewed the agendas and minutes of the Committee meetings since February 2012 and I am satisfied that the Committee continues to conduct its business in a proper manner which complies with good governance.

I have already referred to some of these reports but these are the key achievements for the period:

- SIP reviewed and updated, with improved compliance with Myners Principles
- Governance Compliance Statement revised and shows virtually full compliance
- A new training policy was agreed and the CIPFA framework adopted
- Discretions policy reviewed and updated
- Investment strategy and asset allocation reviewed
- Cash flow projections considered
- Voting activity reviewed
- Communications Policy reviewed and updated
- A Pensions Administration Strategy has been agreed and is being developed
- A treasury management strategy was agreed

In addition, the Committee continues to receive regular reports on fund administration, and the performance of both the internal and external managers.

Investment regulations

As the Committee may be aware, the Investment Regulations were revised with effect from 1st April 2013 to increase the limit for “all contributions to partnerships” from 15% to 30%. This is termed as the increased regulation limit and relates back to when the previous revision was made in 2009.

By way of explanation, the limit on this type of investment was 5% prior to 2009. The revision at that time allowed for an extra limit but was subject to greater restrictions on the governance, e.g. must take proper advice, the investment must be appropriate and suitable (as defined), the decision must describe the exact investment, the limit to apply, the reason, the period of investment, and the SIP must be formally updated and published before the investment can be made.

The added rigour of the governance process imposed with the relaxation of these limits, indicated just how reluctant DCLG were to agree the change at that time, despite strong representations from CIPFA and industry-wide bodies to make the regulations more flexible and consistent with private sector funds. As reported to the Committee previously, there has been continuing pressure on DCLG to relax the regulations and working parties have been set up, disbanded and re-established.

I emphasise this to make the point that it was quite extraordinary that DCLG decided to consult in 2012 on amending the regulations, in response to funds that were resisting Government pressure to invest in infrastructure because of the restriction on investment in partnerships, the common vehicle for infrastructure investment. Past reluctance appeared to be swept aside in this instance and DCLG has now re-established a working party to review the regulations.

What civil servants and ministers say in public at conferences for example, is often used as an indication of intent or draft policy, albeit non-committal and subject to change. Bob Holloway, DCLG, spoke at the LGC Investment Summit in September, which some Committee members attended, in response to a request to explain the current position on the investment regulations. His key points were:

- They are largely immune from reform regulations;
- But still under pressure for review/amendment;
- Pressure for regulations on ethical investment continues;
- Merging of funds/investment; and
- National infrastructure.

While these bullet points are somewhat vague out of context, they nevertheless give some indication of where investment issues may be moving. More recently and more significantly, the Minister, Brandon Lewis, spoke at the NAPF Local Authority Conference in May. In past such speeches, DCLG have used the text of the speech as specific reference points for future action. It is worth repeating the relevant text here.

“Investments

The Scheme is becoming increasingly mature and it is no secret that some funds are close to becoming cash-negative. We therefore need to see even better and more consistent returns on the £150 billion worth of investments in the scheme.

I therefore want to undertake a root and branch review of the LGPS investment regulations. Some have suggested that the funds should be better directed to support growth, particularly local growth. We have already taken steps to allow fund authorities to increase their exposure to limited liability partnerships, but I accept that we may need to go further.

In particular, I want to know if there are any other obstacles in the regulations that prevent you from maximizing your returns. I am not suggesting that we should dispense altogether with the requirement for you to assess the risks associated with your investments. After all, this is taxpayers’ money you are investing and we must continue to get the right balance between risk and reward.”

My main concern is with the words “should be better directed to support growth” which implies greater restriction or central control rather than greater freedom to invest.

New regulations on governance

The Committee has received regular reports on the progress of the new Scheme regulations but as at the time of writing, it is unclear when the final regulations will be laid and made - this is referred to as Workstream 1.

The non-cost elements of the review are referred to as Workstream 2 and include proposals relating to governance. These in part reflect the provisions of the Public Sector Pensions Act 2013 as they relate to the LGPS and other governance issues outstanding from past reviews, principally representation and training as I have reported to the Committee previously.

In September last year, DCLG indicated the following timetable for this phase of the review:

| | | |
|---------|---|--------------------|
| Stage 4 | Administration and Governance Regulations (draft) | April - June 2013 |
| Stage 5 | Make and lay Stage 4 Statutory Instrument | Summer 2013 |
| Stage 6 | Revoke existing regulations and consolidate | Autumn/Winter 2013 |

It seems most unlikely that DCLG will achieve this timetable and it is difficult to gauge progress as the process is not very transparent other than to those directly involved. However, recent press comments following the NAPF Conference in May quote DCLG as saying:

“Provisions for the LGPS new governance structure will not be in place when the scheme goes live in April 2014 it is not necessary to have the provisions for local authority governance boards in place by 2014these provisions will be in legislation by April 2015 instead.”

I have tried to elicit details of what the new governance proposals might cover but I only have public statements to go on. The first update was given in November 2012 and a copy of the essential elements of the proposals is attached as Annex 1. Elements 1 to 7 are the most relevant in terms of governance arrangements, covering the governance structure, the role of the Scheme Advisory Board, and membership of local boards to have minimum standards of training and to include representation of employers and unions.

These are somewhat vague references and it is still unclear how the governance structure will change and affect Dorset in particular. A further joint statement in January 2013 added little detail but states that the Government is committed to creating a Scheme Advisory Board and work is in progress to create a Shadow Pensions Board as a forerunner.

In this latter respect, Dorset officers have been involved in these developments and have provided me with papers being considered by the Society of County Treasurers (SCT). I have set out below the key elements of the governance structure as defined by DCLG in relation to the Public Sector Pensions Act, and added comments where relevant to Dorset.

Responsible Authority - This will be the Secretary of State as is currently the position. Compared to my experience of the past 20 years, I detect a trend of greater direction from Ministers and less control/influence by civil servants, which may add a greater political dimension to future developments.

Scheme Manager - This will be the administering authority as at present. This would appear to reinforce Dorset County Council’s position as responsible for the administration of the pension fund.

Scheme Advisory Board - The overall role of the Board is to advise the Secretary of State as the Responsible Authority and assist Scheme Managers. The more detailed proposals being worked on by the SCT suggest these important governance issues:

- Recommendations will be made to the Secretary of State, the Pensions Regulator, and to local Pension Boards to improve effective administration, governance, performance and costs management.
- The Board will have no statutory powers of its own but will work with existing regulatory and advisory bodies to achieve its objectives.
- Membership will comprise of an independent chair, up to 6 employer representatives and up to 6 member representatives (trade unions), to be in equal numbers, up to 5 advisers, and up to 3 observers nominated by the Secretary of State and likely to include the Pensions Regulator.
- The advisers would cover Scheme actuaries, Scheme legal advisers, CIPFA, fund practitioners, and local authority treasurer groups.
- Sub-Committees will be formed to cover:
 - ◆ Standards and Governance
 - ◆ Investment and Engagement
 - ◆ Administration, communication and other issues
 - ◆ Value for money
 - ◆ Cost management and contributions
- There would appear to be a much wider remit for the Scheme Advisory Board than currently for DCLG, for example, and the intention seems clear that an overarching central body will control the future of the Scheme's management.
- This Body is in effect replicating the development of tri-partite negotiations over the past few years and removing some control from the local level.
- With such an extensive role, particularly in relation to investment, there appear to be no requirements for requisite knowledge and skills of the members.
- There would appear to be in-built conflicts of interest within the membership.

Pension Board - The Board at the local level will cover management and administration, and assist the Scheme Manager to ensure compliance with legislation and with codes of practice.

It is very difficult at this stage to assess how these outline proposals will work in practice and how the regulations will operate in detail. However, I would make these points:

- Little is said about the responsibilities of the Pension Board in relation to the Scheme Manager, other than the suggestion that there will be a greater degree of segregation between the two (see Annex 1 - #5).
- Members of the Pension Board will require a minimum recognised level of skills and knowledge (see Annex 1 - #6) which could imply more formal training and qualification than currently under the CIPFA framework.
- It is possible that employer representatives and trade union representatives will be required to be in equal numbers, mirroring the Scheme Advisory Board.

My original expectation was that the Committee would simply become the Pension Board but that does not deal with the issue of segregation and I am unclear how that would work in practice. It could imply a Board separate from the Committee but that would be inconsistent with DCLG guidance on having one Committee.

Unfortunately, this leaves the picture rather unclear for the Dorset Pension Fund Committee and developments will need to be closely monitored. It is likely that some change in the present structure may be required and relative levels of representation will be directed by regulation rather than by guidance.

Other developments

As if all this was not enough in a period when late regulations are threatening the implementation of the new Scheme, the Minister has made further announcements that will affect the Committee over the coming year.

Using the NAPF Conference platform, the Minister announced a further review of the LGPS in terms of efficiency and cost effectiveness on the basis that *“it was clear the current arrangement was in need of change”*.

He referred to:

- Ways of achieving better value for money for taxpayers
- Shared services, national call-off contracts, and pooling pension fund assets
- Administration costs and fund manager fees
- The need for better comparative data
- The lack of a single LGPS annual Report
- Root and branch review of investment regulations (as referenced above)
- A better way to manage Scheme deficits
- Fund mergers to give employers and taxpayers a better deal

There is a clear intention to start consultation later in the year on a number of broad principles for change, although it is recognised that new regulations may not be possible before April 2014.

As the Committee may be aware, there has been much debate in the press regarding fund mergers, particularly in London, and there has even been a recent press statement from the Pensions Regulator that it *“has promised greater clarity over how it will oversee local authority pension funds in conjunction with other watchdogs”*. The implication in this last statement is that the Pensions Regulator sees a role over scheme funding and investment on similar lines to private sector schemes, but in my experience, the Regulator has limited knowledge of the LGPS.

Finally, the FT reported on 28th May about fees paid to fund managers, quoting a comparison between Devon and Staffordshire, based on a recent study by Investor Data Services. This is likely to fuel the arguments for greater cost efficiencies and fund mergers, even though it seems likely the data comparisons are inconsistent, which in turn will support the Minister’s argument for better data.

Peter Scales
31st May 2013

Scheme governance and cost management (Workstream 2)

Proposals agreed between LGA and trade unions and submitted to Government at the end of July 2012. The essential elements are:

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|-----------|--|
| 1 | Both governance and cost management are equally essential to the future sustainability of the scheme and should not be considered in isolation |
| 2 | A national LGPS board would be set up to include representatives of scheme employers, scheme members, the government and professional bodies. The remit of the board would be to extend best practice, increase transparency, co-ordinate technical and standards issues and provide an effective liaison with the scheme regulator |
| 3 | The board would also manage the future cost of the scheme and explore effective improvements in value for money in the areas of administration and investments |
| 4 | Although not having any statutory powers of its own the board would make recommendations to the Secretary of State, the regulator or professional standards bodies in order to further its remit |
| 5 | At the local level we propose that boards provide for a greater degree of segregation between funds and administering authorities and that the potential for conflicts of interest at both member and officer level is reduced |
| 6 | Membership of local boards is proposed to require a minimum recognised level of skills and knowledge and to include representation for fund employers and trade unions |
| 7 | We also propose that best practice with regard to transparency and accountability is extended across all funds |
| 8 | For cost management a total future service target cost for the scheme from April 2014 be set at 19.5% |
| 9 | The cost of the scheme shall be measured at each valuation taking into account both model and individual fund data with movements in cost driven by changes to membership data or assumptions reflected in changes to future scheme design |
| 10 | Such changes are to be considered, and actions to amend the scheme agreed by both employers and unions with recommendations made to the Secretary of State. Where the movement is 2% or more in either direction the Secretary of State shall be obliged to take action |
| 11 | Although financial assumptions are excluded from the formal process we are proposing that movements in these be considered by the national board in order to ensure the future sustainability of the scheme |
| 12 | Finally the project have recommended that a working party be set up to investigate potential solutions to the issue of past service deficits. |